

# Guidelines for Islamic Real Estate Investment Trusts

## FREQUENTLY ASKED QUESTIONS

- 1. Is an Islamic real estate investment trust (Islamic REIT) permitted to own (purchase) real estate in which the tenant(s) operates mixed activities that are permissible and non-permissible according to the Syariah?**

An Islamic REIT is permitted to own (purchase) real estate in which its tenant(s) operates mixed activities that are permissible and non-permissible, according to the Syariah.

However, the Islamic REIT fund manager must perform some additional compliance assessments before acquiring real estate that has a tenant(s) who operates mixed activities.

- 2. What are the additional compliance assessments?**

An Islamic REIT must obtain the total rental from non-permissible activities from the property that it wants to acquire, and subsequently compare the total rental from non-permissible activities to the total turnover of the Islamic REIT (latest financial year). This is to obtain the percentage of rental from non-permissible activities. The percentage amount will be referred to the 20% benchmark as determined by the Syariah Advisory Council (SAC) of the Securities Commission for the criteria on rental from non-permissible activities. In the event that the percentage exceeds the benchmark, the Syariah committee/Syariah adviser shall advise the Islamic REIT fund manager not to invest in the said real estate.

For example, if the total rental from non-permissible activities is RM210,000 and the total turnover of the Islamic REIT for that financial year is RM1,000,000, then the percentage of rental from non-permissible activities is 21%, which exceeds the 20% benchmark that has been determined by the SAC. In this situation, the Syariah committee/Syariah adviser shall advise the Islamic REIT fund manager not to invest in the said real estate.

- 3. What are non-permissible activities?**

Rental activities that are classified as non-permissible as decided by the SAC are:

1. financial services based on *riba* (interest);
2. gambling/gaming;
3. manufacture or sale of non-*halal* products or related products;

4. conventional insurance;
5. entertainment activities that are non-permissible according to the Syariah;
6. manufacture or sale of tobacco-based products or related products;
7. stockbroking or share trading in Syariah non-compliant securities; and
8. hotels and resorts.

Apart from the activities listed above, the Syariah committee/Syariah adviser can apply *ijtihad*<sup>1</sup> for other activities that may be deemed non-permissible to be included as a criterion in assessing the rental income for the Islamic REIT.

**4. Can an Islamic REIT own real estate in which all the tenants operate non-permissible activities?**

No. An Islamic REIT is not permitted to own real estate, in which all the tenants operate non-permissible activities, for example a casino building in which all the tenants are operating non-permissible activities, even if the percentage of rental from that building to the total turnover of the Islamic REIT is still below the benchmark (20%).

**5. What if an Islamic REIT owns real estate that is vacant and plans to rent it out to a new tenant(s)? Is it bound by the application of the 20% benchmark as mentioned in the answer for question 2 above?**

For a new tenant(s) that plans to rent the real estate of the Islamic REIT, the decision made by the Syariah committee/Syariah adviser does not need to be based on the 20% benchmark because the rental contribution from non-permissible activities is still unknown. Therefore, in this case the Syariah committee/Syariah adviser shall advise the Islamic REIT fund manager not to accept a new tenant(s) that operates activities that are **fully** non-permissible like a gambling operator.

**6. What is the method of calculating the portion of rental of non-permissible activities from the total rental payment paid by a tenant(s) operating mixed activities. For example, say the Islamic REIT receives a rental of RM3,000 a month from a supermarket. The supermarket sells *halal* goods and alcoholic beverages. The question is, how do you determine the rental that is considered as non-permissible from the total rental that is paid by the supermarket (RM3,000)?**

The calculation for the rental of non-permissible activities from a tenant(s) operating mixed activities can be based on the ratio of area occupied for non-permissible activities to the total area occupied. The percentage will be used as the basis for determining the ratio of rental of non-permissible activities to total rental paid by the tenant(s).

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<sup>1</sup> *Ijtihad* is the process of reasoning by Islamic jurists to obtain legal rulings from the sources of Syariah.

For example, in a supermarket, if the total area rented out is 1,000 square feet and the area allocated for the sale of alcoholic beverages is 100 square feet, then the ratio of area used for the sale of alcoholic beverages is 10%. Therefore, the rental from non-permissible activities (sale of alcoholic beverages) is 10% of the total rental paid by the supermarket, that is RM300 a month (10% x RM3,000).

In addition, for activities that do not involve the usage of space, such as service-based activities, the calculation method will be based on the *ijtihad* of the Syariah committee/Syariah adviser of the Islamic REIT. An example of a service-based activity is packaging that involves packaging of goods that are non-permissible.

**7. Is an Islamic REIT required to use instruments that comply with the Syariah principles for purpose of investment, deposit and financing?**

Yes. An Islamic REIT must ensure that all forms of investment, deposit and financing instruments comply with the Syariah principles.

**8. Is an Islamic REIT required to use insurance schemes that comply with the Syariah principles?**

Yes. An Islamic REIT must use *Takaful* schemes to insure its real estate. If *Takaful* schemes are unable to provide the insurance coverage, then the Islamic REIT is permitted to use conventional insurance schemes.

**9. Is an Islamic REIT permitted to participate in the forward sales or purchases of currency for risk management?**

Yes. An Islamic REIT is permitted to participate in forward sales or purchases of currency, and is encouraged to deal with Islamic financial institutions. If the Islamic REIT deals with Islamic financial institutions, then it will be bound by the concept of *wa'd*<sup>2</sup> (only one party is obligated to fulfil his promise/responsibility). The party that is bound is the party that initiates the promise. However, if the Islamic REIT deals with conventional financial institutions, it is permitted to participate in the conventional forward sales or purchases of currency.

**10. Would the Islamic REIT guidelines supercede the Guidelines on Real Estate Investment Trusts issued in January 2005?**

No. The Guidelines on Islamic REIT essentially provide Syariah guidance on the investment and business activities of Islamic REIT and complement the SC's Guidelines on Real Estate Investment Trusts. The issuance of Islamic REIT must therefore comply with both guidelines.

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<sup>2</sup> *Wa'd* means promise.

