Islamic REIT makes a healthy sum

Al-'Aqar KPJ Real Estate Investment Trust this week priced $A81.1 million (MYR235 million) from the first Islamic bond sale globally from a real-estate investment trust.

Al-'Aqar is one of only two Islamic real-estate investment trusts, or REITs, in Malaysia but experts say more are likely to be created both in the Southeast Asian nation and elsewhere, raising the prospects for more sukuk (Islamic bond sales) from the sector going forward.

REITs pool investor capital to purchase and manage a portfolio of properties whose income is largely passed onto shareholders in the form of dividends. An Islamic REIT shares most features of its conventional counterpart but the properties within the trust engage largely in activities permissible under Shariah, or Islamic law.

Many conventional REITs around the world have securitised the income from the properties to raise cash to buy fresh assets.

The Kuala Lumpur-based Al-'Aqar REIT will use the proceeds of the sale of medium-term notes to refinance existing debt and to purchase five hospitals. It has also said it is open to future acquisitions.

So far, it's unclear what those acquisitions could be although the REIT has first right of refusal to acquire hospitals managed by the KPJ Group. Some of those hospitals are located in the Middle East.

KPJ Healthcare is the largest provider of a private healthcare services in Malaysia and the largest shareholder of Al-'Aqar REIT.

The offering was documented under a $103.5 million commercial paper/medium-term note program which also allows for up to $5.1 million in CP issuance. Even if the borrower opts to sell the maximum amount of CP allowed, it will still have the capacity under the program to raise funds for further purchases.

"They will still have $17.2 million which they have said they will use in the future," said a person familiar with the deal.

Al-'Aqar raised the sukuk funds through a special purpose vehicle called Al-'Aqar Capital, which is wholly owned by Amanah Raya, the trustee of Al-'Aqar REIT.

The sukuk comprises $53.5 million in AAA-rated Class A notes, $8.6 million in AA2-ranked Class B paper and $18.9 million in AAA bank-guaranteed Class C bonds. All carry a legal maturity of seven years and an expected maturity of five years.

The Class A paper was priced to yield 4.78 per cent, the Class B at 5.05 per cent and the Class C at 4.28 per cent. All were priced at par.

The offering was sold on a bought-deal basis with arranger AmInvestment Bank taking a large slice of the deal and the remainder placed with other investors in Malaysia.

Sale And Lease Back

Under the structure, the SPV will acquire from the REIT the beneficial interest in six hospitals across Malaysia – Ampang Puteri Specialist Hospital, Damansara Specialist Hospital, Johor Specialist Hospital, Ipoh Specialist Hospital, Selangor Medical Centre and Puteri Specialist Hospital – as well as interest in five new hospitals.

The SPV will then enter into an ijarah arrangement to lease all 11 properties back to the REIT, with the lease payments channeled to the sukuk investors in the form of a coupon-style regular return.

It will use $29.6 million of the proceeds of the sukuk to help buy the five hospitals from KPJ Healthcare.

The five hospitals are Kedah Medical Centre, Perdana Specialist Hospital, KPJ Kajang Specialist Hospital, Sentosa Medical Centre and Kuantan Specialist Hospital.

The trust will use a further $46.2 million of the proceeds to refinance some outstanding Bai Bithamin Ajil debt – a form of Islamic borrowing that has been popular in Malaysia but which Gulf investors don't consider to be Shariah-compliant.

"One of the things they wanted to achieve is to try to make the REIT acceptable in the Middle East," said the person familiar with the deal.

The rest of the proceeds from the sale will be used to pay the fees and expenses related to the purchases and the sukuk sale as well as to put up to $5.1 million into a reserve account.

Al-'Aqar, established in 2006, was Malaysia's first Islamic REIT and was followed by Al-Hadharah Boustead REIT later that same year.

"I would think there would be more set up," says Ong Chee Ting, property analyst at Mayban Securities in Kuala Lumpur. "I think there is a flavour for Islamic products because there are a lot of funds looking to invest in Shariah products."

The Malaysian stock exchange now lists 13 REITS, most set up in the heyday of the REIT boom in late 2006 and the first half of 2007. Since then, the primary and secondary markets for REITs have quieted down largely because the government failed to cut unfavourable withholding taxes.

"But we are looking at a revival of interest because there could be a cut in the withholding tax as early as March," says Ong.

The Sunway and UEM groups have both been mentioned as companies that could set up REITs going forward.

As an Islamic product, Islamic investment trusts must comply with Islamic law meaning, for example, that they shouldn't use or support any forbidden activities such as payment of interest, gambling or manufacture of tobacco or alcohol.

However, recognising that tenants of a building being eyed by an Islamic REIT may be involved partially in such businesses – a hotel that has a small casino facility, for example – Malaysian Securities Commission guidelines say Islamic REITs in Malaysia may receive a maximum 20 per cent of their total rents from non-permissible activities and still be deemed Shariah compliant.

Such rulings have been criticised by some Islamic scholars and experts who say that such products should comply completely with Islamic law.

Assets within the Al-'Aqar REIT are 100 per cent Shariah-compliant, according to the REIT's website.

The terms of the trust – the world's first Islamic healthcare REIT – allow it to invest in non-hospital healthcare assets such as laboratories, universities and schools but the REIT has made little indication of what kind of assets it may look at next.

Analysts have said the REIT could benefit from Malaysia's aging population, the short bed supply in public hospitals and Malaysia's low healthcare expenditure as a percentage of gross domestic product.

RAM Ratings, which ranked the sukuk, noted that the specialised nature of the hospitals makes them fairly illiquid as there is limited secondary trading of hospitals in Malaysia. It's also subject to regulatory and industry factors, the ratings firm said.