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# GFC IMPACT ON REAL ESTATE INVESTMENT TRUSTS (REITs) IN MALAYSIA

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## ABSTRACT

*Real Estate Investment Trust (REIT) is categorised as income stock rather than growth stock. Growth stock generally provides substantial returns on capital whereas income stock will pay higher dividends. REITs which provide steady dividends income are targeted by long term investors with a moderate risk appetite such as insurance companies, pension funds or unit trusts. The recent Global Financial Crisis (GFC) has impacted the Malaysian stock market as a whole, with the Kuala Lumpur Composite Index (KLCI) recording a 45% drop from January 2008 to Oct 2008. The impact of this financial crisis on the economy provides an opportunity to examine the financial performance of M-REITs throughout this period of market turbulence. The aim of this paper is to characterise the impact of 2008 GFC on the financial performance of Malaysian-REITs (M-REITs), particularly Islamic REIT and conventional REITs. Financial analysis was conducted to M-REITs from year 2007 to 2012. Three financial measures, three financial ratios and two investment measures were examined to characterise the financial performance of M-REITs. In general, the results indicate that Islamic REITs outperforms conventional REITs in term of growth of net assets value, share price and market capitalisation but underperforms in terms of efficiency and distribution yield. Islamic REITs perform more like a growth stock compared to conventional REITs whereas conventional REITs are better income stocks compare to Islamic REITs. These findings have contributed to wider understanding of the performance of M-REITs during a period of market turbulence.*

Keywords: GFC, REITs, Malaysia

## INTRODUCTION

The overvaluation of bundled subprime mortgages and the consequent bursting of the housing bubble in the United States (U.S.) caused the values of securities tied to real estate to plunge in late 2007. A number of large financial institutions suffered major losses which required the intervention of national governments to bail out distressed banks. Many countries were facing large declines in their respective stock markets and the period of recession soon turned out to be known as the 2008 global financial crisis (GFC).

Malaysia, being an export oriented economy, was affected when the economies of its major trading partners fell. Gross domestic product (GDP) growth dropped to 0.1% for the fourth quarter of 2008 compared to an average of 6% in the first 3 quarters. In year 2009, GDP recorded negative growth at 6.3%, 3.9% and 1.2% for the first 3 quarters.

During the GFC, M-REITs were one of the most resilient assets. The Kuala Lumpur Composite Index (KLCI) recorded 1,393.25 on first transaction date of 2008 and the index dropped to 884.45 on 2 Jan 2009, resulting in a 36.52% drop for the year. For the same period, the unweighted share price of M-REITs recorded a decrease of 29.21% and led to the market capital decrease of 22.21%; the impact is less than the share market as a whole.

The Malaysian Securities Commission (SC) defines REIT as "unit trust scheme that invests or proposes to invest primarily in income-generating real estate"

Malaysia started the predecessor of REIT – Property Trust Fund (PTF) in 1986 (Newell e*t al.*, 2002). Malaysia was among the first in Asia to develop listed property trusts. The listed property trust was re-launched in January 2005 as REITs with new guidelines. These new guidelines which include exemption of real property gain tax, stamp duty on properties transferred to REITs and transparent tax structure provide a legal framework for better monitoring of the newly introduced REITs.

After the re-launch, there was a surge in the establishment of REITs, with 3, 6 and 2 REITs listed in years 2005, 2006 and 2007, respectively. In November 2005, the SC introduced the Guidelines for Islamic Real Estate Investment Trust. This is the first jurisdiction in the global Islamic financial sector to issue such guidelines and set a global benchmark for the development of Islamic REITs.

The Islamic REITs differ from the conventional REITs, the Islamic REITs' framework are subject to Islamic law principle. The Guideline for Islamic REIT issued on November 2005 by Syariah Advisory Council (SAC) of the SC stated the guidelines for tenant selection, investment, financing and insurance.

As of year 2013, there were 17 equity REITs listed in Bursa Malaysia, with a total net assets valued at RM23 billion. Four out of 17 REITs complied with the guidelines and qualified as Islamic REITs. Those are Al-Aqar Healthcare REIT, Axis REIT, Al-Hadharah Boustead REIT[1] and KLCC Property Holding Bhd.

These M-REITs were predominantly invested in healthcare, commercial office, retail, industrial, hospitality and plantations.

Kok and Khoo (1995) suggested that the listed property trusts outperformed the market portfolio during bearish market period and underperformed during bullish market period. Hamzah *et al.,* (2010) and Ong *et al.,* (2012) deployed Sharpe and Treynor ratio to identify risk-adjusted measures of return based on systematic risks and unsystematic risks. Their research has shown REITs outperforming general market portfolio during crisis period and not performing as well as Kuala Lumpur Composite Index (KLCI) during pre-GFC and post-GFC period. The results are consistent with Modern Portfolio Theory which recognized REITs in the portfolio investment attributable to diversification and risk profile of REITs.

