

THE POTENTIAL OF ISLAMIC REAL ESTATE INVESTMENT TRUSTS IN MALAYSIA

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ABSTRACT

The purpose of this paper is to expand on the research written on the Islamic Real Estate Investment Trusts (I-REITs) thus far; this is to further expose its potential in Malaysia. I-REITs is one of the products of Islamic Capital Market investment which is based on real estate. Even though I-REITs have been established for almost 10 years, only three I-REITs are listed in Bursa Malaysia as at 31 December 2014. Based on a previous study, I-REITs has considerable potentials; these have yet to be revealed. An I-REIT is a property investment that can act as a hedge against inflation. The diversification benefits offered by I-REITs is better than Conventional REITs (C-REITs). The returns of I-REITs in the form of distribution yield are fluctuating, uncertainty and still profitable.

Keywords: *Islamic Capital Market; Conventional REIT; Islamic REIT; property investment; diversification benefits*

ABSTRAK

Kajian ini dihasilkan untuk meluaskan kajian literatur dengan melihat potensi Amanah Pelaburan Hartanah Islam (I-REIT) di Malaysia. I-REIT merupakan salah satu produk Pasaran Modal Islam berdasarkan hartanah. REIT Islam telah ditubuhkan hampir 10 namun hanya terdapat tiga I-REIT yang telah disenaraikan di Bursa Malaysia sehingga 31 Disember 2014. Berdasarkan kajian sebelum ini, I-REIT mempunyai potensi tersendiri yang masih belum diterokai. I-REIT adalah salah satu pelaburan hartanah yang boleh dijadikan sebagai lindung nilai terhadap inflasi. Ia menunjukkan beberapa manfaat kepelbagaian berbanding REIT Amanah Pelaburan Hartanah

konvensional (C-REIT). Pulangan I-REIT dalam bentuk hasil pengagihan y juga agak berubah-ubah, tidak dapat dijangka tetapi masih menguntungkan.

Kata kunci: *Pasaran Modal Islam; REIT konvensional; REIT Islam; pelaburan hartanah; manfaat kepelbagaian*

1.0 INTRODUCTION

Islamic Real Estate Investment Trusts (I-REITs) was established in 2005 to promote the growth and development of the REIT market and Islamic Capital Market (ICM) in Malaysia. Even though I-REITs is still a small cap market, it has hidden potentials that can be explored. It has been almost 10 years since the establishment of I-REITs.

There have not been many studies which focused on I-REITs as compared to the Malaysian REIT (M-REIT) and other REIT (Real Estate Investment Trust) market in the world. The establishment date of each I-REIT are differ from one another. The stock price offer to the public market are also different from each I-REIT. KLCC REIT offered the highest stock price to the public compared to the other I-REIT. Table 1 depicts the offering price for each I-REIT are as follows:

Table 1 : Initial Public Offering (IPO) Price for all I-REIT

I-REIT	Date	IPO Price
Al-Aqar REIT	24 July 2006	RM 0.95 sen
Axis REIT	30 June 2005	RM 1.25 sen
KLCC REIT	10 April 2013	RM 4.00 sen

Source: Author's compilation from Annual Report and Prospectus

Before the establishment of I-REIT market, Malaysia has issued the first I-REIT guideline in the world on 21 November 2005. The guideline had been outlined by Shariah Advisory Council (SAC) of Securities Commission (SC) to assist the establishment of an I-REIT. Briefly, the I-REIT guideline has made a resolution that in acquiring real estate tenant(s), I-REIT has approval from Shariah adviser to assess any property to be acquired by an I-REIT.

Therefore, it is also point out by the guideline that any non-permissible rental must be added together by the fund manager to gain the amount of the total rental from non-permissible

activities. Next, the total rental from the non-permissible activities will be evaluate against the total turnover of the I-REIT (latest financial year) to obtain the percentage of rental from non-permissible activities. The percentage amount must not exceed 20% benchmark that has been determined by the SAC for the purpose on rental from non-permissible activities.

However, if the percentage exceeds the benchmark, the Shariah adviser will consult the fund manager to not invest in the said real estate and subsequently, I-REIT should not hold any tenants that doing business in non-permissible activities even though the percentage is below than the benchmark (20%). This is to protect the image of I-REIT.

