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Understanding REITs and investing in them

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Property investment does not always mean owning a house, dealing with tenants or taking on a hefty mortgage. Without having to invest a large sum, there is another way to make passive income in property and that is through real estate investment trusts (REITs).

The following is a step-by-step guide on how to invest in REITs and everything one needs to know before doing so. Malaysian REIT Managers Association vice-chairman and AmREIT Managers Sdn Bhd deputy CEO Zuhairy Md Isa and Knight Frank Malaysia executive director of capital markets (investment) James Buckley share their insights.

Formation of REITs

For the uninitiated, Buckley offers this definition: "A REIT is an investment vehicle that owns and operates income-generating real estate assets, run by professional property managers called REIT managers. It allows investors to access returns from real estate assets while benefiting from elevated liquidity, transparency and governance, without the risk of direct ownership."

Zuhairy goes on to add that the basic concept of REITs is that instead of purchasing a whole building, investors can buy units in a REIT, similar to buying shares in a company.

On the regulations of REITs, Buckley says they can be established to manage or invest in any property type.

"The formation of REITs is regulated by the Securities Commission Malaysia (SC) via the Guidelines on Listed Real Estate Investment Trusts [Listed Guidelines] under the Capital Markets and Services Act 2007, which imposes specific requirements on any enterprise seeking establishment as a REIT.

On the regulations of REITs, Buckley says they can be established to manage or invest in any property type. "This includes its structure as a trust, management by a licensed REIT manager, initial capital, minimum fund size, asset allocation ratio into real estate and oversight guidelines."

As for shariah-compliant REITs, Buckley says they are additionally regulated by the Guidelines for Islamic Real Estate Investment Trusts, which must be read together with the Listed Guidelines.

Types of REITs

On a global scale, Buckley says REITs are grouped into three categories: equity REITs, which manage or invest in physical real estate assets; mortgage REITs, which manage or invest in loans and other debt instruments secured by real estate collateral; and hybrid REITs, which strike a balance between the two.

In Malaysia, he explains, there are equity REITs and they are usually sector-focused, investing in a particular sector of the property market.

Further elaborating on the subsectors of Malaysian REITs, Zuhairy lists five types, namely retail REITs, office REITs, industrial or logistics REITs, hospitality REITs and healthcare REITs.

According to him, retail REITs focus on owning income-generating retail spaces such as malls, retail centres and outlet complexes. In Malaysia, examples include IGB REIT (KL:IGBREIT) and Sunway REIT (KL:SUNREIT). Their income is largely derived from retail tenants spanning fashion, food and beverage and entertainment outlets.

Office REITs, on the other hand, invest in office towers and commercial buildings, leasing space primarily to corporate ten-



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ants. One such example is AmFIRST REIT (KL:AMFIRST), which generates income through long-term office leases.

For industrial or logistics REITs such as Axis REIT (KL:AXREIT), Zuhairy says, they own assets like warehouses, logistics hubs and manufacturing facilities.

"Their income streams come from manufacturing companies and logistics operators that rely on these facilities for storage and distribution. While generally seen as more resilient, they are still influenced by global trade cycles and fluctuations in manufacturing demand," he explains.

Hospitality REITs specialise in hotel and resort properties, with YTL Hospitality REIT (KL:YTLREIT) being a notable example. He points out that their earnings are closely linked to hotel room revenue and overall tourism activity.

As for healthcare REITs, Zuhairy says they invest in properties like hospitals, clinics and nursing homes.

"In Malaysia, Al-Aqar Healthcare REIT (KL:ALAQAR) is a prominent player. These REITs typically benefit from stable, long-term lease agreements with healthcare operators, providing relatively predictable income," he shares.

Overall risk vs return comparison

ASSET CLASS	INCOME STABILITY	GROWTH POTENTIAL	RISK LEVEL
Healthcare	Very high	Medium	Low
Industrial/logistics	High	High	Medium
Retail	Medium-high	Medium	Medium
Office	Medium	Low-medium	Medium
Hospitality	Low	High	High

Investing in REITs vs stocks

FEATURE	REITs	STOCKS
Nature of investment	Real estate ownership through a trust	Ownership in a company
Main income source	Rental income from properties	Business profits
Dividend policy	Must distribute most income (often >90%)	Dividends optional
Growth potential	Moderate	High
Income stability	Generally stable	Depends on company performance
Sensitivity	Interest rates and property market	Corporate earnings and economy
Volatility	Usually lower	Often higher

Returns and risks

On the returns and benefits of REITs, Buckley says there are several, particularly for investors seeking regular income, diversification and ease of access to real estate.