Graff (2001) described REITs as defensive stocks, which consists of cyclical income producing assets, though having some potential asset appreciation. Basse *et al.* (2009) examined the relationship between REITs and utilities stocks, analysing data from the U.S. from January 1999 to June 2009. The analyses suggest a massive structural break mostly likely occurs in February 2007 and U.S. REITs become more risky relative to investments in utility stocks.

Most researchers evaluate REITs as an industry, there are not many literature comparing financial performance of Islamic REITs with conventional REITs before and after GFC. The aim of this paper is to compare the impact of GFC on the financial performance of Islamic REITs and conventional REITs in Malaysia.

## Financial Analysis of REITs in Malaysia

A number of researchers have assessed performance of PTFs and M-REITs over the last 15 years. For portfolio performance, Ting (1999), Rozali and Hamzah (2006), Hamzah *et al.* (2010), Ong *et al.* (2012) compared the systematic risk and adjusted risk performance of the KLCI or the KL Property Index by evaluating the Sharpe Index, Treynor Index and Jensen Index . Ooi *et al.* (2006) also examined standard deviation and Beta of REITs to review the risk profile of REITs in Asia.

To understand the financial performance, Ooi *et al*. (2006) utilised market capitalization, growth, debt ratio to scan the financial health of M-REITs. Alias *et al.* (2011) compared the financial performance of M-REITs and UK-REITs using the measures including total revenue, net income.

As for the investment performance, a study by Ting (1999) utilised annual return, yield to examine the investment performance of listed property trusts. Ooi *et al*. (2006) checked on dividend yield, REITs annualized gains, equities market annualized return to gain understanding in the investment potential of M-REITs. Alias *et al.* (2011), compare the investment performance of M-REITs and UK-REITs using the following measures and ratio including total return, dividend yield, and price earnings ratio.

A study by Ong *et al.* (2011) deployed net assets value (NAV) approach to assess financial performance of M-REITs.

To investigate the financial performance of M-REITs, this research carried out a details analysis of the following:

1) financial statement analysis, including property income, net assets value and market capitalization
2) ratio analysis, including profitability ratio, efficiency ratio, and leverage ratio
3) investment indicator analysis, including distribution yield and share price

[1] Al-Hadhrah Boustead REIT delisted in February 2014.

## SAMPLING

To study the financial performance of M-REITs during pre- and post-GFC, the selection criteria were

i) Listed on Bursa Malaysia prior to 2008 financial year and remained active till end of 2012 financial year.

ii) No financial restructuring during the study period.

iii) Remain substantially as REIT as define by SC during the study period.

This filter results in 11 REITs that complied with the criteria. The REITs were then divided into Islamic REITs and Conventional REITs. There were 3 Islamic REITs which include Al-Aqar Healthcare REIT, Axis REIT, Al-Hadharah Boustead REIT. There are 9 conventional REITs which are Amanah Harta Tanah PNB, UOA REIT, Quill Capita Trust, Tower REIT, Amfirst REIT, Hektar REIT, Amanahraya REIT, and Atrium REIT.

## METHODOLOGY

The required financial data for analysis was obtained from the financial statements in the companies' annual report filed with Bursa Malaysia (http://www.bursamalaysia.com). In order to determine the financial performance of these REITs before and after the GFC, data were collated from financial year 2007 to 2012.

The impact of GFC on M-REITs was tracked by observing the underlying pattern of financial statement in a trend analysis. Full details of the balance sheet, income statement and cash flow statements of each company were extracted from the Annual Reports. Total property income, total net assets value and total market capitalization were computed. Ratio analysis on profitability, efficiency and leverage provide insight on the financial performance of M-REITs. Investment performance indicators analysis including distribution yield, share price were analyse for the study period.

Given that the largest company in the sample, Axis Real Estate Investment Trust (AXREIT) with an income of RM137 million in 2012 was 10.8 times larger than the income of RM13 million for Amanah Harta Tanah PNB (AHP), a weight was applied to each ratio to ensure that these adequately represented the REITs sector. The use of weights in effect analysed the financial performance of a company that acted as an aggregate of all 11 companies in the sample.

## FINDINGS

Property income is the cyclical income generate from the real estate held by REITs. It is the major contributor to distributable income. Refer to Table 1, property income of overall M-REITs recorded constant growth. The growth rate slowed down from 33% at year 2008 to 9% in year 2009, 7% in year 2010. The compound annual growth rate (CAGR) is 14.1%. Islamic REITs recorded double digit growth from year 2007 to 2011 and 5% in year 2012. The CAGR of Islamic REITs for the study period is 17.7%. Conventional REITs recorded 2% to 35% for growth throughout the study period, with CAGR 12.2%.

