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A place for residential REITs in the South African REIT market

By

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Abstract:

The South African REIT market has grown significantly over the last decade and has consistently produced competitive total returns compared to other international REIT markets. However, the South African REIT market is comprised almost entirely of REITs which are diversified across two or more of the property sectors and is significantly under-weighted in terms of its residential exposure when compared to other developed and emerging REIT markets.

Until June 2015, no pure residential REIT offering existed. This research attempts to better understand the challenges faced with investment in the residential sector in South Africa and in the establishment of residentially focused REITs. It also attempts to gauge market interest in investing in residential rental stock.

Declaration

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration at the Gordon Institute of Business Science, University of Pretoria.

It has not been submitted before for any degree or examination in any other university.

I further declare that I have obtained the necessary authorisation and consent to carry out this research.

Name : ______________________________

Signature: ______________________________

Date: ______________________________

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CHAPTER 1: Introduction and Research Questions

1.1. Introduction and Purpose

A REIT, or Real Estate Investment Trust, is a company that owns or finances income-producing real estate (NAREIT, 2015). REITs provide investors of all types with regular income streams, diversification and long-term capital appreciation (NAREIT, 2015)

The purpose of this research is to seek to explore whether a place exists for residential REITs in the South African REIT market and to better understand what the perceived challenges are with investment in this sector of the South African REIT market.

Cotter & Roll (2015 p. 214) note that residential REITs are an increasingly popular vehicle for investment in real estate, having doubled in number in the United States of America (USA) since 1980 and which have grown at a rate of twice that of the full universe of REITs in the USA. According to the 2014 Broll report (Broll, 2014), research has shown that listed property in emerging markets typically have a 15% residential weighting by value as opposed to South Africa which has a 1% weighting. Newell & Fischer (2009, p.129) cited in Zietz, Sirmans, & Friday (2003, p.127) that whilst the performance of other REIT sectors such as office and retail have received considerable attention, the significance and performance of residential REITS has received limited attention.

There is a gap to explore the establishment of residential REITs in different REIT markets such as the South African market.

1.2. Definition of the Main Problem

At the time that this research commenced (November, 2014), a pure residential REIT offering did not exist in the South African REIT market. Exposure to residential property via a REIT was only possible through investing in sectorally diversified REITs. All residential assets in the South African REIT sector formed part of diversified portfolio's (McIver, 2014). Subsequent to the commencement of this research, one residential REIT has listed on the Johannesburg Stock Exchange (JSE) (Muller, 2015).

The main problem is to understand why the residential sector is so under-represented in the South African REIT market and why only one pure residential REIT currently exists.

1.3. Sub Problems

It appears that not all markets are ready to embrace the introduction of residential REITs. Jones (2007, p.383) focused on researching the challenges experienced in introducing residential REIT's into new markets. In his research he investigated the necessary conditions in the housing market for residential REITs to prosper by investigating the successful case of the United States of America and the unsuccessful case of Australia. Jones (2007, p.389) postulates that whilst REITs are a very attractive property investment medium, the establishment of residential REITs requires a thriving rented sector, local markets with depth and the existence of large landlords. Whether the South African REIT market has the depth and scale necessary is unknown. There is scope to better understand what the challenges are within the sector and in establishing a residential REIT in the South African market.

There is also scope to better understand whether or not the South African REIT market is aware of how South Africa's sectoral diversification compares to that of international REIT markets, with particular focus on South Africa's residential weighting.

Various theories have been debated with regards to investment in specific REIT sectors, specifically the four major sectors of retail, office, industrial and residential. A key issue has been the merits of portfolio diversification and an evaluation of the corresponding risk return benefits across the various property sectors. Young (2000, p.19) found that despite occasional differences in correlations between different property-type REITS, investors were unlikely to earn excess profits by skewing investments towards or away from a specific property type sector. An issue linked to this is the debate of whether or not a REITs' return/risk profile is better if focused (specialised) on one property sector as opposed to being diversified across multiple sectors. Brounen & de Koning (2012, p.197) argued that superior returns have been achieved through investment in REIT's which are focused on one specific property-type as opposed to being diversified across multiple sectors.

Until 19 June 2015, South Africa's listed property sector did not contain a single pure residential REIT, all residential assets in the sector formed part of diversified portfolios (McIver, 2014). It was unknown whether investors in the South African REIT market have a preference for exposure via a focused or diversified REIT.

Based on the above, the following questions have been formulated in response the various sub-problems identified:

1.3.1. Are local REIT managers and Investors aware of how South Africa's sectoral diversification compares to that of international REIT markets, with particular focus on South Africa's residential weighting?

1.3.2. What are the challenges cited by existing REITs and REIT investors in investing in the residential sector?

1.3.3. Is there interest from existing SA REITs and REIT investors in investing in the residential sector?

1.3.4. What are the challenges facing the establishment of residential REITs in the South African market?

1.3.5. Do existing REIT Investors have a preference for investment via a focused REIT as opposed to a mixed REIT?

1.3.6. What scale needs to be achieved in order to successfully list a residential REIT?

1.4. Hypotheses

After analysis of the relevant literature and the prominent themes and issues which emerged, the following hypotheses have been developed:

1.4.1. The reasons why the residential sector is significantly under-represented in the South African REIT market are:

(i) the level of management intensity involved with residential property is too high;

(ii) investors' perceive that there are increased risks associated with residential investments and that these risks are too high;

(iii) the limited ability to continuously escalate residential rentals and

(iv) a legal environment favouring tenants to the detriment of landlords.

1.4.2. The reason why the South African REIT market has only one pure residential offering is the perceived inability to build sufficient scale due to a shortage of available residential rental stock.

1.5. Delimitations:

This research is based on the perceptions of individuals who are currently active in the South African REIT market at a strategic level and / or who represent investors in the REIT sector. It excludes the views of private developers, representatives of private equity property funds and foreign direct investors.

The reason for the exclusion of these potential participants is time and logistical constraints.

1.6. Abbreviations

1.6.1.	USA	United States of America
1.6.2.	PUT	Property Unit Trust
1.6.3.	PLS	Property Loan Stock
1.6.4.	CISP	Collective Investment Scheme in Property
1.6.5.	SA	South Africa
1.6.6.	RDP	Reconstruction and Development Programme
1.6.7.	REIT	Real Estate Investment Trust
1.6.8.	SAREIT	South African Real Estate Investment Trust
1.6.9.	NAREIT	North American Real Estate Investment Trust
		Or National Association of Real Estate Investment Trust
1.6.10.	JSE	Johannesburg Stock Exchange
1.6.11.	MCSI	Morgan Stanley Capital International
1.6.12.	FTSE	Financial Times Stock Exchange
1.6.13.	EPRA	European Public Real Estate Association
1.6.14.	SHRA	Social Housing Regulatory Association

1.6.15. NHFC	National Housing Financial Corporation
1.6.16. DFI's	Development Finance Institutions
1.6.17. LSM	Living Standards Measure

1.7. Importance of this Study

This research is important for various reasons. Whilst the South African listed property sector has consistently been a strong performer by international standards in terms of total returns, it is clearly under-represented in the residential sector. South Africa has a unique political history and the housing shortage has been high on the political agenda since the RDP was implemented in 1994. Information on the challenges within the residential sector, and particularly the rental market, remain relevant while housing issues persist.

Little research has been undertaken on why South Africa has such a low representation of residential property in its REIT market, given that the retail and commercial sectors are now maturing and have historically performed well.

This research is important for both the public and private sectors in understanding how the South African REIT market compares internationally in terms of its residential weighting. It seeks to shed light on what the perceived challenges are with investment in the residential sector and why the first and only residential REIT was only established in June 2015. It helps to identify opportunities which may exist in the provision of certain skills and where other opportunities may exist in the REIT sector as our market continues to mature.

This research also highlights important areas for further research on related topics, all of which are important for the growth of the South African REIT market and South Africa's continued international competitiveness in listed real estate.

1.8. Summary

Whilst South African commercial and retail REITs are mature, the weighting of the residential sector is well below both developed and emerging REIT markets. There is a need to better understand why that is the case. This research seeks to identify the main challenges within the sector and with establishing a residentially focused REIT in South Africa. It also attempts to gauge the REIT markets' interest in the residential sector and investor preference for a specialised REIT offering.

CHAPTER 2: Literature Review:

2.1 A Brief Overview of REITs:

The REIT standard was established in 1960 in the US and has subsequently been adopted in 34 countries (Brounen & de Koning, 2012). REITs were established as a way for individuals to participate in investing in commercial property and as a source of capital for income-producing property owners and developers (Packer, Riddiough, & Shek, 2014).

The bust of the REIT market in the 1970s gave the entire REIT sector a bad name and created suspicion or a perception that the REIT structure was flawed and that the agents associated with REITs were conflicted and incompetent. As a result from the time of the REIT market bust until the early 1990s, REITs were stagnant with almost no growth or increased visibility (Packer, Riddiough & Shek, 2014). In the period from 1985 to 2005 the number of equity REITs in the USA grew from 37 to 152, and the equity REIT market capitalisation ballooned from $3.2 billion to over $300 billion (Anderson, Benefield, & Hurst, 2012). As at 31 December 2014 the US REIT market was comprised of 216 REITs with a combined equity market capitalisation of $907bn (NAREIT, 2015). The Netherlands were the first to adopt the REIT standard (1969) following its success in the US. Belgium and Greece were the only other 2 countries in Europe to adopt the REIT standard before the year 2000. Australia was an early adopter of the REIT standard and has a well developed REIT sector comprising 66 REITs (Brounen & de Koning, 2012). Asia and most European countries have only adopted the REIT standard since the turn of the century (Brounen & de Koning, 2012).

According to Packer, Riddiough, & Shek (2014 p.8) the key rules governing a REIT are that:

- the REIT distribute the majority (at least 90 percent) of its net income to shareholders;
- it operates as a mono-line company in terms of owning only equity or debt interests in real property,
- the ownership of traded shares in the company cannot exceed concentration thresholds, and

- the firm does not operate as a broker-dealer in terms of buying and selling real estate interests too frequently.

The dividend payout requirement detailed above is arguabley the most important rule governing a REIT. This restriction forces firms to distribute the majority of available cashflow as dividends to shareholders and as such REITs can be characterized as cash constrained relative to exchange-listed industrial corporations which do not have any formal obligation to distribute available cash flow to shareholders (Packer, Riddiough, & Shek, 2014). As a result, high-growth REITs need to return to the capital markets frequently in order to raise money for new investment (Packer, Riddiough, & Shek, 2014).

The National Association of Real Estate Investment Trust describes REITs as being modelled after mutual funds and which provide investors of all types with regular income streams, diversification and long-term capital appreciation. To qualify as a REIT a company must:

- “Invest at least 75 percent of its total assets in real estate;
- Derive at least 75 percent of its gross income from rents from real property interest on mortgages financing real property or from sales of real estate;
- Pay at least 90 percent of its taxable income in the form of shareholder dividends each year;
- Be an entity that is taxable as a corporation;
- Be managed by a board of directors or trustees;
- Have a minimum of 100 shareholders;
- Have no more than 50 percent of its shares held by five or fewer individuals”. (NAREIT, 2015).

REITs allow investors to reap the benefits of owning property as an asset class without directly owning and managing property.

2.2 Differences across international REITS

As with US REITs, European and Asian REITs are subject to strict dividend payout requirements. However, unlike US REITs, REITs in many other countries are limited in the amount of financial leverage they can use (Packer, Riddiough, & Shek, 2014). Such limitations are normally in the region of 60 percent. The proportional requirements of total investment which must be invested in real estate, is fairly similar across most jurisdictions (Packer, Riddiough, & Shek, 2014). The management structure and specifically internal verse external management differs across jurisdictions. In the US, regulations changed in 1986 resulting in many US REITS converting to an internal management structure. The effective result of this is that internally managed REITs became going concerns, as opposed to externally managed static pooled asset funds (Packer, Riddiough, & Shek, 2014). Whilst the US, