THE NEW REAL ESTATE INVESTMENT TRUSTS IN MALAYSIA: LESSONS FROM LISTED PROPERTY TRUSTS

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ABSTRACT

Institutional investors hold significant equity levels in overseas Real Estate Investment Trusts (REITs) and evidence reveals that their active participation brings tremendous benefits to the REIT markets. In Malaysia however, the level of institutional investment have historically been rather poor since the establishment of the first Listed Property Trust (LPTs) in 1989. Nowadays, interests in REITs are renewed in Malaysia due to encouraging government incentives and the revised regulations in Securities Commission Guidelines 2005. Axis REIT is listed and a number of REITs are planned for listing by corporations with large property portfolios in the near future. As the investment market welcomes exciting new opportunities, it is timely to consider the needs of institutional investors in Malaysia on the new REITs. This paper examines the reasons of lukewarm response from institutional investors in LPTs and their desirable investment conditions for participating in the new REITs. Finally, the intended actions from corporations planning to list REITs are obtained in response to the institutional investors' needs. The findings from the paper depicts that the thin trading volume of LPTs, small market size of LPT market and slow capital appreciation are the main reasons deterring institutional involvement in LPTs market.

Keywords: Real Estate Investment Trusts, Institutional Investors, Malaysia

1.0 INTRODUCTION

Real Estate Investment Trusts (REITs) are investment vehicles to enable flow of funds from investors to the real estate sector of the economy. REITs investors aim to enjoy *"…real estate return and portfolio objectives while retaining the investment liquidity provided by the secondary market for REIT shares"* (Corgel, et al. 1995).

The importance of realizing an active REITs market in Malaysia is evidenced in the 2004 Budget announcement that the government will set up property unit trusts so that small investors can invest in the local property sector. This is echoed in the following 2005 Budget when efforts were called to enhance liquidity in the real estate sector to increase its contribution to economic development. Favourable tax treatment for REITs were proposed alongside and with the revised Securities Commission Guidelines on REITs in January 2005, Malaysia has since witnessed the launch of Axis REIT in August 2005 together with a slew of REIT listings in the pipeline by corporations with substantial real estate holdings.

Prior to 2005, Malaysia has in existence 3 Listed Property Trusts (LPTs)[1], which are Amanah Harta Tanah PNB (AHT), Amanah Harta Tanah PNB2 (AHT2) and Arab Malaysian First Property Trust (AMFPT). Even though Malaysia is the first Asian country to develop Listed Property Trusts, the sector development has been slow (see Ting, 2002 and Newell, et al 2002).

Ting (1999)[2] and Shun (2003) found amongst the factors that constrained the development of LPTs in Malaysia include (a) poor perception and lack of demand for product amongst investors including institutional investors, (b) properties available for acquisition are providing low yield, (c) too few institutional investors in Malaysia (d) strong performance by competing investment options (e) local investment psyche favours speculative investment.

It is interesting to note that the level of institutional investment is very low in the Malaysian LPTs market. Newell, et al (2002) reported that the overall response of institutional investors in Malaysia towards LPTs is lukewarm and institutional investment only held 4% on average in Malaysian LPTs (Ting, 1999)[3] compared with 29% in American REITs (Chan, et al. 2003) from 1990-1999.

The importance of institutional investment in REITs market is highlighted in much academic literature. Chan, et al (2003) stressed that markets such as REITs with thin stock

[1] LPTs are securitized real estate vehicles similar to REITs. What it is called depends on the country of listing. In Malaysia, such vehicles are called LPTs until the implementation of Securities Commission 2005 Guidelines when they are renamed as REITs. Here, LPTs is used to differentiate the era before 2005 while REITs are used for 2005 onwards.

[2] Taken from Newell, et al (2002)

[3] Taken from Newell, et al. (2002)

trading and less available information particularly benefit from high institutional investor participation, to the extent that "…*increasing involvement of institutional investors is probably the most positive development for REIT stock market*".

Wang, et al. (1995) found that REITs with higher level of institutional ownership outperform those with lower level of institutional investors. The rationale is that institutional investors have the expertise and are more willing to spend resources to monitor their investments. Due to the closer monitoring, it becomes an incentive for the REITs to perform better. Chan, et al (1998) also argued that institutional investors have better control and monitoring ability on the REITs, subsequently increasing the value of the REIT.