I-REIT must ensure that all business and financial facilities or money instruments must follow the Shariah principles. In order to protect the real estate from any loss and risk, takaful (shariah-compliant insurance) scheme can be apply instead of conventional insurance. However, if the takaful scheme is unable to provide the insurance coverage, then I-REIT is permitted to use the conventional insurance scheme [1].

There were a few studies that contain discussions on the I-REITs since its establishment. Similar to REIT, I-REITs also offers the same advantages as C-REITs, although, it has several restrictions in terms of its operation and legislation. REIT offers advantages such as diversification benefits, hedge against inflation, risk reduction and return enhancement in an investment portfolio. It is believed that REIT could give better returns than stock markets and have lower volatility.

The inclusion of REIT in mixed-asset portfolio will enhance returns and reduce risk levels. During the Global financial crisis (GFC), REIT has shown different results in the developed and emerging countries. For the developed country, most of the REIT were severely affected by the inflation during the GFC. However, REIT in an emerging country such as Malaysia was less affected by the impact of GFC. This was possible through the preventive steps taken by REIT management in emerging country by adopting a moderate regressive strategy, low leverage levels and stable income stream [2] [3] [4].

The typical types of asset classes that being invest by investors are common shares, bonds or any cash equivalents. In order to diversify the risk and enhance the return of the investment portfolio, adding alternative asset class could be beneficial. One of the potential asset class that can be add into the investment portfolio is I-REIT. Thus, this study conducted to review the potential of I-REIT in terms of its guideline and regulation and diversification benefits during the financial crisis using the past researchers result.

2.0 ISLAMIC CAPITAL MARKET IN MALAYSIA

Malaysia has invented many key figures opened the way for Malaysia to be a leading Islamic Capital Market (ICM). The milestones were the development of the first Islamic equity unit trust fund, Arab Malaysian Tabung Ittikal (1993). Next milestone is the earliest establishment of full-fledged Islamic stockbroking company, BIMB Securities Sdn. Bhd. in 1994. The SC structured an ICM Unit then evolved into an absolute department in 1995. Later, the Shariah Advisory

Council (SAC) was formed in 1996. In 2001, the Minister of Finance launched the Capital Market master plans of which 13 suggestions were put together to established Malaysia as an international centre for ICM activities.

In the same year, Guthrie Sukuk was introduced as the first global corporate Sukuk. This establishment has made an impact on the international Islamic financial market. Next, in 2002; the Malaysian Government Sukuk was created as the first global sovereign Sukuk in the world. Islamic securities also enjoyed a comprehensive tax incentive package same as conventional securities that was proposed under the Federal Budget 2004 which later, this incentive has been implemented.

In order to enhance the development of ICM in earlier stage, Bursa Malaysia Berhad had demutualised it's exchange and listed on it's own accord. Bursa Malaysia Berhad listed on 18 March 2005, acts as a single consolidated group of containing equities, derivatives and offshore markets. The equities market is split into Main Board, Second Board and a high growth market called MESDAQ.

Some of attractions provided by Bursa Malaysia (BM) consist of large market capitalisation and great amount of listed companies. Besides that, Khazanah had divesting RM246 billion in equities and shares in 40 Government-linked companies which it owns then improving the liquidity of BM. There are about 231 listed companies with market capitalisation more than US\$ 100 million which indicate the growing of the market.

The activity of the market considered active where about RM70 billion being transacted. As at 31 December 2004, there is about 36% of all Shariah listed equity funds in the world are listed on BM with total value of US\$ 1.8 billion compared to a total of US\$ 5.0 billion over the world. To date, the Shariah-compliant securities on BM has reached 674 listed Shariah-compliant securities over 905 total listed securities and equal to RM1022.63 billion in terms of market capitalisation compare with RM1659.02 billion of total market capitalisation [5];[6].

Features of Islamic Finance is very clear and significantly different when compared with conventional finance. One distinctive feature of an Islamic finance is its compliance with all the Shariah laws. Any form of business and financial activity related to what is described as a 'Haram' activity is strictly prohibited and includes certain 'Haram' products; e.g., liquor, pork, and pornography [7];[3].

Islamic finance is not allowed to produce benefits from interests for the purpose of making a profit. Islamic financial institution is a financial institution that provide its customers with financial services that do not oppress them by ridiculous interest rate [7]. The Islamic Equity market is where the investors can purchase shares from the stock market and it has to comply with the principles of Shariah. Purchasing Islamic shares still attract the same risks as the conventional equity market, such as its rate of return and the time affecting the period of investment.

