



## Public Consultation Paper

No. 3/2016

### Proposed Amendments to Guidelines on Real Estate Investment Trusts and Streamlining of Post-Listing Requirements for Listed Real Estate Investment Trusts with Listed Corporations

The Securities Commission Malaysia (SC) invites your comments to this consultation paper. Comments are due by **13 September 2016** and will only be received when submitted at <http://surveys.sc.com.my/s3/Public-Consultation-REITs-Guidelines>.

Additional copies of this document may be made without seeking permission from the SC or downloaded from its website at <http://www.sc.com.my/reit2016>.

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This public consultation paper is dated 14 July 2016

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## 1 INTRODUCTION

- 1.1 Real estate investment trusts (REITs) offer investors an opportunity to diversify their investment portfolio into an asset class that provides potentially stable income stream and attractive distribution yields.
- 1.2 Malaysia's REITs market, which had a total market capitalisation of RM41.07 billion as at 30 June 2016, has seen steady growth over the past 10 years. It is represented by 17 REITs, including four Islamic REITs of which one is part of a stapled structure. Malaysia REITs own a wide range of real estate, including office buildings, retail malls, hotels, healthcare establishments and industrial properties.
- 1.3 To further facilitate the sustainable growth of the REITs market, the SC is currently undertaking a comprehensive review of the *Guidelines on Real Estate Investment Trusts* (REITs Guidelines). In undertaking this review, the SC has taken into consideration the evolving needs of investors and the REITs as well as developments and regulatory requirements in the regional markets. The SC has had discussions with various stakeholders in relation to the proposals under this consultation paper and some of their views have been incorporated.
- 1.4 The primary objectives of this review are as follows:

(i) **Facilitate growth by expanding the scope of permitted activities that can be undertaken by REITs**

The SC proposes to liberalise the permitted activities to afford greater opportunities for REITs to expand their income base to create value for investors. This liberalisation will, among others, enable REITs to redevelop their existing properties or acquire vacant land for purposes of developing new properties to expand their portfolio of income-generating real estate. It will also allow REITs to enter into long-term leases with registered proprietors of real estate.

(ii) **Enhance governance requirements**

While facilitating growth, the SC remains cognisant of the importance of fostering strong governance culture in order to protect investors, maintain market integrity and promote long-term sustainability of Malaysia's REITs market. Measures proposed to enhance governance include the introduction of a requirement for REIT managers to establish an audit committee.

The SC is of the view that these enhanced requirements would not unduly burden the REIT managers as Malaysia REITs have generally, on their own initiative, embraced the recommendations advocated in the *Malaysian Code on Corporate Governance 2012* (MCCG 2012).

(iii) **Improve efficiency through streamlining of post-listing requirements for listed REITs with those for listed corporations**

Besides proposing measures to facilitate growth and enhance the governance structure of REITs, the SC also seeks to achieve parity in regulations between listed REITs and listed corporations by streamlining post-listing requirements in the REITs Guidelines with Bursa Malaysia Securities Berhad (Bursa) Main Market Listing Requirements (Bursa Listing Requirements). The proposed streamlining of regulations will promote greater efficiency in undertaking post-listing transactions by REITs.

- 1.5 This consultation paper seeks feedback on the proposals which will be effected by way of amendments to the REITs Guidelines and Bursa Listing Requirements.

## 2 FACILITATING GROWTH

### PROPOSAL 1 – PROPERTY DEVELOPMENT ACTIVITIES

- 2.1 Although REITs are currently permitted to acquire properties under construction valued at up to 10 per cent of their total asset value (after the acquisition)<sup>1</sup>, they are not permitted to undertake property development activities or acquire vacant land<sup>2</sup>. This restriction was intended to ensure that REITs are not exposed to the risks associated with property development activities, given their nature as an asset class that primarily invest in real estate with the aim of providing investors with returns derived from recurrent rental income.
- 2.2 The SC, however, recognises that if the current requirements are liberalised to allow REITs to develop properties to rejuvenate or expand their portfolio of income-generating real estate, the REITs can create more value for their unit holders. Under the current requirements, REITs that hold old and outdated properties would have to sell such properties back to their sponsors to be redeveloped and subsequently repurchase the redeveloped properties, or otherwise be saddled with a less competitive portfolio of buildings. Allowing REITs to undertake redevelopment of their old properties will enable them to enhance the property yield for the benefit of unit holders. Similarly, allowing REITs to acquire vacant land for purposes of developing new properties will enable them to grow their portfolio of income-generating real estate.
- 2.3 The SC proposes to allow REITs to undertake property development (including acquiring vacant land for this purpose), subject to the value of properties and vacant land earmarked for property development not exceeding 15 per cent of the REIT's enlarged total asset value in aggregate. With this proposal, the current provision that allows REITs to acquire real estate under construction up to a limit of 10 per cent of their total asset value (after the acquisition) will be subsumed within the said 15 per cent limit. Hence this new 15 per cent limit would be an aggregate limit for property development, property under construction and acquisition of vacant land for purposes of development.
- 2.4 To ensure property development activities are undertaken for the purposes of improving rental income potential, the following requirements would be introduced in relation to the holding period of the completed property:
- (i) REITs must continue to hold the completed property for at least two years from the date of completion (i.e. upon attainment of the certificate of fitness) of the property development. This is to ensure that property development activities are conducted with the objective of enhancing the income-generating capacity of REITs for the benefit of unit holders and not for purposes of development and subsequent disposal.