A study from 1979-1989 indicated that REITs performance is positively affected by the flow of information in the market. The demand for such information is largely attributable to institutional investors monitoring their investments (Chan, et al, 2003).

Overall, institutional investor involvement in REITs market is essential and the lukewarm response from institutional investors may have contributed to the slow development of the Malaysian LPT market. Why are institutional investors not interested in investing in Malaysian LPT market? What then are the desirable investment conditions for them to be actively involved in the market?

There are two purposes of this study: 1) Analyze the causes of institutional investors' disinterest in LPTs and determine institutional investors' requirements for REITs. 2) Outline the measures proposed by corporations intending to list REITs in Malaysia in response to institutional investors' requirements.

The rest of the paper is structured as follows. Section 2 discusses the data and methodology that are used in the study. In Section 3, the results from the analysis are discussed. Section 4 concludes and provides the future research direction.

2.0 DATA AND METHODOLOGY

Data is collected through two sets of structured questionnaires consisting of open-ended and Likert summated scale questions for:

(1) Institutional Investors and

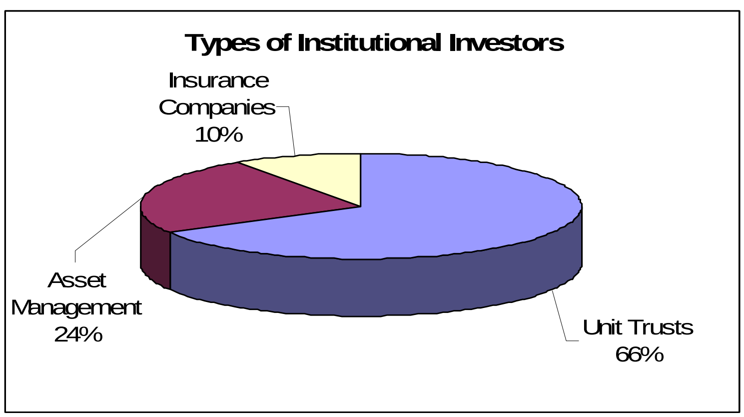
(2) Corporations intending to list REITs

Sample

<u>a) Institutional Investors</u>

The population under study is the pool of publicly listed institutional investor corporations in Malaysia (i.e. *investors).* There are 57 *investors* in total and all were contacted to request for a personal interview with senior fund managers whom were able to represent the overall view of the *investors*. Out of 57 potential respondents, only 21 agreed to be interviewed for this study. The types of participating *investors* are as shown in Figure 1 below. The overall feedback from the remaining 36 *investors* that declined to be interviewed is that they do not invest nor monitor LPTs in their investment portfolios, hence could not contribute very much to this study.

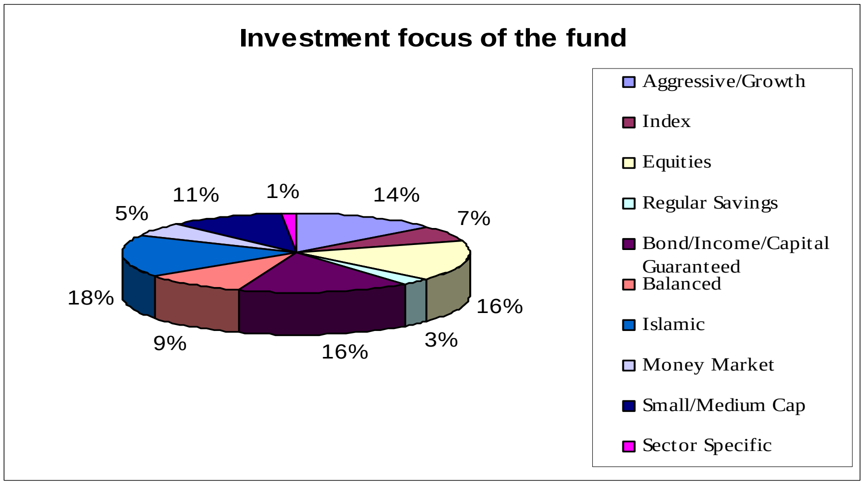
Figure 1



Source: Questionnaire results

Approximately two-thirds of *investors* are from unit trusts, while the remaining are from asset management and insurance companies. Figure 2 below shows the investment focuses within the *investors'* corporations.

