

Optimising Malaysian *Shariah*-Compliant Real Estate Investment Trusts: Perspective of REIT Managers

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ABSTRACT

Globally, the market for *Shariah*-compliant products and services has expanded in recent years. Malaysia, Saudi Arabia and Luxembourg are now considered global Islamic capital market hubs. Islamic capital market products and instruments include the Islamic Equity Market in which the Islamic Real Estate Investment Trusts (REIT) are included. The purpose of this paper is to examine the performance measurement methods adopted by Malaysian REIT (M-REIT) managers, particularly those engaged in *Shariah*-Compliant REIT management. The existing performance measurement methods for conventional and Islamic REITs were identified through an extensive review of the current academic literature. Using semi structured interviews with senior Malaysian REIT managers, including the Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Chief Investment Officer and senior executives, this paper examines various methods and instruments used to measure REIT performance from the management perspective. Based on the semi-structured interviews, the distribution yield was identified as the most significant performance measure and is used as a benchmark by M-REIT managers to enhance REIT performance. Greater transparency in this decision-making strategy may lead to an increase in the efficiency level and better performance to capture greater investor confidence in this promising investment sector.

ARTICLE INFO

Article history:

Received: 1 March 2017

Accepted: 23 November 2017

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Keywords: Malaysia, property investment, REIT, *Shariah*-compliant

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INTRODUCTION

The market for *Shariah*-compliant products and services has expanded significantly over the past years with Malaysia, Saudi Arabia, and Luxembourg becoming the Islamic capital market hubs, which collectively house 71% of Islamic funds globally (Thomson Reuters, 2014). The Global Islamic Asset Management Report by Thomson Reuters (2014) indicates that these three dominant markets remain the most active in developing and regulating their fund sector, evident by their series of initiatives across the Asia and GCC market to help safeguard investors interest.

The Islamic capital market products and instruments include the Islamic Equity Market in which Islamic Real Estate Investment Trusts (REIT) have been introduced. The fundamental difference between the Islamic capital markets and

the conventional capital market is that the former has its own *Shariah* framework. Any violation of this framework will affect the validity of Islamic capital market.

Malaysia was a pioneer in the *Shariah*-compliant real estate investment trust when the Islamic REIT guideline was introduced in November 2005. Singapore, UAE, and Bahrain introduced their first *Shariah*-compliant real estate investment funds, namely Sabana REIT and Dubai Islamic Bank's Emirates REIT in 2010 and Bahrain's Al Salam Bank Asian Islamic REITs fund in 2014. As at December 2014, Malaysian Islamic REITs were the largest in terms of market capitalisation of USD5 billion, followed by Middle East Islamic REITs worth USD501 million and Singapore's Sabana REIT with USD377.2 million (see Table 1).

Table 1
Global Shariah-Compliant REITs: December 2014

No	Country	Fund name	Date established	Market cap US\$ (December 2014)
1	Malaysia	Al Aqar Healthcare REIT	2006	5 billion
		Axis REIT	2005*	
		KLCC REIT	2013	
2	GCC region	Al Mahrab Tower REIT	2008	300 million
		Arabian REIT	2006	
		Inovent REIT	2009	
3	Singapore	Emirates REIT	2010**	201 million
		Sabana REIT	2010	377.2 million

Note. *Axis REIT reclassified into an Islamic REIT in December 2008

** Emirates REIT became a public listed REIT in April 2014

Source: Authors' compilation from Bloomberg and various sources (2015)

Currently, there are 17 Malaysian REITs listed on Bursa Malaysia, of which, four are *Shariah*-compliant, namely Axis REIT, Al Aqar REIT, stapled KLCCP REIT and currently listed Al-Salam REIT (see Table 2). The Axis REIT which was listed as a conventional REIT in 2005, and converted to an Islamic REIT in 2008 with a view to broadening its investor base to include conventional investors and to gauge the demand from Muslim investors. Both foreign

and domestic investors demand a similar level of performance analysis from these *Shariah*-compliant investment vehicles. In addition, performance measurement is crucial for the REIT managers to stay competitive in the market. The purpose of this paper is to investigate the various performance measurement commonly used by the REIT managers, particularly the *Shariah*-Compliant REITs in Malaysia.