Net assets value derived by minus total liabilities from total assets, is a measure in estimating market value of REITs. M-REITs as a whole enjoyed 12.5% CAGR from 2007 to 2012. Islamic REITs outperforms the overall market and recorded CAGR at 20.5%. Conventional REITs recorded below average CAGR at 8.3% for the study period.

Market capitalisation depends on the total number of shares and the share price. Both Islamic REITs and conventional REITs suffered negative growth in 2008 due to the loss of confident in the market. Market capitalisation of M-REITs was RM 4,149 million in 2007 and RM 6,522 million in year 2012. That gave CAGR at 9.5%. Islamic REITs enjoyed 20% to 42% of growth from 2009 to 2012 and ends up with CAGR of 19.3% for the period 2007 to 2012. For the same duration, conventional REITs only recorded CAGR of 2.4% in market capitalisation.

**Table 1: Property Income, Net Assets Value, Market Capitalisation (RM million) from year 2007 to 2012**

| Year | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | CAGR |
|---|---|---|---|---|---|---|---|
| ***Property Income*** | | | | | | | |
| M-REITs | 428 | 572 | 624 | 666 | 785 | 829 | 14.1% |
| Growth (%) | | 33% | 9% | 7% | 18% | 6% | |
| Islamic-REITs | 138 | 179 | 203 | 237 | 297 | 311 | 17.7% |
| Growth (%) | | 30% | 14% | 17% | 25% | 5% | |
| Conventional REITs | 291 | 393 | 421 | 429 | 489 | 518 | 12.2% |
| Growth (%) | | 35% | 7% | 2% | 14% | 6% | |
| ***Net Assets Value*** | | | | | | | |
| M-REITs | 3864 | 4537 | 4832 | 5378 | 6382 | 6963 | 12.5% |
| Growth (%) | | 17% | 7% | 11% | 19% | 9% | |
| Islamic-REITs | 1159 | 1590 | 1823 | 2169 | 2799 | 2939 | 20.5% |
| Growth (%) | | 37% | 15% | 19% | 29% | 5% | |
| Conventional REITs | 2705 | 2947 | 3009 | 3208 | 3584 | 4025 | 8.3% |
| Growth (%) | | 9% | 2% | 7% | 12% | 12% | |
| ***Market Capitalisation*** | | | | | | | |
| M-REITs | 4149 | 3231 | 4292 | 5162 | 5925 | 6522 | 9.5% |
| Growth (%) | | -22% | 33% | 20% | 15% | 10% | |
| Islamic-REITs | 1430 | 1287 | 1827 | 2322 | 2876 | 3457 | 19.3% |
| Growth (%) | | -10% | 42% | 27% | 24% | 20% | |
| Conventional REITs | 2719 | 1944 | 2465 | 2840 | 3050 | 3065 | 2.4% |
| Growth (%) | | -28% | 27% | 15% | 7% | 1% | |

Table 2 illustrates the financial ratios analysis for M-REITs from 2007 to 2012. The profitability ratio - gross profit margin was calculated from the property income. Overall, M-REITs have gross profit margin at 0.81 to 0.83. This is contributed by Islamic REITs at 0.91 to 0.93 and 0.74 to 0.77 from conventional REITs. The figure shows Islamic REITs always more profitable than conventional REITs.

Property income to assets ratio is an efficiency ratio measuring the efficiency of assets generating property income. The ratio varies widely from industry, so comparison only meaningful when they are made in the same sector. M-REITs' efficiency shows 12 % decreasing from 0.092 in 2007 to 0.080 in 2012. Islamic REITs showed greater slump at 19% decrease from 0.094 in year 2007 to 0.076 in year 2012. Conventional REITs recorded 7% drop in efficiency, which is 0.90 in year 2007 to 0.84 in year 2012.

Debt ratio measure how much REITs relay on leverage in the business. In general M-REITs relay on 30% loan in 2007 and around 35 % for the remaining years. Compare to the industry, Islamic REITs always relay lesser on loan, anyway the debt ratio increased from 0.24 in year 2007 to 0.33 for year 2012. The debt ratio for conventional REITs was around 0.34 to 0.38.

**Table 2: Gross Profit Margin, Property Income to Assets Ratio, and Debt Ratio from year 2007 to 2012**

| *Year* | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| ***Gross Profit Margin*** | | | | | | |
| M-REITs | 0.82 | 0.82 | 0.81 | 0.82 | 0.83 | 0.83 |
| Islamic-REITs | 0.92 | 0.93 | 0.92 | 0.92 | 0.92 | 0.91 |
| Conventional REITs | 0.77 | 0.76 | 0.74 | 0.76 | 0.77 | 0.76 |
| ***Property Income to Assets Ratio*** | | | | | | |
| M-REITs | | 0.092 | 0.086 | 0.083 | 0.086 | 0.080 |
| Islamic-REITs | | 0.094 | 0.081 | 0.080 | 0.084 | 0.076 |
| Conventional REITs | | 0.090 | 0.089 | 0.086 | 0.088 | 0.084 |
| ***Debt Ratio*** | | | | | | |
| M-REITs | 0.30 | 0.35 | 0.36 | 0.35 | 0.35 | 0.35 |
| Islamic-REITs | 0.24 | 0.30 | 0.32 | 0.31 | 0.29 | 0.33 |
| Conventional REITs | 0.34 | 0.38 | 0.38 | 0.38 | 0.40 | 0.37 |

Distribution yield is an important investment indicator for REITs, it describe the percentage of return on investment. Overall M-REITs distribution yield increase from 7.87% in year 2007 to 10.4% in 2008, following by a drop to 7.37 in year 2010, 7.49 in year 2011 and further dropped to 6.67 in 2012. In this case, the fluctuation is mainly bought by Islamic REITs which the distribution yield fluctuated between 5.82 and 11.45. The distribution yield for Islamic REITs is always lower than the industry except in year 2008. Conventional REITs in this case is relatively stable and fluctuate around 7.28% to 8.04%.

Share price will affect the market value of REITs. For overall REITs, the weighted share price was RM1.30 in year 2007, recorded a drop to RM0.90 in 2008, followed by constant growth to RM1.65 in year 2012. This recorded a CAGR at 4.9%. For Islamic REITs, the starting price was RM1.43 dropped to RM1.00 in 2008 and increase to RM2.21 in year 2012. This means a CAGR at 9.2%. Conventional REITs suffered a price dropped from RM1.22 in year 2007 to RM0.84 in year 2008, subsequently increase to RM1.24 in year 2012, which is 0.2% of CAGR.

**Table 3: Distribution Yield, Share Price from year 2007 to 2012**

| *Year* | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| ***Distribution Yield (%)*** | | | | | | |
| M-REITs | 7.87 | 10.40 | 8.30 | 7.37 | 7.49 | 6.67 |
| Islamic-REITs | 7.58 | 11.45 | 7.81 | 6.86 | 7.04 | 5.82 |
| Conventional REITs | 8.04 | 9.80 | 8.59 | 7.72 | 7.82 | 7.28 |
| ***Share Price (RM)*** | | | | | | |
| M-REITs | 1.30 | 0.90 | 1.20 | 1.38 | 1.46 | 1.65 |
| Islamic-REITs | 1.43 | 1.00 | 1.41 | 1.66 | 1.83 | 2.21 |
| Conventional REITs | 1.22 | 0.84 | 1.08 | 1.18 | 1.18 | 1.24 |

## DISCUSSION

For the study period, property income always shows positive growth. It is observed that 7 out of 11 samples are listed in Bursa Malaysia on either year 2006 or year 2007, hence the occupancy rate is not at optimum level for first or second year. The 33% growth comes from the improvement in occupancy rate. At a normal condition, the rental contract will be 2+2 years, with rental increment to offset the impact of inflation.

The growth rate of total assets always greater than total liabilities throughout the study period, hence the net assets value of the sample companies is increasing at a firm and steady 7% to 19%. The CAGR for net assets value is 12.5%. Despite a 22% drop in market capitalisation in year 2008, the overall CAGR for the study period was 9.5%. The above measures show that M-REITs were growing at a rate greater than the economy.

The analysis showed, that Islamic REITs have higher growth in net assets value, market capitalisation, and share price. These means the appreciation of the share value was higher than conventional REITs, Islamic REITs were better growth stock than conventional REITs.

On the other hand, the efficiency ratio and distribution yield of conventional REITs outperform Islamic REITs, this means conventional REITs utilised the assets in a more efficient manner and hence in term of return on investment, conventional REITs give out higher percentage than Islamic REITs. This means conventional REITs were better income stock than Islamic REITs.

This give an insight to investors about the characteristics of Islamic REITs and conventional REITs in Malaysia, hence enhance the investors' investment strategies.

## CONCLUSION

In general, the CAGR for property income, net assets value recorded double digit growth at 14.1% and 12.5% throughout the study period. Even though market capitalisation suffered dip in year 2008, the CAGR was 9.5% for 2007 to 2012. M-REITs are growing at a greater rate than the country economy.

From the analysis, Islamic REITs have higher assets appreciation and conventional REITs reported higher and stable dividend. It is found that Islamic REITs are better growth stock than conventional REITs and conventional REITs are better income stock than Islamic REITs.

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