Figure 2: Fund Focus



Source: Questionnaire Results

The *investors* issue various types of funds and more than 60% of investment focuses are in Islamic, Bond/ Income, Equities and Aggressive/ Growth. The *investors*' overall perception towards LPTs and investment strategies on LPTs are shown in Table 1 below. 85% of *investors* (18 respondents) have neutral perception of LPTs, out of which 52% may consider but 33% of *investors* will not invest in LPTs in future. Only 5% of *investors* have previously invested in LPT but is not seeking for further investment. In summary, the study tends to agree with Shun (2004) that institutional investors have poor perception of LPTs in Malaysia.

Table 1: Overall *Investors'* Perception and Investment Strategy

LPTs Investment Strategy	Overall perception towards LPTs (% *investors)*					Total
	Very poor	Poor	Neutral	Good	Very Good	
Active LPT investment strategy						0
Previously invested in LPT and not seeking for new LPT investment		5%				5%
Never invested in LPT but may consider			52%	5%		57%
Would not invest in LPT in future	5%		33%			38%
Total	5%	5%	85%	5%	0	100%

Source: Questionnaire Results

<u>b) Corporations intending to list REITs in Malaysia</u>

Questionnaires were sent to 7 public listed corporations which have announced[4] interest to list REITs in Malaysia (i.e. *REIT Corporations).* Citing information confidentiality, only 3 REIT-listers have agreed to participate[5] in this early survey.

3.0 RESULTS FROM ANALYSIS

Table 2 below summarizes the main reasons (most important to moderately important) for disinterest in LPTs amongst *investors*.

This study will analyse each of the reasons and reveal *REIT corporations'* intended actions to attract *investors'* participation in their REITs.

Table 2: Main Reasons for Disinterest in LPTs

Reasons	Mean Score	Level of Important
Thin trading volume of LPTs	4.25	Most important
Market size of LPTs is too small in Malaysia	4.05	Most important
Slow capital appreciation	3.90	Most important
Poor historical returns of LPTs	3.80	Important
Low dividend yield compared to other investment types	3.55	Important
Low fluctuation in returns	3.35	Moderately important
Lack of management expertise in LPTs	3.05	Moderately important
The property sector is not performing well	3.00	Moderately important

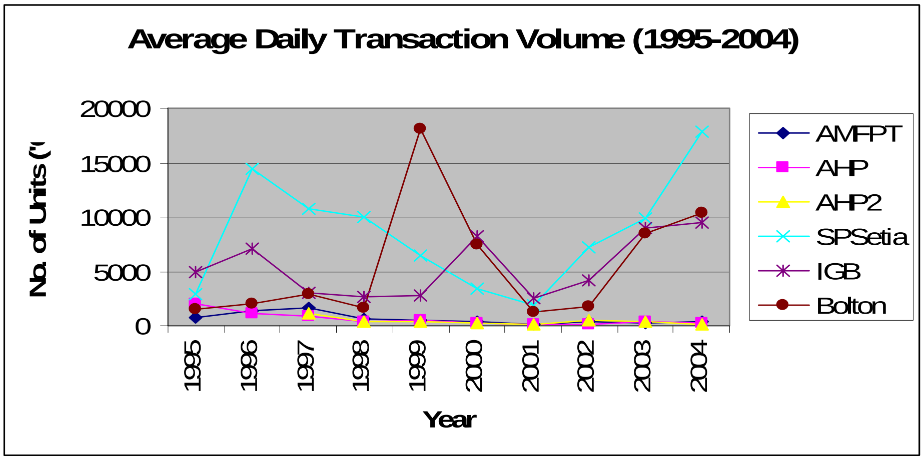
Source: Questionnaire Analysis

<u>Thin Trading Volume of LPTs</u>

Investors strongly agreed that thin trading volume is the main cause of their disinterest in the Malaysian LPTs market. Figure 3 illustrates the average traded daily volume of the 3 LPTs and 3 property company shares (examples used for illustration here are SP Setia, Bolton and IGB) within the period of 1995-2004.

[4] For examples see New Straits Times 2005a, 2005b; The Edge, 2004; Business Times, 2005; Malaysian Business, 2005.
[5] For the same reason, respondents have requested their personal and corporation's identities to remain confidential.

