

Indexing Islamic REITs

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Publicly traded property stocks, including real estate investment trusts (REITs), allow market participants to obtain exposure to real estate, an illiquid asset class, without sacrificing the liquidity benefits of listed equities. They also typically offer relatively high dividend yields, may serve as an inflation hedge and could help to diversify a portfolio comprised of several asset classes. These characteristics have contributed to the appeal of REITs among both conventional and Shariah investors. Shariah-compliant real estate indices are designed to provide Islamic investors with a wider range of tools to evaluate the performance of Shariah-compliant real estate equity funds and to support ETFs and other index-based financial products.

What Is a Shariah-Compliant REIT?

The S&P Shariah and Dow Jones Islamic Market Indices evaluate REITs using the same, globally consistent methodology utilized to screen all equity securities. As shown in Exhibit 1, companies must meet both business activity and financial ratio screens in order to be included in the Islamic index.

While real estate investing tends to align with Shariah principles from a business activity standpoint, some real estate companies have exposure to non-permissible income sources such as gambling, alcohol and banking via their tenants' underlying businesses. Many REITs also tend to have relatively large debt holdings and therefore, often fail the leverage ratio requirement.

Exhibit 1: S&P Shariah and Dow Jones Islamic Market Index Screening Methodology

Non-Permissible Activities (Revenue Must Be Less Than 5% of Total)	S&P Shariah	Dow Jones Islamic Market
Alcohol	X	X
Gambling	X	X
Movies	X	X
Music	X	X
Non-Islamic Financial Services	X	X
Pork	X	X
Pornography	X	X
Television	X	X
Tobacco	X	X
Weapons/Defense		X
Hedging of Gold & Silver	X	
Financial Ratio Thresholds		
Total Debt / Market Cap (%)	33	33
Total Cash + Investments / Market Cap (%)	33	33
Total Receivables / Market Cap (%)	49	33

Source: S&P Dow Jones Indices LLC. Data as of May 31, 2022. Table is provided for illustrative purposes. For additional details on the index methodologies, see the [S&P Shariah Indices Methodology](#) and [Dow Jones Islamic Market Indices Methodology](#).

It is important to note that several countries, such as Malaysia, have specific Islamic REIT designations often referred to as i-REITs. These entities are considered Shariah-compliant by S&P Shariah and Dow Jones Islamic Market Index methodologies regardless of whether they meet the specific thresholds described in the methodology, given that they are overseen by Shariah boards that certify their operations as fully Islamic in nature.

Islamic Real Estate Indices: Index Design Considerations

S&P DJI offers a variety of Islamic real estate indices mirroring the set of indices available for conventional investors. Some indices are focused exclusively on REITs, while others are broader in scope, including REITs and REIT-like companies that derive a majority of their revenue from rental income and real estate development activities. Some indices also exclude certain specialty REITs, such as cell tower and timber REITs, to focus on more traditional property types such as office buildings, apartments, shopping centers and warehouses. Exhibit 2 summarizes the key differences between major categories of Islamic real estate indices.

Exhibit 2: Islamic Real Estate Index Overview

Category	Index Category			
	Core REIT	All Equity REIT	Property	Real Estate Sector
Representative Index	S&P Global REIT Shariah	S&P Global All Equity REIT Shariah Capped Index	S&P Global Property Shariah	DJIM Global Real Estate
Type of Company Eligible				
REITs (Traditional Property Types)	Yes	Yes	Yes	Yes
Specialized REITs	No	Yes	No	Yes
Real Estate Operating Companies	No	No	Yes	Yes
Real Estate Service Firms	No	No	No	Yes

Source: S&P Dow Jones Indices LLC. Data as of May 31, 2022. Table is provided for illustrative purposes.

Many Islamic real estate indices also employ stock capping in order to reduce concentration in the largest holdings. This is important, as the universe of real estate securities meeting all Shariah compliance screens can be limited, which can cause a high concentration in the largest index constituents if weighted purely by market capitalization.

