



Pasir Gudang Industrial Estate

Whether a Local Authority under the Local Government Act 1976 can create a Special Purpose Vehicle ("SPV")

'SPV' - A Company for Issuance of Municipal Sukuk

The Act states that a Local Authority, i.e. a City Council, Municipal or District Council is a body corporate - and therefore, it can "do and perform such acts and things as bodies corporate may by law do and perform."

Part 1 – Definition of a Local Authority and the Governing Laws

Similar to many countries, a local government system provides a significant impact and influence on the general public. In Malaysia, specifically Peninsular Malaysia, there are various sections or layers to the government body in which a local authority is the lowest in the hierarchy of the local government system. Hence, a local authority in Peninsular Malaysia refers to the division of the government which consists of the city or rural area or even a combination of both. The types of local authorities can be divided into three (3) separate categories which include:

- 1) City Council (area consisting of not less than 500,000 people)
- 2) Municipal (area consisting of not less than 150,000 people)

Cont. on Pg. 2

Options for Local Government Bodies in Fund Raising

A close review of the Federal Government's 2023 total Budget allocations of RM 388.1 Billion, will show that only 2.1 % of this amount or RM 8.15 Billion will be allocated, divided and juggled among all of the country's 13 States, for the running of the various State Governments and its Local Municipalities, with the unfortunate result that - many of these States, in particular, their Local Municipalities, will have limited or insufficient annual funds in the form of grants from the Federal government.

Because of this shortfall of budget allocation to State Govts, it is the Local Municipalities, in particular, which will feel this pinch the most and usually end up having to borrow funds from banks by using their Reserved Funds as collateral. This is an unfortunate trend because these Reserved Funds are, for the most part, kept in fixed deposits (FD) and breaking the term of the FD automatically leads to loss.

One area that ARSA has expertise in is its development of a sustainable model for raising funds for Local Government bodies - with the status of 'Majlis Perbandaran' or 'municipality': This model of raising funds is through the issuance of 'Sukuk' - a bond that is issued in compliance with Shari'ah principles. Cont: Pg. 2

'Does a local authority have the power, by law, to incorporate a company in Malaysia?'

3) District Council (area consisting of less than 150,000 people)

In order to consistently regulate the local authorities in Peninsular Malaysia, the Local Government Act 1976 (Act 71) was introduced. Other enactments were also introduced including the Town and Planning Act 1976 and the Street Drainage and Building Act 1974 which are aligned with the intentions of providing a more comprehensive structure of the laws, rules and regulations governing local authorities. However, it is pertinent to note that the main law governing any local authority is the Local Government Act 1976 which covers the functions, powers, and enforcements of all local authorities in the states of Peninsular Malaysia.

Part 2 – Incorporation of a Company in Malaysia

Establishing a company, specifically a private limited company, is the most common type of business entity in Malaysia. An incorporation of a company or a body corporate can be set up relatively quickly in Malaysia via registration at Companies Commission of Malaysia/Suruhanjaya Syarikat Malaysia or more commonly referred to as "SSM". Any private person or body corporate can set up a company in Malaysia as long as the criteria required by SSM are met, such as a successful application and reservation of a company name, as well as preparing and providing the adequate particulars and documentations required under Section 14 (1) of the Companies Act 2016 which may include, amongst others:-

- 1) name of proposed company;
- 2) status of private or public company;
- 3) proposed type of business;
- 4) address of registered office;
- 5) complete details of every person/body corporate who is/are to be members(s) of the company;
- 6) details of the director(s) of the company;
- 7) details of the secretary of the company;
- 8) details and of class and number of shares to be taken by member(s) of the company; and
- 9) any other information as the Registrar may require.

Cont. on Pg. 3

Cont. from Pg. 1

Options for Local Government Bodies in Fund Raising

For instance, in 2005, ARSA was counsel for PG Municipal Assets Berhad ('PGMAB') in its Islamic Municipal Bonds issuance of RM 80.00 Million under the Shariah principles of Mudharabah, which is a form of financing via profit arrangement, to raise funds for Pihak Berkuasa Tempatan Pasir Gudang ("PBT Pasir Gudang"), a local authority. PGMAB is an 'SPV' incorporated by this Pasir Gudang local authority. (See earlier article "Whether a Local Authority under the Local Government Act 1976 can create a Special Purpose Vehicle ("SPV)").

It is particularly notable that the P.G. area comprises a large number of industrial properties and estates ("Industrial Estates"), operating within its municipality area of administration.