Figure 3



Source: Bursa Malaysia

Before the implementation of 2005 REITs guidelines, LPTs are required to be subsidiaries of financial institutions and the *investors* think this hinders LPTs from acquiring prime, high-yielding properties. *Investors* feel the existing real estate assets of LPTs are not attractive, causing low transaction volume and resulted in the lowered liquidity level of LPTs market.

Overall, most *investors* want an average daily transaction volume of at least 250,000 units as evidence of liquidity in the REITs market.

In response, *REIT corporations* intend to inject their prime and more renowned properties into the initial REITs launches. They feel that good assets selection is important where different asset profiles, notably those with more mass appeal, targeted at middle-income market will be better received. All 3 *REIT corporations* plan to conduct education and awareness campaigns for the investment public through general media before launching their REITs to ensure maximum exposure for strong investor interest.

<u>Small Market Size of LPTs in Malaysia</u>

Investors feel the small market capitalization of approximately RM239.5million (in 2004) prevent effective development of LPTs market (see Table 2). Newell et. al. (2002) found that LPTs account for less than 1% of companies listed on the Kuala Lumpur Stock Exchange.

Table 2: Total Assets & Market Capitalization of LPTs (as at 31 Dec 2004)

Listed Property Trusts in Malaysia	Total Assets (RM million)	Market Capitalization (RM million)
AM First Property Trust	**189.0**	**125.900**
Amanah Harta Tanah PNB	**126.517**	**68.000**
Amanah Harta Tanah PNB2	**65.400**	**45.596**
Total	**380.917**	**239.496**

Source: Annual Reports (2004) AMFPT, AHT and AHT2

The development of the LPT market is slower compared to overseas REITs. For example, while Malaysia launched its first LPT in 1989, REITs in Japan (introduced in 2000) now amount to 12 listed JREITs with approximately US$11 billion market capitalization (European Public Real Estate Association, 2004).

Investors rationalize that small market capitalization, coupled with stringent gearing limit prevent LPTs from acquiring more lucrative prime properties and most *investors* feel that market capitalization of at least RM500 million per fund is more suitable in the Malaysian context.

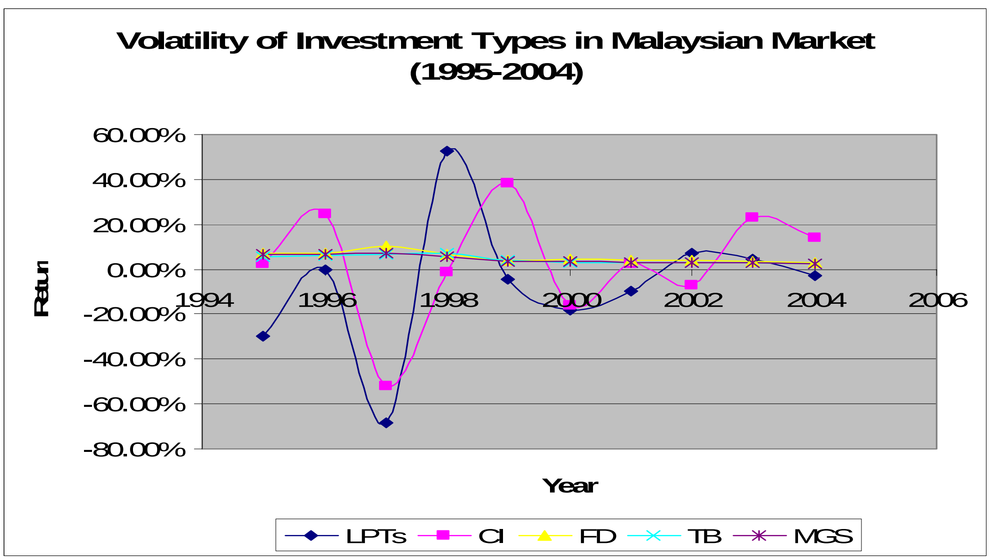
Some empirical evidence shows that besides having larger buying ability, larger REITs have better economies of scale and higher profit margins (Ambrose & Linneman, 2001). Bers and Springer (1998) found economies of scale for cost expenses in larger REITs. However, the evidence is inconclusive e.g. Ambrose, et. al (2000) found no scale economies from size of REITs while Mueller (1998) determined that rate of operational and debt cost efficiency diminishes as REITs increase beyond certain size limits.

