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DEAL: first Malaysian sukuk to monetise real estate project billings

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SkyWorld has issued Malaysia's first *sukuk* which monetises progress billings, securitising future payments received from the sale of yet-to-be completed units in a mixed development project located in Kuala Lumpur.

The MYR1 billion (\$250 million) Islamic bond, issued in December, will be used to fund the property developer's ongoing projects. It was structured using MYR600 million Islamic medium term notes under a *sukuk musharakah* programme and MYR400 million notes under a *sukuk murabahah* programme.

Cash flows



The transaction has been structured to mitigate the construction and liquidity risks associated with real estate development projects by placing progress billings upfront.

NewParadigm partner Charanjeev Singh, who advised on the issuance, said that the structure provides more efficient project management cash flows.

"The primary objective of this programme is to monetise progress billings straight away allowing for more efficiently managed project development cash flows," he said. "The financial programme is structured on a limited recourse basis."

"The key feature of this structure is that the promoter is unrated and the rating is actually focused on the relevant development project to be securitised," he added.

Any future receipts made when SkyWorld sells their beneficial rights related to specific property development projects to the issuing special purpose vehicle (SPV) (SkyWorld Capital) will be used to fund the remaining construction costs. These costs are related to the respective development projects and meet the SPV's fees, expenses and obligations. Rating Agency of Malaysia will include only the executed sales and purchase agreements up to the transaction's close.

The first tranche under the *musharakah* was a RM50 million issuance supporting the development of the SkyAwani Residences project, SkyWorld's first corporate social responsibility initiative

under an affordable housing scheme promoted by the city of Kuala Lumpur. *Musharakah sukuk* are traditionally used for borrowing to fund large-scale construction projects,

The *sukuk murabahah* programme, which involved the sale of assets or commodities, is subordinated to the *musharakah* one, and is guaranteed by Malaysian insurer Danajamin. The *sukuk musharakah* will carry a credit rating with the first tranche accorded AA3, while the *sukuk murabahah* will be unrated.

Singh said that the notes were largely sold with end-financing secured for end purchasers, substantially reducing the buyers' default risk.

"Given the projects overall high take-up rate and a large proportion financed by mortgages, buyers' default risk on progress payments are substantially reduced," he said.

Legal challenges

Because the structure is so unique, NewParadigm was faced with a number of legal challenges. One was to comply with both the Malaysian Housing Development Regulations 1991 and Housing Development Act 2012.

"The application of progress billings is strictly governed by the act, where it may only be utilised for the completion of construction and servicing of any borrowings undertaken for the development project," he said. "Repayment of the principal can only be done upon completion of the relevant development."

Another challenge was making the rated and unrated *sukuk* work together. This was facilitated by the priority of payment under a waterfall account which in turn was differentiated between an ongoing concern basis and event of default basis.

The security trustee of the project will be granted step-in rights to appoint a new contractor or help the independent project certifier take over the role as developer as a way to further mitigate the potentially uncertain development process. The *sukuk murabahah* programme is able to mitigate any shortfall in meeting payment milestones, as well as the redemption of principal by the legal maturity date. In addition, the issuer can draw against the *sukuk murabahah*, which further reduces the risk of cost overruns and addresses timing mismatches between progress billing receipts and ongoing construction costs.

There were several additional risks to account for: construction risks associated with the issuance, the status of SkyWorld as a new player in the industry, having only been established in 2013, and a single-site risk, vulnerable to cashflow timing mismatches.

"Each individual tranche under the issuance is secured against a specific single development project and, as a result, any adverse cashflow impact is likely to be more pronounced than for other transactions backed by multiple projects at differing stages of construction and locations," said Singh. These risks are however mitigated in part by the contingent commodity-based *murabahah* programme.

Islamic finance

There is an entire universe of *sharia* compliant financial products that is yet to be developed. Securitisation is a way to leverage Islamic finance and introduce it to new areas.

However, despite the widely-held view that Islamic finance is thriving, growth has been over-estimated.

"Much of the Islamic finance industry is dominated by conventional bankers, who do not typically hold any ideological affinity to the Islamic economic model," said Gateway Law partner and Cordoba Capital founder Harris Irfan. "They see it like tax structuring, but rule circumvention is not the point of Islamic finance."

COUPON/REDEMPTION

- The 4.75% notes under the *musharakah sukuk* are due June 2019 and are rated AA3 by RAM Berhad.

SHARIA JUDGMENT

- The Sharia pronouncement for the *sukuk musharakah* was dated November 27 2017. It was signed by Datuk Dr. Mohd Daud Bakar, the *shariah* adviser for the transaction

Tear sheet

The deal closed on December 8. The Legal adviser was Adnan Sundra & Low.

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