This fact alone makes it an ideally located municipal area to issue such a bond, for the simple reason that Industrial Estates, per se, are subject to higher assessment rates payable - when compared to residential dwellers - which pay lower assessment rates: thus, in this instance, for PGMAB, it was an efficient revenue collection source which was used to repay amounts due under the said bond.

Therefore, it is no surprise that PBT Pasir Gudang issuance was a success and this structure could be replicated in other municipalities with similar scenario. It could be used as a template or, at least, an option for local municipalities to help them in balancing their otherwise 'tight' budget, while collecting higher assessment rates from Industrial Estates in their administrative area.

By: Nadiah Abdul Haleem Shah, Partner
Contact: nadiah@arsa.com.my



CITY / DISTRICT/ MUNICIPAL COUNCIL

Pasir Gudang Industrial Estate

Once SSM has processed all the information and documents required to incorporate the company, a notice of approval and registration is issued and a Certificate of Incorporation will be issued by SSM upon request together with payment of the prescribed fee(s).

Part 3 – Incorporation of a Specialist Purpose Vehicle Company (“SPV”) by a Local Authority in Malaysia (SPV for Issuance of Sukuk)

In determining the meaning of a local authority and the brief details of setting up a company have been covered in Parts 1 and 2 above, the correlating issue between the two parts can now be evaluated, which is, as the main title of this article above suggests, ‘Does a local authority have the power, by law, to incorporate a company in Malaysia?’ In order to ascertain a comprehensive answer to this question, firstly, it must be understood that a local authority, though not incorporated via the

procedures provided by SSM, is recognized, by law, as a body corporate as stated in Section 13 of the Local Government Act 1976:-

“Every local authority shall be a body corporate and shall have perpetual succession and a common seal, which may be altered from time to time, and may sue and be sued, acquire, hold and sell property and generally do and perform such acts and things as bodies corporate may by law do and perform.”

In reference to the above cited legislation, it is clear that the Local Government Act 1976 illustrates that a local authority, whether it be a City Council, Municipal or District Council, to be a body corporate in its own right. This means that the law recognizes any designated local authority to “do and perform such acts and things as bodies corporate may by law do and perform.” As it is also common knowledge that a body corporate or a company has the

power to set-up wholly owned subsidiaries. It can be deduced that Section 13 of the Local Government Act 1976 would allow local authorities, who are considered a body corporate, to have all rights and powers that a body corporate has, including setting up and owning a company under Malaysian law. In furtherance of the above, for the purpose of the topic of this article, the incorporation of the company or more specifically, an SPV, is for the purpose of issuance of ‘Sukuk’, which is a type of Islamic financial certificate that is Shariah-compliant, comparable to a bond as its conventional counterpart. As the main reason for the question of incorporation of company herein arises due to the Sukuk requirement of incorporating an SPV, Section 41 of the Local Government Act 1976 can be closely examined in which it states:-

“(1) Subject to any other written law, a local authority

Sukuk...and SPV (are) relatively rare amongst local authorities...

may, by resolution and with the consent of the State Authority, from time to time raise by way of loans such amounts of money upon such conditions as he State Authority shall approve..."

local authority, as per any private entity or body corporate (as long as their articles/constitutions allow), has the authority to obtain financing for the purpose of the business or transactions that are within the purview of powers conferred on a local authority by the relevant laws and of course, subject to the approval of the State Authority. Relating this Section 41 to the previous

Section 13, both of the Local Authority Act 1976, it can be concluded that as Section 13 of the Local Authority Act 1976 grants the recognition that a local authority is a body corporate and is able to carry out and perform actions as any body corporate may do, by law, and Section 41 of the Local Authority Act 1976 also allows a local authority to raise a loan, if in any case, a local authority wishes to obtain financial assistance via a Sukuk issuance, then a local authority shall be able to perform all requirements necessary for the issuance of the said Sukuk, including the need to incorporate an SPV. As the SPV is a pre-requirement for a Sukuk transaction, as long as the State Authority approves of the Sukuk transaction as well as the local authority abiding by Section 41

the Local Government Act 1976 and other relevant laws, incorporating an SPV is in line with the intentions of obtaining financial assistance while being within the ambits of powers via Section 13 of the Local Government Act 1976.

... the incorporation of the company or more specifically, a SPV, is for the purpose of issuance of 'Sukuk', which is a type of Islamic financial certificate that is Shariah-compliant ...