Nonetheless, according to *REIT corporations*, the initial launch of their REITs will be much 'larger' than LPTs i.e. around RM500 million – RM800 million. To counter the 'stagnant' market capitalization problem, *REIT corporations* are planning more properties and acquisitions in the pipeline to assure that their REITs grow over time.

<u>Low capital appreciation, historical returns, dividend yield and returns fluctuation</u>

Investors find LPTs returns unattractive and lower than other investment options. Using price fluctuations, this study[6] found that LPTs recorded lower average annual returns than Bursa Malaysia Composite Index (CI), as well as when compared against Fixed Deposit (FD), Treasury Bills (TB) and Malaysian Government Securities (MGS) within 1995 – 2004, with the exception of 1998 and 2002 (see Figure 4 below). This study tends to agree with previous research findings of Newell, et. al. (2002) where all LPTs except Amanah Harta Tanah PNB underperformed the CI and the then Kuala Lumpur Stock Exchange Property Index within March 1991 - March 2000.

Figure 4



Sources: Bursa Malaysia & Bank Negara Malaysia

[6] Using annualized average LPTs prices compared to year-on-year Composite Index movement.

Investors perceive LPTs to offer low, stable returns but historical price returns from 1995 – 2004 (as illustrated in Figure 4) reveal LPTs as highly volatile investment. In fact, over 1995-2004, the average risk of LPTs is higher compared to the CI (see Table 3 below).

Table 3: Risk-Return of Investments (1995-2004)

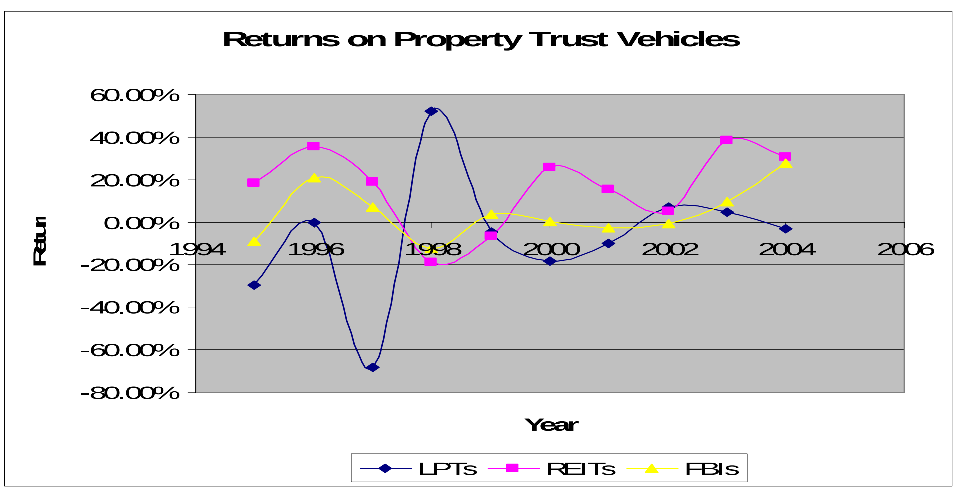
Instrument	LPT	CI	FD	TB	MGS
Average Return	-6.96%	2.81%	5.43%	4.34%	4.40%
Std Dev	28.83%	24.01%	2.16%	1.75%	1.81%

Source: Bursa Malaysia, Bank Negara Malaysia

This study concurs with Newell, et. al. (2002) where LPT risks were found to be high, i.e. AMFPT (36.6%), AHT (85.8%) compared to CI (39.12%) within March 1991-March 2000.

This study also found that (see Figure 5 below), compared to similar instruments overseas such as REITs in the United States and FBIs in Netherlands, Malaysian LPTs have higher volatility and lower average annual returns.