BM has categorised the securities that follow Shariah principle as Shariah-compliant stocks. The main business and source income must be permissible in Shariah principle. SC has listed the Shariah-compliant securities on the Main Board in BM. Besides, BM has an updated

new index for Shariah-compliant security namely, Kuala Lumpur Shariah Index (KLSI). This is to assist Muslim investors to recognise the top Shariah-compliant companies in Main Board of BM [8].

Malaysia has been leading in Sukuk Volume when measured by Issuer Nation and this amounts to USD 20.6 billion compared to United Arab Emirates's (UAE) and Saudi Arabia's USD 8.8 billion and USD 7.0 billion respectively. Malaysia has outstanding Sukuk volume by USD 21.7 billion compared to the USA by USD 21.2 billion. Malaysia is one of the world's most advanced Islamic Markets, but only three I-REITs out of 16 REITs are in Malaysia [9].

3.0 MALAYSIA REAL ESTATE INVESTMENT TRUSTS

In Asia Pacific, REIT could be considered as one of the growth markets. Table 3.1 presents the market capitalisation of REIT with the selected countries in Asia Pacific. Australia has the highest market capitalisation total of US 85.15 billion. While, New Zealand possess the smallest market capitalisation in terms of REIT. Singapore REIT's market capitalisation is moderate (USD 45.47 billion) however the percentage of REIT underlying in real estate market is the largest in Asia Pacific (19%).

Property business in Singapore shown more interest in REIT market in their property sector. Compared to Japan, it has second largest market capitalisation meanwhile the percentage of REIT as its underlying real estate market is small (3%). The property sector in Japan are less focus on REIT market. For Malaysia, both of the REIT market cap (USD 6.77 billion) and the percentage of REIT as underlying real estate market (8%) are quite low. There are many space for Malaysia to expand the REIT business in the property sector. Overall, the total REIT market capitalisation for the Asia Pacific was USD 236.57 billion [10].

Table 2: Market Capitalisation of Asia Pacific REIT

Country	REIT Market Capitalisation (US\$bn)	Institutional Real Estate Size (US\$bn)	REIT as % of Underlying Real Estate Market
Singapore	45.47	241	19%
Australia	85.15	656	13%
Hong Kong	23.80	211	11%
Malaysia	6.77	84	8%
New Zealand	2.92	73	4%
Japan	72.46	2678	3%

Source: APREA (2014)

Table 2 indicates that Malaysia has a high market transparency compared with countries such as Taiwan, Thailand, the Philippines, Indonesia, South Korea, Vietnam, Macau, Mongolia and Myanmar [11]. This means that Malaysia property market is transparent with their information and knowledge which facilitates investors in understanding the current condition of the property investment in Malaysia.

Table 3: Real Estate Transparency In Asia Pacific

Real Estate Transparency in Asia Pacific, 2014			
Country	Transparency	Composite Score	
		Score 2012	Score 2014
Australia	Highly Transparent	1.36	1.4
New Zealand	Highly Transparent	1.48	1.4
Singapore	Transparent	1.85	1.8
Hong Kong	Transparent	1.76	1.9
Japan	Transparent	2.39	2.2
Malaysia	Transparent	2.32	2.3
Taiwan	Semi-Transparent	2.6	2.6
Thailand	Semi-Transparent	2.94	2.8
Philippines	Semi-Transparent	2.86	2.8
Indonesia	Semi-Transparent	2.92	2.8
South Korea	Semi-Transparent	2.96	2.9
Vietnam	Low Transparency	3.76	3.6
Macau	Low Transparency	3.27	3.6
Mongolia	Opaque	4.31	4.5
Myanmar	Opaque	NA	4.5

Source: Jones Lang Lasalle (2014)

Table 3 shows the composition of Real Estate in Asia Pacific countries [12]. Countries with the highest percentage were Japan with 37.4 percent of the total Real Estate sector in Asia Pacific. China is the second largest with a percentage of 26 percent. Malaysia has only 1.2 of a percentage of the real estate portfolio in Asia Pacific. If linked between Gross Domestic Product (GDP) by sector in Malaysia Real Estate, the Real Estate sector has a relatively large share in Malaysia. While the Philippines and Vietnam country occupies the last place with a share of 0.7 and 0.2.