Table 2
List of Malaysian REITs: December 2015

Malaysian REIT	Date listed	Property sector	Market cap (RM Million)	Rank by market cap
KLCC REIT	May 2013	Office and retail	12,745.65	1
Pavilion REIT	Dec 2011	Retail	4,677.66	2
IGB REIT	Sept 2012	Retail	4,652.20	3
Sunway REIT	Jul 2010	Retail, hotel, office	4,524.18	4
CapitaLand Malaysia Mall Trust (formerly known as CapitaMalls Malaysia Trust)	July 2010	Retail	2,800.00	5
Axis REIT	Aug 2005	Office, industrial	1,803.00	6
YTL Hospitality REIT (formerly known as Starhill REIT)	Dec 2005	Hotel	1,375.00	7
Al-Aqar Healthcare REIT	Aug 2006	Healthcare	1,020.00	8
MRCB-Quill REIT (formerly known as Quill Capita Trust)	Jan 2007	Office, commercial	714.29	9
UOA REIT	Dec 2005	Office	676.60	10
Hektar REIT	Dec 2006	Retail	608.96	11
Al-Salam REIT	Sept 2015	Retail, industrial, office	539.40	12
AmFirst REIT	Dec 2006	Office, retail	511.37	13
Amanahraya REIT	Feb 2007	Office, retail, industrial, hotel	498.70	14
Tower REIT	Apr 2006	Office	345.02	15
Atrium REIT	March 2007	Industrial	133.98	16
Amanah Hartanah PNB (AHP)**	Dec 1990	Office	101.00	17

Note. Islamic and *Shariah*-Compliant REITs shown in bold

*AHP was established as property trust funds and reclassified as REIT in August 2005.

Previous Studies on Malaysian REIT Performance Measurement

Literature suggested various methods were adopted to measure the performance of the *Shariah*-compliant investment vehicles compared with conventional investment asset classes. Chuweni et al. (2014) reviewed previous literature on performance measurement of Malaysian Islamic REITs. Other studies measured and analysed performance of Islamic REITs using various approaches and strategies in order to maximise shareholder returns and interest (Chuweni, Ahmad, & Mohd Adnan, 2014; Chuweni, Ahmad, & Ting, 2014). For instance, Chuweni, Ahmad and Chuweni (2016) analysed and compared the performance of *Shariah*-Compliant REITs in Malaysia and other countries using a cross section analysis of financial ratios. Their REIT funds included three Malaysian REITs, Axis REIT, Al-Aqar Healthcare REIT and KLCC REIT, Singapore's Sabana REIT and UAE's Emirate REIT. Results revealed that the Emirates REIT was the highest performer followed by the Malaysian REITs and Sabana REIT. Osmadi and Razali (2014) measured the financial and management strength of three Malaysian REITs, namely Al-Aqar KPJ REIT, Al-Hadharah Boustead REIT and Axis REIT during the global financial crisis (GFC) from 2007-2009. Their results revealed that Malaysian Islamic REITs performed well and retained financial and management strength during the GFC, implying the *Shariah* restrictions could provide a competitive advantage in real estate investment.

Akinsomi, Ong, Ibrahim and Newell (2014) measured the idiosyncratic risk of four groups of investment vehicles, namely restrictive *Shariah*-compliant portfolio, less restrictive *Shariah* portfolio, Equity REIT portfolio and the overall REIT market portfolio. They found a significant positive relationship between idiosyncratic risk and *Shariah*-Compliant REIT returns despite the restrictive *Shariah*-compliant portfolio. Razali and Sing (2015) measured the systematic risk of Islamic and conventional REITs in Malaysia from 2005 to 2014 by using static and time-dependent capital asset pricing models. They found Malaysian Islamic REITs exhibited low systematic risks, suggesting investor's protection against market volatilities.

Newell and Osmadi (2009) measured the performance of Malaysian Islamic REITs using risk-adjusted total returns and found that they could enhance portfolio diversification. Similarly, Rozman, Azmi, Mohd Ali and Razali (2015) extended the study and examined the risk-adjusted performance of Malaysian Islamic REITs in a mixed asset portfolio. Their result shows that Islamic REITs outperformed both share and bond market and has low correlation between share and bond, suggesting high diversification benefits for the investors.

In terms of corporate governance, Chuweni and Ahmad (2014) used descriptive and content analysis to examine ownership structure and financial statements to determine the optimal type of Malaysian Islamic REITs. They found that the emerging governance model is the

best model for Malaysian Islamic REITs due to the dominant characteristics of the concentrated and pyramidal model. Chuweni, Azri and Ting (2016) evaluated the price determinations for Malaysian Islamic REITs using the Dividend Discount Model, the Net Asset Value, and the Price Earnings Ratio. They identified the price earnings ratio as the best pricing method to forecast the REIT expected performance and prices.

Rubio, Hassan and Merdad (2012) measured the risk and return relationship of Islamic and conventional mutual funds using the non-parametric approach of Data Envelopment Analysis. The results revealed that the Islamic fund exhibited higher efficiency performance compared with their international counterpart. In a study by Bahlous and Mohd. Yusof (2014) measured using Autoregressive-Distributed lag (ARDL) Islamic investment funds were found to provide regional diversification. A similar result was noted for Malaysian unit trusts. Using different performance measurement to the Sharpe, Treynor, Jensen, Fama Carhart's four-factor pricing models, Hassan, Khan and Ngow (2010) found that Malaysian unit trust funds provided international diversification benefits to reduce financial risks. However, Mansor and Bhatti (2011) contradicted this result when they measured the risk-return analysis on the performance of Malaysian Islamic mutual funds using monthly average returns from 1996 to 2009. Their results showed that Islamic portfolios carried greater risks than the conventional ones.