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<sup>1</sup> Paragraph 8.14(e) of the REITs Guidelines.

<sup>2</sup> Paragraphs 8.44(b) and 8.44(c) of the REITs Guidelines.

- (ii) In the event that a REIT wishes to dispose of the completed property during the 2-year holding period, the REIT must seek its trustee's consent and obtain approval from unit holders by way of a special resolution.
- 2.5 For clarity, the SC further proposes that "property development activities" be defined as "the construction or re-development of a building or the extension to an existing building". In this regard, property development activities do not include renovation, refurbishment or retrofitting.
- 2.6 Together with the proposed liberalisation of permitted activities, the SC proposes for the threshold on minimum investments in real estate and/or single purpose companies be increased from the current requirement of 50 per cent<sup>3</sup> of a REIT's total asset value, to 75 per cent. This means that a REIT's minimum investments in real estate and/or single purpose companies must be at least 75 per cent of its total asset value at all times. This is to ensure that REITs have a substantial portion of their investments in income-generating real estate.

### Issue for Consultation (Proposal 1)

- Question 1: Do you agree with the SC's proposal to allow REITs to undertake property development activities by way of redeveloping their existing properties or acquiring vacant land for purpose of development? Please provide specific reasons for your views.
- Question 2: Do you agree with the proposed aggregate limit of 15 per cent of a REIT's total enlarged asset value for property development, property under construction and acquisition of vacant land for development? Please provide specific reasons for your views. If you disagree with the proposed limit, please indicate what you consider as appropriate together with the rationale thereof.
- Question 3: Do you agree with the SC's proposal for a REIT to be required to hold the completed property for at least two years from the date of completion of the property development? Please provide specific reasons for your views.
- Question 4: Do you agree with the SC's proposal for a REIT to seek its trustee's consent in the event the REIT wishes to dispose of the completed property during the 2-year holding period? Please provide specific reasons for your views.
- Question 5: Do you agree with the SC's proposal for a REIT to seek its unit holders' approval by way of a special resolution in the event the REIT wishes to dispose of the completed property during the 2-year holding period? Please provide specific reasons for your views.
- Question 6: Do you agree with the proposed definition of "property development activities"? Please provide specific reasons for your views.
- Question 7: Do you agree with the SC's proposal that REITs must have at least 75 per cent of their total asset value invested in income-generating real estate and/or single purpose companies? Please provide specific reasons for your views.

<sup>3</sup> Paragraph 8.07 of the REITs Guidelines.

**PROPOSAL 2 – PRIVATE LEASES**

- 2.7 The REITs Guidelines currently do not provide for REITs to acquire interest in real estate through a long-term lease agreement with a lessor where the lessor is not a government or a government agency (private lease)<sup>4</sup>.
- 2.8 The SC recognises that private lease transactions for various purposes other than for REITs have taken place in Malaysia for many years, particularly in private commercial arrangements. Investments in private leases by REITs are also gaining traction in the region and industry participants have expressed an interest in such investments.
- 2.9 The SC notes that while acquisition of properties through direct ownership grants a REIT legal ownership of the properties, acquisition through private leases grants the REIT beneficial interest derived through a lease agreement. As this arrangement is contractual in nature, there may be risks associated with negotiated terms of the lease agreement where such terms may not be in favour of the REIT.
- 2.10 In view of the above, the SC proposes to allow REITs to acquire properties through private leases, provided the following requirements are met:
- (i) The private lease must be registered with the Land Office. Where the private lease relates to foreign real estate, the private lease must be registered or recognised by the relevant land authority under a land registry framework equivalent to that of Malaysia;
  - (ii) The total value of private leases with remaining lease period of less than 30 years should be less than 25 per cent of the total asset value (after acquisition) of a REIT;
  - (iii) The REIT manager must obtain legal advice on the acquisition of the private lease to ensure the interests of the REIT are protected in the lease agreement; and
  - (iv) The REIT manager must provide additional disclosures on such private lease arrangements in the prospectus, announcements, circulars and annual reports, where applicable. The additional disclosures include the following:
    - Remaining term of the lease held by the REIT;
    - The private lease is a lease registered with the Land Office, or its equivalent for foreign real estate;
    - Name of the lessor of the real estate;
    - Whether the lessor is a related party; and
    - Any other information in relation to the private lease arrangement that is relevant for investors' consideration in deciding whether to invest or stay invested in the REIT.

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<sup>4</sup> Paragraph 8.11 of the REITs Guidelines.

**Issue for Consultation (Proposal 2)**

- Question 8: Do you agree with the SC's proposal to allow REITs to acquire the legal and beneficial interest in real estate through private lease agreements? Please provide specific reasons for your views.
- Question 9: Do you agree with the SC's proposal to limit the total value of private leases with a remaining lease period of less than 30 years to less than 25 per cent of the total asset value (after acquisition) of a REIT? Please provide specific reasons for your views. If you disagree with the proposed limits, please indicate what you consider as appropriate together with the rationale thereof.
- Question 10: Do you agree with the additional disclosures proposed and are there any further disclosures to be made?