Every legislative framework is very important for REIT in order to develop and operate the business. Every REIT legislation is different from country to country. Malaysia also has its own REIT legislation and framework so that the investors, company and stakeholders of REIT are aware of the procedure or rules set by the SC. Even though I-REIT has its own class and bound with Islamic principles, it is still enjoying the same tax treatment with the C-REITs. However, I-REITs still must follow the I-REIT guideline that has been issued by SC. Table 4 tabulates the summary of Malaysia REIT legislation by [10] and [13].

Table 4: Global Universe of Real Estate Market 2011 (Asia Pacific)

Global Universe Of Real Estate Market 2011 (Asia Pacific)						
Country	Population(M)	GDP (US\$B)	GDP per Capita (US\$)	Real Estate (US\$B)	Real Estate Percentage	Real Estate To GDP Percentage
Japan	126.5	5951	47060	2678	37.4	45
China	1320	7035	5330	1864	26	26
Australia	22.5	1458	64720	656	9.2	45
South Korea	49.6	1098	22110	467	6.5	42
India	1202	1963	1630	350	4.9	18
Singapore	5.2	268	51500	241	3.4	90
Hong Kong	7.1	234	32870	211	2.9	90
Taiwan	23.2	477	20510	198	2.8	42
Indonesia	245.6	831	3380	189	2.6	23
Thailand	68.2	344	5040	89	1.2	26
Malaysia	28.6	265	9260	84	1.2	32
New Zealand	4.4	163	36800	73	1	45
Philippines	101.8	237	2330	48	0.7	20
Vietnam	88.7	123	1390	21	0.2	17
Total	3293.4	20447	303930	7169	100	

Source: Author's Compilation & Prudential Real Estate Investors (2012)

Table 5: Malaysia REIT legislation framework

Malaysia REIT legislative system	
Element	Regulations
Organisational Rules	<ul style="list-style-type: none"> • REIT are set up as a Malaysian registered trust • Management Company that manages and administers the trust must get the approval from SC same as the trustee. • The lowest fund size must be at least RM100 million. • The REIT management company only allowed up to 70% (previously 49%) of foreign effective equity. • Minimum of 30% Bumiputera effective equity and at least RM1 million funds shareholder all the times are required in the REIT management company. • Only qualified property manager could manage the property held by the REIT. • There is unlisted or listed REIT in Malaysia. However, listed REIT must follow the listing rule and shareholding requirements as required based on the Listing Requirement issued by the BM. • From 28 December 2012 onwards, REIT should hold their Annual Grand Meeting within four months from its financial year and the rules are mandatory. • For I-REIT, all of the tenants are not allowed to operate non-permissible activities. All new tenants must also comply with these non-permissible activities. • Only up to 20% of the floors are for the tenants who will compromise to include some mixed activities. Otherwise, if the business activities do not involve in the retail area, Shariah adviser (appointed by I- REIT management) will decide on their tenancy based on their <i>ijtihad</i> according to Shariah principles.
Income and asset rules	<ul style="list-style-type: none"> • The REIT income must be from a qualifying investment such as real estate, real estate-related asset, money and deposit market instrument or non-real estate-related assets. • A minimum of 50% of a fund's total asset value must be invest in real estate or single-purpose company that run the business on real estate at all times.

- Maximum 25% of total non-real estate-related asset or cash, deposit or any money market instruments are allowed from the fund's total asset value.
- A REIT cannot dispose its asset with a price lower than 90% value from valuation report and cannot buy any asset with price more than 110% of its assessed value from a valuation report.
- If the disposal property asset value surpasses 50% of the fund's total value, a sanction from the unit holder is mandatory by way of an ordinary resolution outside of the disposal made for the purpose of closing up the fund.
- Only 5% value of the total funds total asset value are allowed for the single issuer to purchase the securities issued.
- Only 10% are allowed for any group of companies' to issues securities from total funds' asset value.
- Only 10% of securities issued by any single issuer for the fund's investment in any class of securities.
- Any placement of deposits made by fund's property must be through a licensed institution.
- The funds are not allowed to participate in any of the following activities:
 - prolong loans or credit facilities
 - property development
 - obtain vacant land
- Rental incomes must be gained from permissible business activities according to the Shariah principles. Only 20% of total turnover are allowed for rental income coming from non-permissible activities (I-REIT only).
- Any kind of investment, deposit, financing, money market instruments must be based on the Shariah principles (I-REIT only).
- I-REIT must purchase takaful scheme only to protect their business; however, conventional scheme is allowed if there is no other takaful scheme available.