METHOD

To achieve an in-depth understanding of the performance measurement method used by the REIT managers, semi structured interviews were conducted with senior top REIT managers, namely Chief Executive Officer, Chief Operating Officer, Chief Financial Officer, Chief Investment Officer and senior executives. An open-ended approach to interview questions was used to encourage the top REIT managers to offer their opinions based on the normal practice in the industry. This approach was designed to ensure an elevated level of reliability of the study. Furthermore, the respondents are top decision-makers involved in the fund's management and operation, performance measurement, risk management and property investment portfolios.

All Malaysian REIT managers were invited via email to participate in this study. A telephone call was then made with the relevant Personal Assistant to arrange for a face-to-face interview. From this method of respondent recruitment, ten respondents agreed to participate and face-to-face interviews were conducted in April and May 2016. The profile of respondents is outlined in Table 3. The respondents are very experienced professionals and representatives of both *Shariah*-compliant REITs (4:40%) and conventional REITs (6:60%). The study is gender balanced with males (5:50%) and females (5:50%).

The interviews were conducted on a confidential basis and verbatim notes were compiled for data analysis purposes.

The interviews were designed to last 40-60 minutes in duration. Initially, open ended unprompted questions were asked by the Interviewer followed by prompted questions to further explore issues raised by the Respondents. Data was analysed using coding and data entry in QSR NVivo Version

11 computer software. Coding involved assigning responses or answers into many themes. For the interview analysis, a few themes were identified and this paper will mainly focus on the various performance and benchmark measurement methods.

Table 3
Respondents' profile

Respondent	Position	Working experience (in years)
R1	Chief Operating Officer	13-15 years
R2	Chief Executive Officer	13 – 15 years
R3	Chief Executive Officer	20 – 30 years
R4	Senior executive	10 – 15 years
R5	Chief Financial Officer	20 – 30 years
R6	Chief Financial Officer	20 years
R7	Senior executive	20 years
R8	Chief Executive Officer	20 – 30 years
R9	Chief Financial Officer	20 years
R10	Senior executive	20 years

RESULTS AND DISCUSSION

This section analyses the results of the interviews conducted and develops a descriptive model of how REIT Managers measure and benchmark their performance against their peers in the industry.

Performance Measurement Methods

When the respondents were asked about their REIT performance measurement, one of the dominant themes that emerged was that distribution yield or distribution per unit (DPU) growth which was most commonly used followed by various other methods including asset growth or capital appreciation, net asset value, total

return, management expense ratio, market capitalisation and earning per share. The following are the examples and the reasons for choosing distribution yield as the preferred performance measurement:

“The measurement of REITs performance, REITs is based on the dividend pay-out, so the key performance is your ability to pay sustainable returns in the form of dividend as it is not really an instrument, unlike other capital markets where you buy and flip easily. REITs share price doesn't fluctuate that much”.

(Respondent 1)

“For REIT, normally the investors invest in REIT because of the yield, and the dividends that we distribute. So, naturally, when it comes to our performance, it’s driven by the returns or the dividend that we distribute. We have yield and the other one is capital appreciation. The capital appreciation is the appreciation in share price. For the long-term investor, they stay on for every quarter dividend payment. Some investors, when the share price moves, they sell”.

(Respondent 6)

“The lower your dividend yield is, the better your performance. It means higher market price. If you look at all the top five REITs in Malaysia, out of 17, you’ll find that in the top five in terms of assets size and market cap, these larger REITs are substantially bigger than the balance. So, you find that the yields that they command are around 5-6% across dividend yield. Whereas, the one that are outside these large REITs are around that 7-8%. It comes up to the yield; you find that lower yield has more demand for the unit of the share price”.

(Respondent 8)

“The key performance measurements at REIT level are dividend yield, total return, DPU growth Premium/discount to NAV,

Market capitalisation and asset under management”.

(Respondent 9)

“We measure the REIT performance using distribution yield derived from the formula of the ration of the income distribution paid to a REIT unitholder by REIT’s price paid by the unit holders or the prevailing market price of the REIT. Other indicators include net asset value, management expense ratio and total return”.

(Respondent 4)

Almost all respondents said that the distribution yield was the most significant performance measurement method for analysing REIT performance. However, Respondents 2 and 3 nominated asset growth or capital appreciation as the most significant performance measure rather than distribution yield for the following reason:

“The investors are also looking for how managers would like to grow the REIT which determines performance. Investors are looking towards how a manager can add more assets because by adding more assets, it will increase value and more income that you can distribute. So, in total, growing asset is first criteria followed by distribution yield because automatically when you have a new asset, then it will enhance your distribution yield and before we require assets, we must

make sure that they (the assets) that we require must not dilute the existing dividend”.