"A key advantage is their ability to generate consistent dividend income as they are required to distribute at least 90% of their taxable income. They also provide exposure to a diversified portfolio of properties without requiring large capital or active management and are highly liquid because they are traded on stock exchanges.

"This makes REITs a convenient way to invest in real estate compared to owning physical property directly," says Buckley.

Concurring with him, Zuhairy says that as REITs sit between physical real estate and stocks, which is a combination of property ownership with the liquidity of shares, it makes them a simple way to invest in real estate without directly buying property.

He further compares REITs and stocks. "In terms of performance, stocks depend on company profits and growth, as seen in firms like Malayan Banking Bhd (KL:MAYBANK) and Tenaga Nasional Bhd (KL:TENAGA). REITs, on the other hand, are driven mainly by rental income, property values and occupancy rates.

"They also differ in dividend policy. Regulated by the SC, REITs must distribute at least 90% of their taxable income. This is why they typically offer higher dividend yields than stocks."

However, REITs are not without their risks. For one thing, Buckley says, prices can be volatile in the short term as they are influenced by overall market sentiment, similar to stocks.

"They are also sensitive to property market conditions such as occupancy rates and rental income trends. A key risk factor is interest rate movements. When interest rates rise, REITs tend to face higher borrowing costs, which can reduce profitability," he says.

He explains that higher interest rates make alternative income investments like bonds more attractive, potentially leading to lower demand and price declines for REITs. Conversely, when interest rates fall, REITs generally benefit from lower financing costs and increased investor demand for yield, which can support both prices and returns.

Locally, another challenge encountered earlier this year was the removal of the 10% withholding tax on Malaysian REIT distributions, which Buckley worries will have a negative impact on investor sentiment and demand in the short term, primarily due to lower post-tax returns.

"Under the previous regime, investors benefited from a simple and relatively low final tax, making REITs attractive as a stable income investment. With the shift to progressive tax rates, higher-income and foreign investors may face significantly higher effective tax rates, reducing net yields and making Malaysian REITs less competitive compared to markets like Singapore and Hong Kong," he points out.

He adds that this could lead to some capital outflows and downward pressure on REIT prices, particularly as foreign investors, while not dominant, still represent a meaningful portion of the market.

However, Buckley reassures that the change does not directly affect the underlying fundamentals of REITs such as rental income, occupancy rates or asset quality.

This is because Malaysian REITs are still required to distribute a high proportion of their income, and their long-term performance will continue to depend on property market conditions and management quality, he adds.

"Given that the market is largely sup-



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ported by domestic institutional investors, the overall impact may be cushioned over time. In the longer term, investors may become more selective, placing greater emphasis on REITs with strong growth prospects rather than purely high dividend yields, which could lead to a more fundamentally driven market," Buckley notes.

Concurring with Buckley, Zuhairy says while recent tax changes have affected sentiment, they have not altered the underlying cash flows.

"Rents are being collected. Occupancies are stable to improving. Assets are operating. What we are seeing is a reset in perception, not a deterioration in fundamentals."

In particular, he observes strong momentum in retail and industrial segments, supported by domestic consumption, tourism recovery, and structural demand in logistics and supply chains.

For Malaysian REITs, he says the focus is simple. "Protect income, enhance asset value and deliver sustainable distributions. On that basis, I believe it will continue to deserve a place in long-term, income-focused portfolios."

Choosing the right REIT

When assessing a REIT, Zuhairy advises investors to take into account key indicators to understand performance and stability. One of the main metrics is net property income (NPI), which measures the profit generated from properties after deducting operating expenses from rental income. He stresses that a higher NPI generally signals stronger property performance.

Another important measure is distribution per unit (DPU), which represents the dividend paid to investors. A higher and consistent DPU usually indicates steady income, he adds.

Meanwhile, investors should also look at the occupancy rate to see how much of the property is currently leased. A higher occupancy means more reliable rental income.

Besides that, Zuhairy also

suggests looking at the gearing ratio, which reflects how much debt a REIT has. "In Malaysia, limits are set by the SC, which typically caps gearing at 50%, with most REITs operating between 30% and 45%. Higher gearing can increase risk, especially when interest rates rise."