Distribution
rules

- The distribution of income must be streamed from realised gains or realised income.

	<ul style="list-style-type: none"> • REIT must provide a minimum of 90% of their 'total income' to be excluded from income tax; other than that, 25% of their total income will be taxed. • Whether the respectable REIT is being exempted from tax or is taxed, the taxable income that is distributed to investors will be subject to taxes when in the hands of investors. • If, the REIT are subject to be taxes (i.e. not distributed at least at 90% of income), then the distributed income will be taxed in the hand of investors except such distribution are made out of the exempt income of the taxed REIT. • When the REIT pays tax, it will be the credit for the REIT against unitholders' tax. • If the REIT has been exempted from the tax for above 90% total income distribution, the unit holder for the individuals and foreign institutional investors are subject to a final withholding tax till end of 31 December 2016. • If the REIT has been exempted from the tax for above 90% of the total income distribution, the non-resident companies must pay 25% for the withholding tax effective from the year of assessment in 2009 and hereafter. • Whether the REIT is subject to taxation or not, the Malaysian resident company must declare the income distribution as their taxable income in their tax returns.
Gearing restriction	<ul style="list-style-type: none"> • Typically, when borrowings are incurred, it must not go over 50% of the total asset value, however, if the borrowings do exceed the limit, an approval for the unit holder must be obtained from an ordinary resolution. • The borrowing must be made from a licensed financial institution aligned with the Financial Services Act 2013 and Islamic Financial Services Act 2013, effective from 1 July 2013 or through the issuance of debentures.
Other consideration	<ul style="list-style-type: none"> • Foreigners are only allowed up to 70% equity holding in the management company, however, there must be at least 30% of equity held by Bumiputera (indigenous) unit holders.

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- Any instruments related to transferring the disposed property from the REIT must be approved by the SC in order to get the exemption from stamp duty.
 - Exemption of real property gains tax can be made if the disposal of REITs' properties derives any chargeable gains.
 - A corporate tax deduction is allowed and exempted to start a new REIT.
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Source: APREA (2014) and Hwa, (2007)

REIT in Malaysia has been operating for almost a decade; yet, the development of REIT in Malaysia is not as outstanding as in Singapore or Japan. The legislation must be changed to attract more investors to get involved in the REIT market in Malaysia. Some of the rules need to be re-assessed in order to increase the competitiveness of REIT in Malaysia with other countries in Asia. There should be more incentives in the form of benefits and advantages offered to investors, or any company and institutions showing an interest in the REIT market. This will expand the development of REIT all over the Malaysia instead of just within the main cities.

4.0 POTENTIAL OF ISLAMIC REAL ESTATE INVESTMENT TRUSTS IN MALAYSIA

I-REITs is a collective investment scheme that combines real estate and real estate trust funds. In November 2005, the SC has issued the guidelines for I-REITs [14]. There are a number of I-REITs in Malaysia which are attractive due to the types of properties they have invested in, the REIT's structure, the board of directors, and the principles of the company itself. The I-REITs companies that have been registered with the SC in Malaysia are; Axis REIT, Al-Aqar REIT and the newly established Stapled Kuala Lumpur City Centre (KLCC) REIT.

However, Boustead REIT has delisted and changed over to become a Private Property Trusts instead of an I-REIT this year. Instead of having a large Islamic Capital Market in Malaysia, there are only about three I-REITs in Malaysia and only two out of the three are considered matured. Thus, there are opportunities to be gained by property investors by being part of an Islamic Real Estate Investment Trusts; there are potentials to enhance and generate some profits. Overall, Axis REIT, Al-Aqar Healthcare REIT and KLCC REIT have shown gains in their financial statement annually. Table 1 shows a bit of fluctuation in the total net income for Al-Aqar REIT but the net asset value per unit and market capitalisation are increasing. The distribution yield for Al-Aqar REIT decreasing from 2011 to 2014.