(Respondent 3)

“It’s quite straightforward. At the end of the day, how much you can give to your unitholder? So, unitholder normally will look at two things; the capital appreciation of their units and how much we pay them in terms of income distribution. So, they will look at dividend yield and the performance of the market. So, we try to give the best yield for our unitholder. Even in the difficult market conditions, we try to pay out more than 90% and give a competitive rate of a dividend or income distribution to the unitholders”.

(Respondent 2)

Benchmarking against Other Peers

When the REIT managers were asked if there was any difference in terms of the performance methods for benchmarking purposes, the predominant answer remains that it is the distribution yield that will attract investors to the REIT.

“The main criterion to benchmark with others is actually your distribution because, if you perform well, your distribution must be good as compared to others. That is the main criteria. No one will pick your share if you only can distribute

below than the average determined by the industry.

(Respondent 3)

If the benchmarking against other market players is based on the total assets (REIT size), Respondents 1 and 5 said that comparison by size is not fair because REITs come in different sizes.

“There are a lot of ways to benchmark ourselves against other REITs funds. We can’t really benchmark the price, dollar to dollar because of the REITs fund, they come in variation of sizes. It’s not a fair comparison but the best way to compare ourselves against the market is to see, first, our dividend payout, whether it has been consistent...”.

(Respondent 1)

“Normally, the benchmark based on the market is the yield. If you want to benchmark this on the total asset, then we are very small, but if you benchmark against the yield, we are one of the highest paid yield in the market”.

(Respondent 5)

Respondents 1 and 6 also confirmed that managing the asset is the critical to compare the performance and benchmark against peers in the industry.

“...another way to compare the performance is to see how active the REITs is. So basically, a REITs

manager, their real test come to place is when they can basically grow the assets or the portfolios. So that's how I always measure myself against other REITs".

(Respondent 1)

"Growth is also one part of ensuring that we continue to provide a steady income of the dividends. We need to have also a big asset to inject so that we can see the meaningful rate of growth. So, when talking about growth we look not only the size of the asset, but the asset that we want to inject must also be dividend accretive. REITs asset must be making money with an income cashflow that we can get from that asset."

(Respondent 6)

Benchmarking also depends on the purpose of the investment and the investors' objective. For instance, Respondents 5 and 2 claimed that apart from yield, certain investors look at liquidity and the period of investment.

"...depends on what is the purpose of benchmarking. Normally, investor, their first intention is to get the highest yield possible, but certain investor they look at liquidity and long term. If you look for liquidity, then REIT would be not favoured or favourably lower because REITs don't have much liquidity in the market. So, benchmarking depends on the

objectives, where, how and what is the purpose".

(Respondent 5)

"I think for REIT market, most people are there for the long term. They hold the shares or the unit for a long term for the yield and capital appreciation. For Malaysian REIT, we rarely have seen much capital appreciation because, in terms of share price, it is very stable. For us, we have shareholders which have been very loyal to us since day one. They are still there because of the attractiveness in holding the units for them"

(Respondent 2)

Analysis of interviews has shown that there is a alignment between the opinions of *Shariah*-compliant REIT managers and conventional REIT managers in terms of performance measurement methods adopted and benchmarking against their peers. Despite the *Shariah*-Compliant REITs having a limited investment universe, the results from the previous literature indicate there is a diversification benefit which provides greater opportunity for global investors, not limiting the REIT to investment from those seeking *Shariah*-compliant investments. The opportunity and potential of the *shariah*-compliant market are also reflected in the response of non-*Shariah*-Compliant REIT managers that they would consider converting to *Shariah*-compliant REITs should the right circumstances occur.

CONCLUSION

The paper examined various methods and instruments to measure REIT performance from the management perspective. Based on the semi-structured interviews, the distribution yield or the distribution per unit (DPU) growth was identified as the significant performance measure and used as a benchmark by M-REIT managers to enhance REIT performance. Therefore, it is recommended that the distribution yield be used as one of the variables in regression analysis or other performance measurement methods such as the efficiency and productivity model with a view to optimising Malaysian REIT performance. The authors will extend this research with respect to the management and operation of REITs and undertake future research in identifying the key determinants of best practice for each M-REIT, particularly the *Shariah*-Compliant REITs. Greater transparency in decision-making strategies will lead to increased efficiencies and superior performance in the sector, which will elevate investor confidence in this promising investment sector.

ACKNOWLEDGEMENTS

The authors gratefully acknowledge the funds provided by Malaysian Ministry of Higher Education and Universiti Teknologi MARA (UiTM) to undertake this study.

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