**PROPOSAL 3 – INCOME SUPPORT**

- 2.11 An income support arrangement is where a vendor of a real estate commits to a REIT that the real estate acquired would be able to generate a yield that is above market rate. Further, the vendor guarantees the returns to the REIT for a specified period in the sale and purchase agreement. While REITs in other jurisdictions have allowed income support arrangements, there are currently no specific provisions in the REITs Guidelines for such arrangements.
- 2.12 Income support arrangements can take various forms such as–
- (i) a REIT acquiring a property where the vendor provides minimum rental guarantee for a fixed tenure post-acquisition by the REIT;
  - (ii) a REIT acquiring a property where there is a sale and leaseback arrangement with the vendor for its own use at above market rate for a relatively short period; and
  - (iii) other forms of financial engineering which have the effect of artificially enhancing the yield of a property on an unsustainable basis.
- 2.13 While the SC recognises that there could be legitimate reasons for income support arrangements in certain circumstances (for example, where the property is newly completed and the rental rate or occupancy level has not stabilised), concerns may arise over such arrangements as follows:
- (i) The income support may have the effect of inflating the valuation of the property, which could result in the REIT over-paying for the property;
  - (ii) Investors may be misled by the headline yield when the income support provides only short-term enhancement to the REIT's yield that may not be sustainable after the expiration of the income support period, particularly when the income support is structured to provide a rental rate that is significantly higher than the prevailing market rental rate; and

- (iii) The REIT may be exposed to the credit risk of the party providing the income support.
- 2.14 Given the above, it is proposed that where REITs acquire real estate with income support arrangements, the market value of the real estate to be acquired should exclude the impact of the income support arrangement.
- 2.15 Where the acquisition of the real estate includes income support arrangements, investors should be provided with relevant information for them to make an informed decision. As such, the SC proposes to require the following additional disclosures on income support arrangements in the prospectus, circulars, announcements and annual reports, where applicable:
- (i) Detailed terms of the income support arrangement, including how the income support is priced into the purchase consideration for the real estate (where applicable), and the tenure or remaining tenure of the income support, as the case may be;
  - (ii) Expected yields with and without the income support arrangement;
  - (iii) Payments receivable or received from the income support arrangement; and
  - (iv) Any other information in relation to the income support arrangement that is pertinent to an investor's decision to invest or stay invested in the REIT.

### **Issue for Consultation (Proposal 3)**

Question 11: Do you agree with the proposed approach in addressing income support arrangements? Please provide specific reasons for your views.

Question 12: Do you agree with the proposed additional disclosures? Please provide specific reasons for your views. If you believe investors/unit holders should be provided with any other information, please indicate what that would be with the rationale thereof.

### **PROPOSAL 4 – ISLAMIC REITs**

- 2.16 Currently, Islamic REITs are allowed, at the point of establishment, to acquire real estate with tenants that carry out Shariah non-compliant activities provided the percentage of total rental received from such Shariah non-compliant activities (Shariah Non-Compliant Rental) is less than 20 per cent of the Islamic REITs' total turnover<sup>5</sup>. However, the current requirement does not allow the Islamic REITs to accept new tenants or renew existing tenants whose activities are fully Shariah non-compliant<sup>6</sup>.
- 2.17 The SC recognises that Islamic REITs with investments in commercial retail properties typically have a tenancy mix consisting of tenants with Shariah compliant and Shariah non-compliant activities. For

<sup>5</sup> Paragraph 1.1(c) of the Islamic REITs Guidelines.

<sup>6</sup> Paragraph 1.2 of the Islamic REITs Guidelines. Once a tenancy has expired, existing tenants are considered to be new tenants.

such properties, a good tenancy mix is necessary to achieve high occupancy rates. Therefore, the SC proposes a change in approach, as follows:

- (i) At the point of establishment, Islamic REITs would be allowed to acquire real estate with tenants that carry out Shariah non-compliant activities provided the percentage of Shariah Non-Compliant Rental is less than 20 per cent of the Islamic REIT's total turnover.
- (ii) Islamic REITs must thereafter reduce the percentage of Shariah Non-Compliant Rental from less than 20 per cent to less than five per cent of the Islamic REIT's total turnover ("less-than-five per cent threshold") by the end of the fifth full financial year post establishment.
- (iii) Islamic REITs would be allowed to accept new tenants and renew tenancy agreements of existing tenants whose activities are Shariah non-compliant, subject to the following:

(a) Acceptance of new tenants and renewal of existing tenants up to the end of the fifth full financial year

Prior to an Islamic REIT reaching the end of the fifth full financial year post establishment, the Islamic REIT may accept new tenants and renew tenancy agreements of existing tenants whose activities are Shariah non-compliant, provided that–

- the percentage of Shariah Non-Compliant Rental is less than 20 per cent of the Islamic REIT's total turnover; and
- the Islamic REIT reduces the percentage of Shariah Non-Compliant Rental to less than five per cent of its total turnover by the end of the fifth full financial year.