This is a sign that Al-Aqar REIT is not performing well in terms of distribution yield. It is the same case for Axis REIT, refer to the Table 2; the market capitalisation and distribution yield for Axis REIT shows slight fluctuation, but the net asset value per unit and total net income are

increasing year by year. This shows that both companies' management are totally committed to enhancing their company's growth. These results showcased the I-REIT as a better investment vehicle. KLCC REIT just entered the REIT market in 2013. It's market capitalisation increased with 12.8% ratio from the year 2013 to 2014. KLCC REIT's distribution yield is lower compared to Axis REIT from the year 2013 to 2014. This is due to the maturity and establishment of Axis REIT long before KLCC REIT. Table 4.3 summarised the KLCC REIT financial statement [15] [16] [17].

Table 6: Al-Aqar REIT

Al-Aqar REIT	Year			
	2011	2012	2013	2014
Total Net Income (RM 000')	84,502	62,527	73,726	63,561
Net Asset Value Per Unit (RM)	1.13	1.15	1.18	1.19
Distribution yield (%)	6.69	6.05	5.90	5.54
Market Capitalisation (RM 000')	735,523	898,132	925,981	960,793

Source: Al-Aqar REIT Annual Report

Table 7: Axis REIT

AXIS REIT	Year			
	2011	2012	2013	2014
Total Net Income (RM 000')	80,999	103,116	111,281	110,455
Net Asset Value Per Unit (RM)	2.08	2.17	2.23	2.42
Distribution yield (%)	6.56	5.94	6.31	5.46
Market Capitalisation (RM 000')	1,118,993	989,705	RM 1,348,418	1,982,030

Source: Axis REIT Annual Report

In 2013, AXIS REIT Annual Report 2013 use USD. Author converted it using the exchange rate of RM1 = USD 0.30451 as on 31 December 2013.

Table 8: KLCC REIT

KLCC REIT	Year	
	2013	2014
Total Net Income (RM 000')	145,329	267,550
Net Asset Value Per Unit (RM)	4.12	4.19
Distribution yield (%)	4.95	5.01
Market Capitalisation (RM 000')	10,561,198	12,113,784

Source: KLCCP Annual Report

Sabana Shariah-compliant REIT continued to be the largest listed Shariah Compliant REIT in the world in terms of its market capitalisation and total asset size of approximately S\$746.0 million and S\$1.2 billion respectively as at 31 December 2013 compared to any Malaysian I-REITs. Even though Sabana Shariah Compliant REIT only started its operation on 26 November 2010, they still proved that they could be a world leader in the development of I-REIT when compared to other earlier established listed I-REIT companies [18]. An I-REIT market's operational system is no different than the C-REIT apart from the fact that an I-REITs must follow the Shariah principles in managing their business.

5.0 DIVERSIFICATION BENEFITS

Diversification benefits in real estate always attract investors because it generates different movements within the stock market. Diversification benefits can be identified using the correlation analysis. I-REITs always allows some diversification benefits in mixed-asset portfolio. Table 5.1 demonstrates the results from a correlation analysis made by [2]. I-REITs shows lower correlation than C-REITs ($r = 0.29$ and $r = 0.60$). The lower correlation between asset class shows the diversification offers are much higher.

Table 9: Diversification benefits of I-REIT and C-REIT (August 2006 – December 2008)

Study	Result	Indicator
Newell and Osmadi (2009)	I-REITs with stock market ($r = 0.29$) C-REITs with stock Market ($r = 0.60$) I-REITs with other KLSE sub-sector ($r = 0.26$ to $r = 0.36$) C-REITs with other KLSE sub-sector ($r = 0.43$ to $r = 0.70$)	I-REITs show lower correlation with the stock market and other KLSE sub-sector than C-REITs. Thus showing more diversification benefits offered by I-REITs.

6.0 ISLAMIC REIT IN GLOBAL FINANCIAL CRISIS

Most of the stock markets and other sectors were impacted by the Global financial crisis (GFC). The consequences of the GFC have resulted in the deterioration of many sectors which includes the I-REIT in Malaysia. [2] have studied the impact of GFC on the I-REITs and other asset classes. The study was divided into three sub-period analysis; pre-GFC (August 2006 to August 2007) and GFC (September 2007 to December 2008).