Performance Analysis

Despite underperforming in 2022, S&P Global Islamic Real Estate Indices outperformed the conventional S&P Global Property Index over the past one-, three- and five-year periods (see Exhibit 3). Interestingly, the Islamic indices also experienced lower volatility despite being substantially more highly concentrated on both country and stock level bases.

Exhibit 3: Comparative Risk/Return Metrics

Period	S&P Global Property	S&P Global Property Shariah	S&P Global All Equity REIT Shariah Capped Index
Return (%)			
YTD	-12.26	-17.76	-15.79
1-Year	-4.72	4.06	6.35
3-Year	3.04	8.48	12.69
5-Year	4.41	7.15	10.56
Standard Deviation (%)			
3-Year	18.67	16.80	16.88
5-Year	16.09	14.49	15.00

Source: S&P Dow Jones Indices LLC. Data as of May 31, 2022. Past performance is no guarantee of future results. The S&P Global All Equity REIT Shariah Capped Index was launched Dec. 28, 2020. All data prior to index launch is back-tested hypothetical data. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure linked at the end of this post for more information on the inherent limitations of back-tested performance.

Two major drivers of the outperformance were their overweights to the U.S. and specialized REITs—both of which outperformed over the periods measured. In fact, as of May 31, 2022, the [S&P Global Property Shariah](#) and [S&P Global All Equity REIT Shariah Capped Index](#) each had a weight of over 80% to the U.S., while the conventional S&P Global Property had a 52% weight to the U.S. It is difficult to attribute the outperformance or risk reduction specifically to Shariah-compliance criteria, though theoretically, REITs with relatively low leverage may provide more stability and therefore, better long-term risk-adjusted performance in comparison to their highly levered peers.

Conclusion

Islamic real estate indices offer market participants unique tools to define the opportunity set of Shariah-compliant property companies and gauge their performance. However, it is important to look under the hood to understand how the index is constructed both from a Shariah-compliance perspective and the types of real estate companies eligible for inclusion.

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Performance Disclosure/Back-Tested Data

The S&P Global All Equity REIT Shariah Capped Index was launched Dec. 28, 2020. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. However, when creating back-tested history for periods of market anomalies or other periods that do not reflect the general current market environment, index methodology rules may be relaxed to capture a large enough universe of securities to simulate the target market the index is designed to measure or strategy the index is designed to capture. For example, market capitalization and liquidity thresholds may be reduced. Complete index methodology details are available at www.spglobal.com/spdji. Past performance of the Index is not an indication of future results. Back-tested performance reflects application of an index methodology and selection of index constituents with the benefit of hindsight and knowledge of factors that may have positively affected its performance, cannot account for all financial risk that may affect results and may be considered to reflect survivor/look ahead bias. Actual returns may differ significantly from, and be lower than, back-tested returns. Past performance is not an indication or guarantee of future results. Please refer to the methodology for the Index for more details about the index, including the manner in which it is rebalanced, the timing of such rebalancing, criteria for additions and deletions, as well as all index calculations. Back-tested performance is for use with institutions only; not for use with retail investors.

S&P Dow Jones Indices defines various dates to assist our clients in providing transparency. The First Value Date is the first day for which there is a calculated value (either live or back-tested) for a given index. The Base Date is the date at which the index is set to a fixed value for calculation purposes. The Launch Date designates the date when the values of an index are first considered live: index values provided for any date or time period prior to the index's Launch Date are considered back-tested. S&P Dow Jones Indices defines the Launch Date as the date by which the values of an index are known to have been released to the public, for example via the company's public website or its data feed to external parties. For Dow Jones-branded indices introduced prior to May 31, 2013, the Launch Date (which prior to May 31, 2013, was termed "Date of introduction") is set at a date upon which no further changes were permitted to be made to the index methodology, but that may have been prior to the Index's public release date.

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