(b) Acceptance of new tenants and renewal of existing tenants after the end of the fifth full financial year

After the end of the fifth full financial year post establishment, an Islamic REIT may accept new tenants and renew tenancy agreements of existing tenants whose activities are Shariah non-compliant, provided that the percentage of Shariah Non-Compliant Rental is less than five per cent of the Islamic REIT's total turnover.

- (iv) Islamic REITs would be allowed to acquire additional real estate having tenants that carry out Shariah non-compliant activities, subject to the following:

(a) Acquisition of real estate up to the end of the fifth full financial year

Prior to an Islamic REIT reaching the end of the fifth full financial year post establishment, the Islamic REIT may acquire additional real estate with tenants that carry out Shariah non-compliant activities, provided that–

- the percentage of Shariah Non-Compliant Rental after such acquisition is maintained at less than 20 per cent of the Islamic REIT's total turnover; and
- the Islamic REIT reduces the percentage of Shariah Non-Compliant Rental to less than five per cent of its total turnover by the end of the fifth full financial year.

(b) Acquisition of real estate after the end of the fifth full financial year

After the end of the fifth full financial year post establishment, an Islamic REIT may acquire additional real estate with tenants that carry out Shariah non-compliant activities, provided that the percentage of Shariah Non-Compliant Rental is less than five per cent of the Islamic REIT's total turnover.

- 2.18 The five-full-financial-year period will provide a reasonable time to enable the REIT manager to manage the tenancy mix in its portfolio of real estate in order to pare down the Shariah Non-Compliant Rental. After the end of the five full financial years, Islamic REITs must ensure that they maintain the less-than-five per cent threshold for Shariah Non-Compliant Rental.
- 2.19 In the event Islamic REITs are unable to comply with the less-than-five per cent threshold at the end of the fifth full financial year, Islamic REITs must channel the excess amount of the Shariah Non-Compliant Rental to *baitulmal* and/or charitable bodies as advised by the Shariah adviser within one year from the end of the fifth full financial year.
- 2.20 After the end of the fifth full financial year, the requirement in paragraph 2.19 remains applicable for as long as Islamic REITs are unable to comply with the less-than-five per cent threshold. The excess amount of the Shariah Non-Compliant Rental must be channelled to *baitulmal* and/or charitable bodies as advised by the Shariah adviser within one year from the end of each financial year.

**Issue for Consultation (Proposal 4)**

Question 13: Do you agree that an Islamic REIT be given five full financial years to comply with the less-than-five per cent threshold? Please provide specific reasons for your views.

**PROPOSAL 5 – UNIT BUY-BACK**

- 2.21 The current REITs Guidelines have no provisions for REITs to buy back their units. The SC has received requests from the industry to allow unit buy-back for listed REITs, similar to share buy-back for listed corporations.
- 2.22 Buy-backs are a form of return of cash to unit holders. When used appropriately, buy-backs can help to reduce cost of capital and effectively deploy available funds.
- 2.23 The SC proposes to allow listed REITs to buy back their own units. The unit buy-back would be subject to restrictions and notification requirements similar to those applicable to unit buy-backs by a

business trust under the Bursa Listing Requirements, including that the units purchased must be immediately cancelled.

**Issue for Consultation (Proposal 5)**

Question 14: Do you agree with the SC's proposal to allow listed REITs to buy back their own units? Please provide specific reasons for your views.

Question 15: Do you agree with the SC's proposal for the unit buy-back to be subject to restrictions and notification requirements similar to those applicable to unit buy-backs by a business trust under the Bursa Listing Requirements? Please provide specific reasons for your views.

Question 16: Do you agree with the SC's proposal for the units purchased to be subsequently cancelled? Please provide specific reasons for your views.

**PROPOSAL 6 – LEVERAGE LIMIT**

2.24 REITs are currently subjected to a leverage limit of 50 per cent of their total asset value, which may be increased if the REITs obtain approval of their unit holders by way of an ordinary resolution<sup>7</sup>.

2.25 With the current flexibility, there is a risk that a REIT may over-leverage in pursuit of rapid growth. To contain this risk and ensure sustainable growth, the SC proposes to adopt a fixed leverage limit of 50 per cent without the option for REITs to increase this limit by obtaining approval of the unit holders.

2.26 Based on the information available to the SC, this change is not expected to have an adverse impact on the REIT industry as the leverage levels of existing REITs are below the 50 per cent limit.

**Issue for Consultation (Proposal 6)**

Question 17: Do you agree with the SC's proposal to adopt a fixed leverage limit of 50 per cent? Please provide specific reasons for your views.

<sup>7</sup> Paragraph 8.37 of the REITs Guidelines.

### 3 ENHANCING GOVERNANCE

#### PROPOSAL 7 – STATEMENT OF CORPORATE GOVERNANCE AND INTERNAL CONTROL

- 3.1 Under the Bursa Listing Requirements, listed corporations are currently required to ensure that their respective board of directors provides a narrative statement on the listed corporation's corporate governance practices and a statement about the state of internal controls in the listed corporation's annual report. These requirements are currently not applicable to REITs<sup>8</sup>.
- 3.2 In line with the recommendations set out in the MCCG 2012 and to streamline the requirements for all listed issuers, the SC proposes for the board of directors of REIT managers to include a Statement of Corporate Governance and Internal Control in the annual report of REITs.