However, the author wanted to focus on the risk-adjusted performance of I-REITs and C-REITs only. Table 6.1 tabulates the risk and return of I-REITs and C-REITs by using sub-period analysis. Before the GFC occurred, the average annual return for the C-REITs (31.57%) is higher than I-REITs (5.88%), however, the annual risk for I-REITs was observed to be much lower when compared to the C-REITs (15.14%).

Even though the risk level for I-REITs was lower than the C-REITs, in terms of Sharpe ratio, the C-REITs (1.84) had superior performance than the I-REITs (0.15) in the pre-GFC period. Larger Sharpe ratio indicated better performance of asset class [19]. While, in GFC period, the return of C-REITs decreased drastically to -16.21% and the return of I-REITs also decreased to -5.31%.

Meanwhile, the risk level of I-REITs (13.41%) and C-REITs (9.40%) showed a slight improvement in the GFC period. In terms of Sharpe ratio, I-REITs has a better performance than the C-REITs. Table 2 depicts the diversification benefits of I-REITs and C-REITs using the sub-period analysis.

Table 10: Risk-adjusted performance for I-REITs and C-REITs using sub-period analysis

Pre-GFC (Aug 2006 to Aug 2007)				
	Average Return	Annual	Annual Risk	Sharpe ratio
Islamic REIT	5.88%		14.22%	0.15
Conventional REIT	31.57%		15.14%	1.84
GFC (September 2007 to December 2008)				
Islamic REIT	-5.31%		13.41%	-0.69
Conventional REIT	-16.21%		9.40%	-2.14

Source: Newell and Osmadi (2009)

The diversification benefits shown between I-REITs and KLCI ($r = 0.36$) is lower than C-REITs and KLCI ($r = 0.61$). In fact, the correlation between I-REITs and C-REITs was also low ($r = 0.44$). However, the result indicates that I-REITs offers higher diversification benefits than C-REITs as shown when comparing the relationship against KLCI. During the GFC period, the I-REITs ($r = 0.23$) was still providing better diversification benefits than the pre-GFC period ($r = 0.36$). C-REITs was still showing a lesser diversification benefits in the GFC period ($r = 0.60$). Furthermore, the diversification offer between I-REITs and C-REITs is significant when the correlation decrease to $r = 0.22$.

Table 6.2: Correlation analysis using sub-period analysis.

Pre-GFC (August 2006 to August 2007)			
	KLCI	Islamic REIT	Conventional REIT
KLCI	1.00		
Islamic REIT	0.36	1.00	
Conventional REIT	0.61	0.43	1.00
GFC (September 2007 to December 2008)			
KLCI	1.00		
Islamic REIT	0.23	1.00	
Conventional REIT	0.60	0.22	1.00

Source: Newell and Osmadi (2009)

From the sub chapter 5.0 and 6.0, I-REIT market still give better diversification potential than C-REIT. Eventhough I-REITs was affected by the GFC, it still give low loss (negative return) compare to C-REITs. It also can be conclude that diversification potential of each asset either good or poor can not change the return and risk level of the asset in certain time of period. However, diversification is still important to the investment portfolio through combination of several asset class in order to protect the investment from deficient. The concept is when one asset class in the portfolio does not perform poorly maybe the other asset class still doing well.

7.0 CONCLUSION

I-REITs could unleash its true potential if some improvement is made to the regulations and legislation framework. The transparency of the real estate market in Malaysia could help boost the property investment in Malaysia, especially the I-REIT market. Due to some restrictions based on Shariah principles, the supply of I-REITs became less than C-REITs because some activities are not allowed to operate and products such as alcohol, tobacco, gambling, conventional banks and others are banned.

In order to overcome these obstacles, the SC must find new alternatives or promote additional benefits in order to attract investors to I-REITs. It is a fact that I-REITs can provide investors with good dividends. However, with only three I-REITs in Malaysia, the development of I-REITs will be a challenge. The aim of this paper is to expand on the existing literature on the I-REIT market. It has potential as an alternative investment that could be used as a hedge against inflation and during GFCs. The diversification benefits gained in investing in I-REIT market can be clearly seen; as the price does not move together with the stock market price and other sub-sector markets. I-REITs can generate impressive profits for its investors through the distribution of its dividend. The study on I-REITs should be expanded from time to time in order to deliver a better understanding of its Shariah-compliant market to investors and how it operates.

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