Finally, one should also look at net asset value, which shows the value of the REIT's assets after liabilities, while weighted average lease expiry (WALE) indicates how long tenants are contracted to stay. A longer WALE suggests more stable income and lower risk of vacancies, he adds.

Buckley observes new investors often make the mistake of focusing on high dividend yield when investing in REITs.

"While a high yield may look attractive, it can sometimes signal underlying issues such as declining property income or high risk," he says.

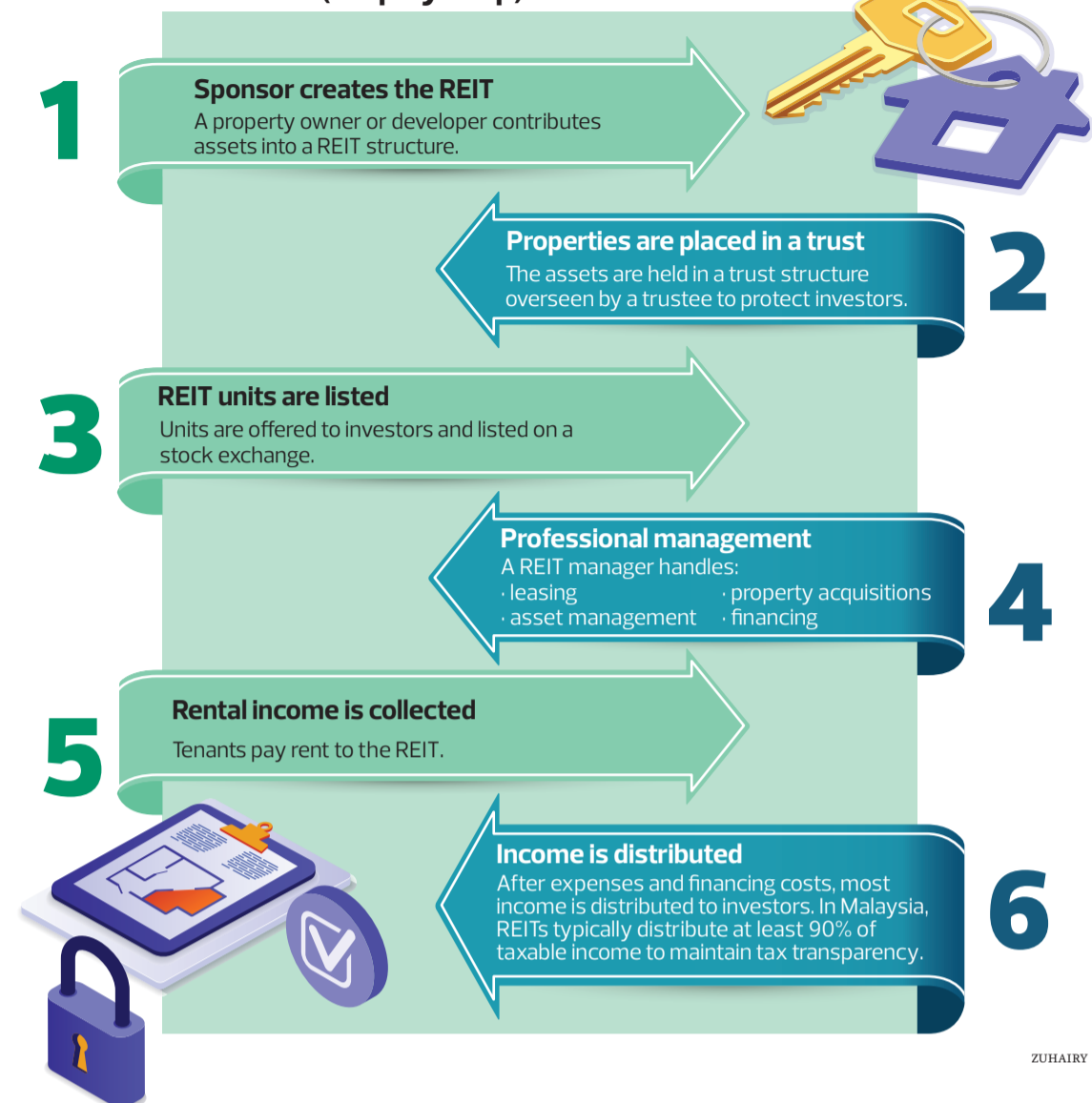
Buckley also highlights that investors should not overlook the quality of the underlying assets, including occupancy rates, tenant profiles and lease structures, which are critical for sustaining income.

