

Relevance and Issues of REITs to Islamic Finance

- An Investors View -

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Key benefits of a REIT for Islamic Investors

- *Muslim investors strongly prefer real estate as asset class*
- *The portfolios are dominated therefore with illiquid assets rather than tradeable fixed income products*
- *Listed REITs could offer the same return profile with better exit opportunity*
- *REITs could be possibly considered in a growing number of jurisdictions to choose as an investment vehicle, either existing ones or those to be set up as alternative to a new fund*

Key Issue: Excluded Tenants

The recent Malaysian standard on Islamic REITs excludes the following tenants as non-permissible:

- *Financial Services based on Riba*
- *Gambling/Gaming*
- *Manufacture or sale of non-halal products or related products*
- *Conventional Insurance*
- *Entertainment activities that are non-permissible according to the Shariah*
- *Manufacture or sale of tobacco-based products or related products*
- *Stockbroking or share trading in Shariah non compliant securities, and hotels and resorts*

Key Issue: Debt Screen

The debt screen filters like for equities do apply; the maximum debt would be 33 % from the market value (not NAV):

- *Knock-out for conventional REITs – not enough remaining REITs to create a sub-index of Dow Jones Indexes; a few only eligible for investors but no substantial choice*
- *Trading of Islamic REITs (there is no existing REIT yet):*
 - *„GCC Shariah Standards“ – the same applies*
 - *Malaysia – if debt Islamically asset backed originated – possibly tradeable*

Conclusion: Debt restricts the secondary market! The key benefit is gone...

A Possible Solution?

Why not doing the leverage at the clients stage?

- *Pro: Optimal risk/return profile adjustment according to personal risk appetite, structured e.g. with Murabaha margin facility*
- *Pro: REIT remains tradeable without debt – pure equity*
- *Contra: Individual leverage possibly more expensive*
- *Contra: Fundraising may take longer*
- *Pro/Contra: If profits are transferred tax free, then individual leverage could be efficient*

The T A X question could be different from any given two jurisdictions involved.

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