#### Issue for Consultation (Proposal 7)

Question 18: Do you agree with the SC's proposal for the board of directors of a REIT manager to provide a Statement of Corporate Governance and a Statement of Internal Control in the annual report of a REIT? Please provide specific reasons for your views.

#### PROPOSAL 8 – AUDIT COMMITTEE

- 3.3 The REITs Guidelines set out the required governance structure for REIT managers, including the required minimum number of independent members on the board of directors and the investment committee<sup>9</sup>. The REITs Guidelines also require an internal audit function to be established and a compliance officer to be appointed in the REIT manager<sup>10</sup>. While the roles and responsibilities of each of these oversight functions have been set out in the REITs Guidelines, there is no expressed requirement for an audit committee to be established.
- 3.4 The primary purpose of an audit committee is to provide oversight of the financial reporting process, the audit process, the system of internal controls, risk management, conflict of interest arising from related party transactions and regulatory compliance. In this respect, the audit committee plays an important role in the investor protection framework.
- 3.5 For listed corporations, which must establish an audit committee<sup>11</sup>, this oversight role is particularly important where there is a conflict between the interests of the corporation's management and controlling shareholders and the interests of minority shareholders.

<sup>8</sup> Paragraph 8.36 of the Bursa Listing Requirements.

<sup>9</sup> Paragraphs 3.06 and 6.03 of the REITs Guidelines.

<sup>10</sup> Paragraphs 3.23 and 3.18 of the REITs Guidelines.

<sup>11</sup> Paragraph 3.05 of the Bursa Listing Requirements.

- 3.6 The conflict of interest issues for a REIT are quite similar to those of a listed corporation, given the structure where the sponsor of the REIT typically holds a controlling stake in the REIT manager. Hence, the SC is of the view that requiring an audit committee in the governance structure will further strengthen the oversight of the activities of the REITs.
- 3.7 It should be highlighted that the audit committee of a REIT is the audit committee of the REIT manager and not the REIT itself. However, it is expected that the audit committee will oversee the transactions of the REITs.
- 3.8 Taking the above into consideration, the SC proposes to require REIT managers to establish an audit committee and that the requirements as provided for in the Bursa Listing Requirements be adopted for REITs.
- 3.9 Based on the information available to the SC, it is noted that a majority of the existing REITs have fully or partially complied with the audit committee requirement. In view of this, the SC proposes that REIT managers be required to fully comply with the proposed requirements by the next financial year end of the REITs.

#### **Issue for Consultation (Proposal 8)**

- Question 19: Do you agree with the SC's proposal to make it mandatory for REIT managers to establish an audit committee? Please provide specific reasons for your views.
- Question 20: Do you agree that the requirements in the Bursa Listing Requirements in relation to audit committee be made applicable to REITs? Please provide specific reasons for your views.

#### **PROPOSAL 9 – CHANGE OF REIT MANAGER**

- 3.10 Currently, the REITs Guidelines require the trust deed of a REIT to contain provisions relating to the removal of the REIT manager by unit holders<sup>12</sup>. However, the manner in which the REIT manager can be removed is not specified in the REITs Guidelines.
- 3.11 The SC notes that REITs in other jurisdictions benchmarked accord the right to their unit holders to remove the REIT manager by way of a simple majority vote passed at a general meeting.
- 3.12 To enable unit holders of Malaysia REITs to enjoy similar rights accorded to unit holders of REITs in benchmarked jurisdictions, the SC proposes to introduce a provision to allow the removal of the REIT manager by way of a resolution passed by a simple majority of unit holders voting at a general meeting.

<sup>12</sup> Paragraph 8(p), Schedule A of the REITs Guidelines.

- 3.13 Under the current requirements of the REITs Guidelines, a REIT manager must not exercise the voting rights for the units it or its nominees hold in any unit holders' meeting<sup>13</sup>, and related parties of the REIT manager can neither vote nor be counted in the quorum at such general meeting since they have interest in the outcome of the transaction tabled for approval which is different from the interests of other unit holders<sup>14</sup>.
- 3.14 Notwithstanding the current requirements, with the proposal to introduce the provision to allow the removal of the REIT manager by way of a resolution passed by a simple majority of unit holders voting at a general meeting, the SC further proposes that in such circumstance, the REIT manager, its nominees and its related parties be allowed to vote and be counted in the quorum at the meeting.

#### **Issue for Consultation (Proposal 9)**

- Question 21: Do you agree with the SC's proposal to introduce a requirement to allow the removal of the REIT manager by way of a resolution passed by a simple majority of unit holders voting at a general meeting? Please provide specific reasons for your views.
- Question 22: Do you agree with the SC's proposal to allow a REIT manager and related parties of the REIT manager to vote and be counted in the quorum at the meeting to remove the REIT manager? Please provide specific reasons for your views.

#### **PROPOSAL 10 – TERMINATION OF A REIT**

- 3.15 While a REIT is being terminated, the REITs Guidelines require the REIT's accounting period to continue to run and its annual and interim reports will also continue to be required, where applicable<sup>15</sup>.
- 3.16 In addition, the REITs Guidelines further require the trustee to arrange for the auditor of the REIT to conduct a final review and audit of the REIT's accounts<sup>16</sup>. For transparency purposes, the SC proposes that on completion of the termination of the REIT, the following must also be made available to unit holders:
- (i) A REIT manager's report, explaining how the real estate has been disposed of, the transaction price and salient terms of disposal; and
  - (ii) A trustee's report, stating that the REIT manager has managed and terminated the REIT in accordance with the provisions of the REIT's deed.