To avoid these pitfalls, he suggests investors take a more balanced approach by assessing income sustainability, asset quality and financial strength, rather than chasing yield alone.

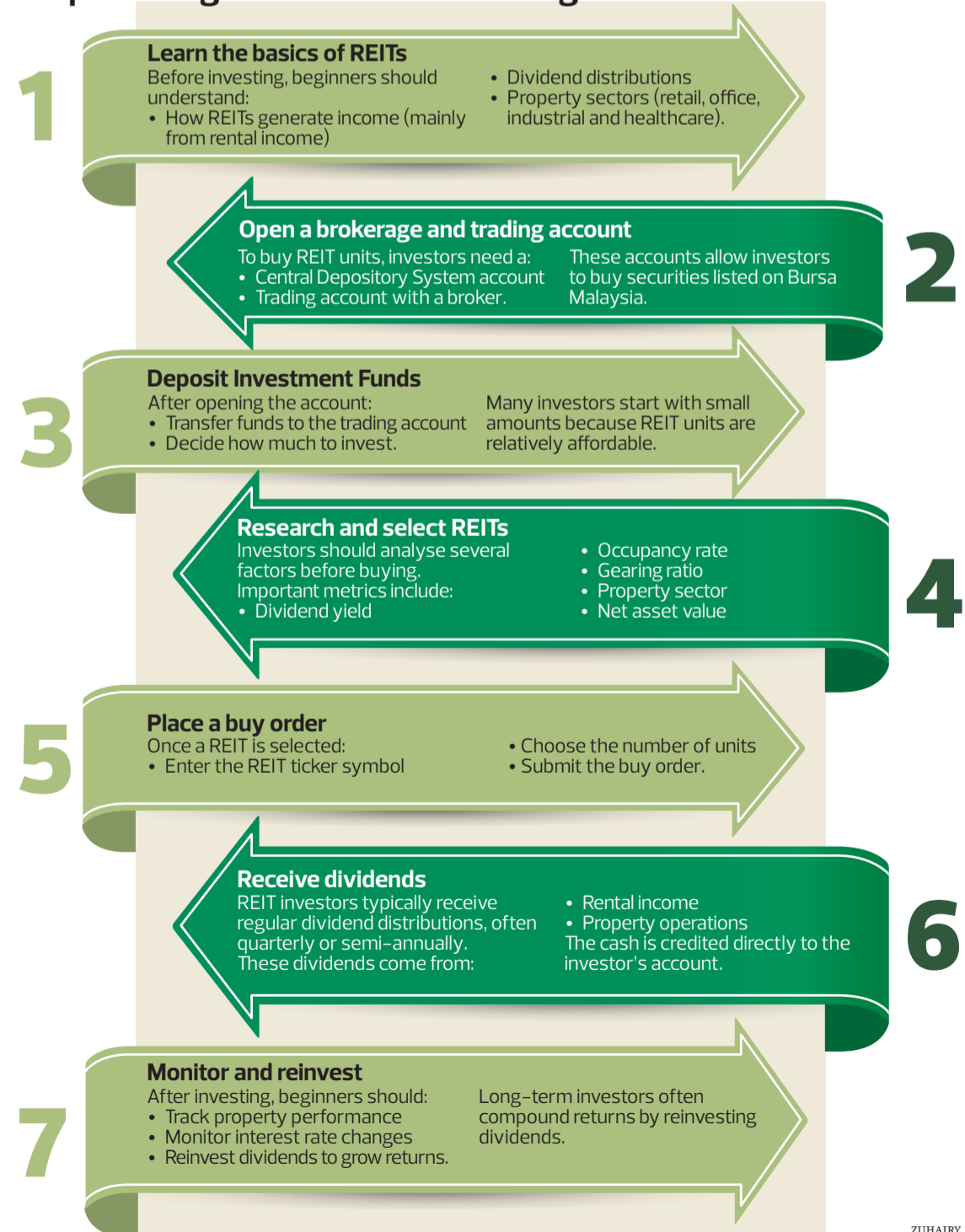
He adds that it is also important to consider diversification across different REIT sectors to reduce concentration risk. Additionally, understanding how interest rate movements impact REIT performance can help investors make more informed decisions pertaining to timing and allocation.

"Taking a long-term view and focusing on well-managed REITs with strong fundamentals can significantly improve investment outcomes," Buckley says.

How a REIT works (step by step)



Steps for beginners to start investing in REITs



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