Part 4 – Current Practices and Possible Future Development

Taking into consideration the information provided above in Parts 1, 2 and 3, it is still worth noting that the concept of obtaining financing through Sukuk and the need for incorporation of SPV is relatively rare amongst local authorities, in comparison to obtaining financing via a conventional bank loan. Although there is a previous case in which a local authority had obtained financing via a Sukuk issuance in the past, the concept of Sukuk amongst local authorities is still relatively

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uncommon, hence, case laws or preceding discussions or judgments on any issues or barriers that local authorities may face are not widespread and has not yet become common knowledge to the public.

Having said that, it is still pertinent to highlight that since there is no exact or specific provision of law in the Local Government Act 1976 that negates the local authority's ability to incorporate a company, and only sections that seem to be

As the SPV is a pre-requirement for a Sukuk transaction, as long as the State Authority approves of the Sukuk transaction as well as the local authority abiding by Section 41 of the Local Government Act 1976 and other relevant laws, incorporating an SPV is in line with the intentions of obtaining financial assistance while being within the ambits of powers via Section 13 of 1976 Act

supporting the ability of a local authority to do so are available. As discussed above, it is probable that in the near future, Sukuk issuance will be more fairly common as an alternative mode of funding for local authorities due to the benefits and features that Sukuk may provide compared to a standard and traditional financing from a financial institution.

- PRACTICE AREAS -
Abdul Raman Saad & Assocs.

MANAGING PARTNER

Datuk Dr Abdul Raman Saad
 (dars@arsa.com.my)

BANKING & CONVEYANCING

Lew Chung Han (chlew@arsa.com.my)
 Sabreena Abdul Raman
 (sabreena.raman@arsa.com.my)
 Emeilda Jamalludin
 (emeilda@arsa.com.my)

REAL ESTATE AND PROPERTY

Lew Chung Han (chlew@arsa.com.my)
 Sabreena Abdul Raman
 (sabreena.raman@arsa.com.my)
 Emeilda Jamalludin
 (emeilda@arsa.com.my)

CORPORATE AND COMMERCIAL

Datuk Dr Abdul Raman Saad
 (dars@arsa.com.my)
 Lew Chung Han (chlew@arsa.com.my)
 Azharuddin Ahmad Jais
 (azhar@arsa.com.my)
 Nurul 'Akhmar Mohd Shafiee
 (nurul.akhmar@arsa.com.my)

**CAPITAL MARKET AND
 CORPORATE FINANCE**

Nadiah Abdul Haleem Shah
 (nadiyah@arsa.com.my)
 Nurul 'Akhmar Mohd Shafiee
 (nurul.akhmar@arsa.com.my)

**INFORMATION TECHNOLOGY,
 TECHNOLOGY AND
 TELECOMMUNICATION (ITT)**

Datuk Dr Abdul Raman Saad
 (dars@arsa.com.my)
 Azharuddin Ahmad Jais
 (azhar@arsa.com.my)

**LITIGATION AND ALTERNATIVE DISPUTE
 RESOLUTION**

Nasyitah Ruzanna Abdul Raman
 (nasyitah@arsa.com.my)
 Rohana Ngah
 (rohanangah@arsa.com.my)

HIBAH & WASIAT (WILL AND PROBATE)

Nasyitah Ruzanna Abdul Raman
 (nasyitah@arsa.com.my)
 Zainursyazwani Zakaria
 (zainur@arsa.com.my)

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www.arsa.com.my

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CONTACT US

Abdul Raman Saad & Associates

www.arsa.com.my

Head Office

KUALA LUMPUR
 C-2-1, Pacific Place Commercial Centre
 Jalan PJU 1A/4, Ara Damansara
 47301 Petaling Jaya
 Selangor Darul Ehsan
 Malaysia
 Tel: +603-7859-9229
 Fax: +603-7734-5777
 Email: arsakl@arsa.com.my

Branch Offices

JOHOR BAHRU
 No. 3, Jalan Permas 10/3
 Bandar Baru Permas Jaya
 81750 Masai, Johor
 Malaysia
 Tel: +607-388-6363
 Fax: +607-388-2020 / 386-3030
 Email: arsajb@arsa.com.my

MELAKA
 240A & B, Jalan Melaka Raya 1
 Taman Melaka Raya
 75000 Melaka, Malaysia
 Tel: +606-282-1446 / 283-3793
 Fax: +606-284-7868
 Email: arsamk@arsa.com.my