Figure 5

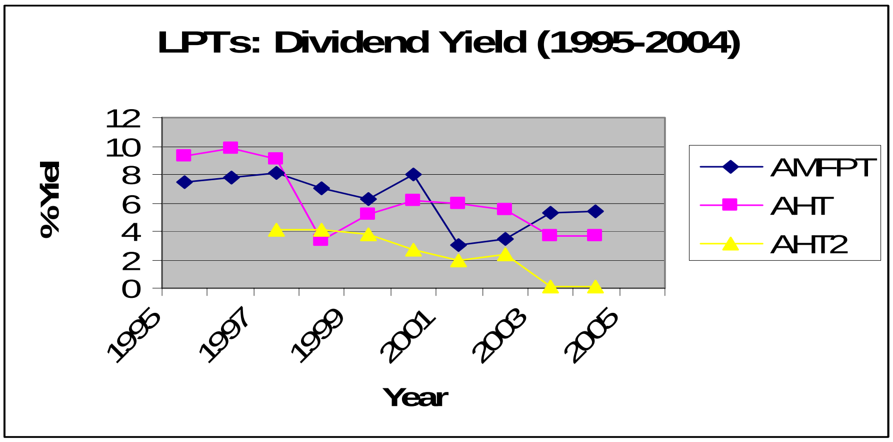


Sources: Bursa Malaysia, NAREIT, EPRA

The *investors*, notably from unit trusts, expect average annual capital gains of 10% - 20% in order to attract their participation in REITs.

Besides capital gains, it is found that *investors* want LPTs dividend yield which are higher than bonds and fixed deposit and most quote at least 7% annual dividend yield as desirable for REITs. A compilation of LPTs dividend yield from 1995-2004 (shown in Figure 6 below) reveals that only pre-1998 dividends of all LPTs meet *investors'* requirements (with exception of AMFPT in 2001).

Figure 6



Sources: Annual Reports of AMFPT, AHT, AHT2[7]

Investors mentioned that better tax treatment for REITs in Malaysia (tax exemption at both fund and investor levels) will enhance overall return, although the new tax-exemption at fund level is found to be encouraging.

REIT corporations advised that their properties injected into REITs are carefully selected, high yielding properties in prime location. This study found that as all *REIT corporations* intend to hold 20 – 30% equity in their REITs, it is in their primary interest that their REITs continue to grow and provide attractive returns. In fact, one *REIT corporation* intends to wait until their property yields stabilise at an optimal rate before including them in their REIT. This opposes the perception that REITs companies want to realize quick gains by 'dumping off' their assets into REITs or artificially drive up the yields to obtain higher capital value for their assets.

[7] All dividends are based on percentage of issue price (i.e. distribution yield)

Although the involvement of *REIT corporations* signify its continued commitment to their properties under the REIT, empirical evidence shows the effect of such 'insider ownership' of REITs where lower levels of such ownership are associated with increased market-to-book ratios (Friday, et. al, 1999). This means that a high level of ownership of the *REIT corporations* may decrease the market value of the REIT.

<u>Lack of Portfolio Management Expertise and Poor Performance of Domestic Property Market</u>

The *investors* cite a lack of portfolio management expertise in LPTs as one of the reasons which deterred them from investing. Although it is difficult to pinpoint lack of expertise as the sole cause of poor LPTs performance, a rule-of-thumb measure is used in this study to calculated the supposed investment yields of properties within the LPTs portfolio (in Table 4 below).

Table 4: Calculated Investment Yield from LPTs property assets

Listed Property Trust	Property	Net rent^ (RM /sq.ft/ month)	Net Lettable Area (sq.ft)	Vacancy (%)	Capital value (RM'000)	Investment yield (%)
AHT	**Plaza IBM**	2.33	201,959	0	69,600	8.11
	Bangunan AHP	2.37	95,801	15.47	37,000	6.22*
	Sri Impian	1.89	38,288	0	9,000	9.64
AHT2	**Bangunan Mayban Finance**	1.90	25,584	0	8,800	6.63
	Bangunan TAR	1.99	41,434	0	12,500	7.91
	Plaza Mayban Trust	1.77	32,952	0	9,300	7.52
AMFPT	**Bangunan AmBank Group**	2.88	360,166	1.87	170,000	7.18*
	AmBank Group Leadership Centre	0.94	57,801	16.89	19,000	2.83*

^ *after deducting maintenance costs from average rental*
* *taking into account reported vacancy rate*
Sources: Annual Reports of AHT, AHT2 and AMFPT (2004)

The above table shows that most LPTs' properties experience lower vacancy rate than the sub-sector average in Kuala Lumpur of 18.6% (Table 5 below). Most of the calculated investment yields of LPTs were equivalent or higher than the average yields in the office property sub-sector, except for AMFPT's AmBank Group Leadership Centre. Overall, this study tends to disagree with the perception of investors on the portfolio management of LPTs.

Table 5: Kuala Lumpur Office Property Sub-sector's Performance

Vacancy rate	18.6%
Net rent	RM 310 psm pa
Capital value	RM 4,402 psm
Investment yield	6.0-8.0%

Source: Jones Lang Lasalle's Asia Pacific Property Digest 4Q 2004

On REITs portfolio management, all *REIT corporations* intend to continue managing the properties under their REITs through their subsidiary or associated company to ensure that the asset quality and services offered to existing clients do not deteriorate. This is the most obvious way in which the *REIT corporations* exert control on the quality of property management of their REITs.

Investors feel that the poor performance of the domestic property market affected their interest in LPTs. It is found to the contrary, as shown in Table 6 below, where the office sub-sector in Malaysia (Kuala Lumpur) actually performed better than overseas property markets which possess active REITs. Nonetheless, Malaysian LPTs are still not as successful as REITs in Japan (Tokyo) or Singapore.

Table 6: The performance of Office Sub-Sector in Malaysia and Others Countries in 4th Quarter 2004

Key Indicators	**Hong Kong**	**Tokyo**	**Seoul**	**Singapore**	**Kuala Lumpur**
Vacancy Rate	6.9%	6.2%	2.9%	13.6%	18.6%
Net Rent	HK$4,303 psm pa	JPY65,121 psm pa	KRW474,840 psm pa	S$437 psm pa	RM310 psm pa
Capital Value	HK$79,571 psm	JPY824,244 psm	KRW3,524,551 psm	S$10,333 psm	RM4,402 psm
Investment Yield	2.4-3.6%	4.9-5.8%	8.2%	3.5-4.0%	6.0-8.0%

Source: Jones Lang Lasalle's Asia Pacific Property Digest 2004

In response, all *REIT corporations* do not think that the LPTs performance is caused by the poor underlying property market. Rather, they believe that a diversified portfolio of properties from different sectors will inevitably perform better. All *REIT corporations* intend to list a mixed portfolio of property assets rather than a specialized portfolio, with a large retail element as it is the best performing sub-sector (Table 7 shows sub-sector performance).

Table 7: Performance of Major Sub-Sector of Malaysian Property Market 2004

Key Indicators	Residential	Office	Retail
Vacancy Rate	0.3%	18.6%	16.1%
Net Rent	RM 344 psm pa	RM 310 psm pa	RM 1,567 psm pa
Capital Value	RM 4,058 psm	RM 4,402 psm	RM 4,561 psm
Investment Yield	8.5%	6.0-8.0%	8.5-12.0%

**Residential: refers to high-end condominiums in Kuala Lumpur only.*
Source: Jones Lang LaSalle Asia Pacific Property Digest 4Q 2004

One *REIT corporation* informed of the geographical spread of the portfolio to include urban centres in major towns too rather than only in Kuala Lumpur and Johor Bahru. All *REIT corporations* agreed that a mixed portfolio with geographical diversification will ensure a more balanced return to the investors.

Although a diverse REIT portfolio, both geographically and by property type seems logical in lowering risk and enhancing overall return – there are empirical evidence that proved otherwise, e.g. diversification by property type brings lower returns and at higher risk level (Chen & Peiser 1999). Chan et. al. (2003) explained that diversified REITs were found to have higher expense ratios than focused REITs, hence a diversification strategy cannot be adopted simply for risk-reduction but must prove overall positive effect on the profitability and value of the REIT.

4.0 CONCLUSION AND RECOMMENDATIONS FOR FUTURE RESEARCH

The main reasons for disinterests in LPTs from *investors'* views are thin trading volume, low capital appreciation and dividend yield, poor historical returns, perceived poor portfolio management and poor underlying performance of the property market. This study found that the plans of *REIT corporations* are very positive and meet the overall demand of *investors*.

To-date, the performance of Axis REIT since its initial launch in early August 2005 seems very encouraging, where the price has increased by about 4%. The prices and trading volumes of LPTs have increased during the launch period of Axis REIT, indicating increased investor confidence in property trusts.

As such, it is recommended that further research is carried out on the effects of Axis REIT on the pre-existing LPTs and the strategies of the latter to compete with the newer and seemingly more attractive REITs in the future. Research may be conducted on the diversification benefits of including overseas REITs in a Malaysian REIT portfolio, as there seemed to be correlational benefits indicated in this study.

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