<sup>13</sup> Paragraph 15.48 of the REITs Guidelines.

<sup>14</sup> Paragraph 15.49 of the REITs Guidelines.

<sup>15</sup> Paragraph 15.28 of the REITs Guidelines.

<sup>16</sup> Paragraph 15.27 of the REITs Guidelines.

3.17 Further, the SC proposes that within two months of the completion of termination, copies of the financial statements be distributed to unit holders and filed with the SC.

#### **Issue for Consultation (Proposal 10)**

Question 23: Do you agree with the SC's proposal to require that on completion of the termination of a REIT, unit holders be provided with a REIT manager's report explaining how the real estate has been disposed of, the transaction price and salient terms of disposal? Please provide specific reasons for your views.

Question 24: Do you agree with the SC's proposal to require that on completion of the termination of the REIT, unit holders be provided with a trustee's report stating that the REIT manager has managed and terminated the REIT in accordance with the provisions of the REIT's deed? Please provide specific reasons for your views.

Question 25: Do you agree with the SC's proposal to require copies of the REITs financial statements to be distributed to unit holders and filed with the SC within two months of the completion of the termination of the REIT? Please provide specific reasons for your views.

#### **PROPOSAL 11 – REVALUATION OF REAL ESTATE**

3.18 The REITs Guidelines currently require a revaluation to be carried out at least once every three years by an independent valuer duly appointed by the trustee<sup>17</sup> and only allow a valuer to conduct up to two consecutive valuations of any particular real estate of a REIT<sup>18</sup>. Notwithstanding the requirement to carry out revaluation at least once every three years, the SC notes that most of Malaysia REITs have been revaluing their real estate annually.

3.19 The SC is of the view that an annual revaluation is beneficial as it ensures that the latest market value of the REIT's real estate is reflected in the REIT's balance sheet.

3.20 In view of the above, the SC proposes that–

- (i) each of the real estate of a REIT be revalued by an independent valuer at least once in each financial year; and
- (ii) a valuer be allowed to conduct valuations of any particular real estate of a REIT for up to three consecutive years only.

<sup>17</sup> Paragraph 10.03 of the REITs Guidelines.

<sup>18</sup> Paragraph 10.07 of the REITs Guidelines.

3.21 The purpose of the limitation on the number of consecutive years of valuations of a particular real estate by an independent valuer is to mitigate the risk of impairment of independence of the valuer arising from an extended engagement.

**Issue for Consultation (Proposal 11)**

Question 26: Do you agree with the SC's proposal to require a revaluation of each of a REIT's real estate to be conducted at least once in each financial year? Please provide specific reasons for your views.

Question 27: Do you agree with the SC's proposal to allow a valuer to conduct valuations of any particular real estate of a REIT for up to three consecutive years only? Please provide specific reasons for your views.

#### 4 STREAMLINING OF POST-LISTING REQUIREMENTS

4.1 Under the current regulatory framework for REITs, the SC's approval is required under section 212 of the *Capital Markets and Services Act 2007* (CMSA) for the following:

- (i) The establishment of a REIT;
- (ii) Proposals for the listing and quotation of units of a REIT on the Main Market of Bursa; and
- (iii) New issuances of units by listed REITs (except for rights issues and bonus issues).

4.2 Moving forward, the SC proposes to adopt the following approach for listed REITs:

- (i) The SC's approval would continue to be required for the listings of a REIT. This approach permits the SC to continue with its gatekeeping function at entry point to safeguard market interests; and
- (ii) Once listed, subsequent issuances of units by the REIT, including through placement exercises and issues to finance the acquisition of assets, would no longer require the approval of the SC under section 212 of the CMSA.

To facilitate the above, requirements relating to issuances of securities by listed REITs will be incorporated in the Bursa Listing Requirements.

4.3 Other provisions presently in the REITs Guidelines relating to post-listing transactions will also be incorporated in the Bursa Listing Requirements.

4.4 The SC and Bursa have also mapped the requirements for listed REITs against those for listed corporations to consider where it may be appropriate to streamline the requirements.

4.5 The streamlining review will also include other listed unit trust schemes, i.e. Business Trusts and Exchange Traded Funds, and a separate consultation will be undertaken by Bursa in relation to the above proposal.

4.6 The following paragraphs discuss some of the areas where differences are noted between requirements for listed REITs and listed corporations, and the SC's proposals thereon.

## PROPOSAL 12– ISSUANCE OF SECURITIES

### General Mandate for Issuance of Securities

- 4.7 Currently, under the Bursa Listing Requirements, listed corporations may issue new shares or convertible securities under a general mandate from shareholders, provided such issuance does not exceed 10 per cent of the nominal value of their issued and paid-up capital (excluding treasury shares)<sup>19</sup>. There are also various other provisions relating to share issuances under general mandate as outlined in paragraphs 6.03 and 6.04 of the Bursa Listing Requirements.
- 4.8 For listed REITs, the SC proposes to adopt requirements similar to those for listed corporations, save for the threshold. The 20 per cent threshold<sup>20</sup> for units issued under general mandate currently provided in the REITs Guidelines will continue to apply. As REITs' principal activity is limited to ownership and rental of properties, the higher threshold for issuance of units under general mandate will allow the REITs greater flexibility to raise funds for their operations and expansion such as for acquisition of additional properties. Additionally, unlike listed corporations, REITs have low levels of cash reserve.

### Issuance of Bonus Units

- 4.9 Currently, where a listed corporation intends to make a bonus issue of securities by way of the capitalisation of reserves arising from (real estate) revaluation surplus, only up to 80 per cent of the revaluation surplus may be capitalised for this purpose<sup>21</sup>. REITs are allowed to capitalise up to 90 per cent<sup>22</sup>.
- 4.10 The SC proposes to streamline the requirements for REITs and listed corporations and in this respect will adopt the threshold of 80 per cent.

#### Issue for Consultation (Proposal 12)

- Question 28: Do you agree with the SC's proposal to retain the general mandate threshold of 20 per cent that is currently provided for in the REITs Guidelines instead of adopting the 10 per cent threshold in the Bursa Listing Requirements that applies to listed corporations? Please provide specific reasons for your views.
- Question 29: For the provisions relating to issuance of bonus units, do you agree with the SC's proposal to streamline the requirements for REITs and listed corporations and in this respect adopt the threshold of 80 per cent? Please provide specific reasons for your views.

<sup>19</sup> Paragraph 6.03 of the Bursa Listing Requirements.

<sup>20</sup> Paragraph 14.03(a) of the REITs Guidelines.

<sup>21</sup> Paragraph 6.30(2) of the Bursa Listing Requirements.

<sup>22</sup> Paragraph 6.59(3) of the Bursa Listing Requirements and paragraph 14.20 of the REITs Guidelines.

**PROPOSAL 13 – TRANSACTIONS**

4.11 Transactions entered into by REITs are currently governed by provisions in the REITs Guidelines. Chapter 10 of the Bursa Listing Requirements, which deals with transactions by listed issuers, does not apply to REITs<sup>23</sup>.

4.12 Under the REITs Guidelines, unit holders approval is only required for–

- (i) disposals of real estate where the value of the real estate to be disposed of exceeds 50 per cent of the fund's total asset value<sup>24</sup>; and
- (ii) acquisitions of real estate from related parties where the transaction value is equal to or greater than five per cent of the total asset value of the fund (after acquisition)<sup>25</sup>.

4.13 The SC proposes to adopt the following requirements for the acquisition and disposal of real estate by REITs, which will harmonise the requirements for transactions entered into by REITs with the requirements for transactions entered into by listed corporations as provided for in the Bursa Listing Requirements:

(i) Requirement for an announcement to be made

A listed REIT must make an announcement to Bursa where the transaction value is–

- (a) five per cent or more of the fund's total asset value; or
- (b) in the case of a related-party transaction, 0.25 per cent or more of the fund's total asset value.

This requirement will not apply in the event the transaction value is less than RM500,000.

(ii) Requirement to obtain unit holder's approval

A listed REIT must obtain unit holders' approval by way of an ordinary resolution where the transaction value is–

- (a) 25 per cent or more of the fund's total asset value. This requirement will not apply in the event the transaction value is less than RM500,000; or
- (b) in the case of a related-party transaction, five per cent or more of the fund's total asset value. The REIT must also appoint an independent adviser for the transaction, similar to the requirements for listed issuers under paragraph 10.08 of the Bursa Listing Requirements.

<sup>23</sup> Save for paragraphs 10.04(3) to 10.04(9) of the Bursa Listing Requirements.

<sup>24</sup> Paragraph 8.17 of the REITs Guidelines.

<sup>25</sup> Paragraph 9.05(a) of the REITs Guidelines.

4.14 Under the REITs Guidelines, the SC specifies the following requirements in relation to the price for any acquisition and disposal of real estate:

- (i) A fund should not acquire real estate at a price more than 110 per cent of the value assessed in a valuation report<sup>26</sup>.
- (ii) A fund should not dispose of real estate at a price lower than 90 per cent of the value assessed in a valuation report<sup>27</sup>.

In view of the proposals outlined in paragraph 4.13 above, the SC is considering to remove the limitations to the acquisition and disposal pricing. Unit holders would instead be empowered to decide on the transaction, and be given the relevant information to do so. This would include independent valuation reports and where it is a related party transaction, independent advice.

#### **Issue for Consultation (Proposal 13)**

Question 30: Do you agree with the thresholds proposed for when REITs must make an announcement in relation to acquisition and disposal of real estate? Please provide specific reasons for your views.

Question 31: Do you agree with the thresholds proposed for when unit holders' approval would be required for acquisition and disposal of real estate by REITs? Please provide specific reasons for your views.

Question 32: Do you agree with the SC's proposal that a REIT must appoint an independent adviser where it undertakes a related party acquisition or disposal where the value is five per cent or more of the fund's total asset value? Please provide specific reasons for your views.

Question 33: Do you think the requirements in relation to the price for any acquisition and disposal of real estate by REITs should be removed? Please provide specific reasons for your views.

<sup>26</sup> Paragraph 8.18 of the REITs Guidelines.

<sup>27</sup> Paragraph 8.19 of the REITs Guidelines.

## 5 OTHER AMENDMENTS PROPOSED

### PROPOSAL 14 – PROPERTY MANAGEMENT

- 5.1 REIT managers are currently required to appoint a property manager approved by the trustee to manage the real estates of the REIT<sup>28</sup>. This requirement in the REITs Guidelines is read in conjunction with the provisions in the *Valuers, Appraisers and Estate Agents Act 1981* (VAEA Act 1981) which state that the property manager must be a registered valuer with the Board of Valuers, Appraisers and Estate Agents unless the property is managed by the owner.
- 5.2 Following the amendment to the VAEA Act 1981, parties who are not registered valuers are allowed to own up to 49 per cent of the equity interest of a property management company, while the remaining 51 per cent will continue to be owned by a registered valuer. This amendment provides an opportunity for a REIT manager to participate in the equity of a property management company that manages the real estates of the REIT.
- 5.3 In view of the above, the SC proposes to allow REIT managers to take up equity interest in a property management company. This would enable the REIT managers to advise and participate in the management of the real estates of the REIT. However, to address any potential conflict of interest, the SC proposes that a requirement that the property management company can only manage the real estates owned by the REITs that are managed by the same REIT manager be imposed.

#### Issue for Consultation (Proposal 14)

- Question 34: Do you agree with the SC's proposal to allow a REIT manager to take up equity interest in a property management company? Please provide specific reasons for your views.
- Question 35: Do you agree with the SC's proposal to allow the property management company referred to in paragraph 5.3 above to only manage real estates owned by REITs that are managed by the same REIT manager? Please provide specific reasons for your views.
- Question 36: In your opinion, is the proposed requirement set out in paragraph 5.3 above adequate to manage any potential conflict of interest? Please provide specific reasons for your views.

<sup>28</sup> Paragraph 3.21 of the REITs Guidelines.

**PROPOSAL 15 – INTERNAL MANAGEMENT**

- 5.4 The SC has received inquiries whether REITs are allowed to be internally managed. Internally managed REITs may be in the form of a REIT owning the shares of the REIT manager or where the units of a REIT are stapled to shares of the REIT manager.
- 5.5 The SC will amend the REITs Guidelines to add further clarity that an internally managed REIT structure is allowed.

**Issue for Consultation (Proposal 15)**

Question 37: What are your views on internally managed REITs?

**PROPOSAL 16 – UNLISTED REITs**

- 5.6 The REITs Guidelines currently allow for the establishments of unlisted REITs, where the units may be offered to both retail investors and Sophisticated Investors.
- 5.7 However, unlisted REITs are often viewed as illiquid and offering limited transparency compared to their publicly listed counterparts. This can be an issue with retail investors who usually lack holding power and ability to demand information.
- 5.8 Illiquidity in unlisted REITs stems from the fact that they may be unable to meet redemption requests as their assets comprise real estates which are not easily disposed of. Their unlisted nature also means that information on the REITs would not be publicly available and investors will have limited information, including financial information to make an informed decision about their investment in the unlisted REITs.
- 5.9 Nevertheless, the SC acknowledges that unlisted REITs can serve a purpose, providing REIT managers with an avenue to scale up their portfolio of income-generating assets before going for a listing, particularly where the assets are being acquired from multiple vendors who are not sponsors of the REIT.
- 5.10 In view of the above, the SC is considering limiting the offer of unlisted REITs to Sophisticated Investors.

**Issue for Consultation (Proposal 16)**

Question 38: What are your views on SC's proposal to limit the offer of unlisted REITs only to Sophisticated Investors?

**GLOSSARY OF TERMS**

Bursa	Bursa Malaysia Securities Berhad
Bursa Listing Requirements	Main Market Listing Requirements of Bursa
CMSA	<i>Capital Markets and Services Act 2007</i>
Islamic REITs Guidelines	<i>Guidelines for Islamic Real Estate Investment Trusts</i>
Less-than-five per cent threshold	Threshold of Shariah Non-Compliant Rental as a percentage of total turnover
Listed corporations	Corporations whose shares are listed on the Main Market of Bursa
Listed REITs	REITs whose units are listed on the Main Market of Bursa
MCCG 2012	<i>Malaysian Code on Corporate Governance 2012</i>
Shariah Non-Compliant Rental	Rental received from Shariah non-compliant activities
Private lease	A long-term lease agreement with a lessor where the lessor is not the government or a government agency
REITs	Real estate investment trusts
REITs Guidelines	<i>Guidelines on Real Estate Investment Trusts</i>
SC	Securities Commission Malaysia
Shariah adviser	Must either be– (a) a person or a corporation, registered with the SC; (b) a licensed Islamic bank; or (c) a licensed bank or licensed investment bank approved to carry on Islamic banking business.
Single purpose companies	Unlisted companies whose principal assets comprise of real estate
Sophisticated Investor	Any person who falls within any of the categories of investors set out in Part 1, Schedule 6 and 7 of the CMSA
VAEA Act 1981	<i>Valuers, Appraisers and Estate Agents Act 1981</i>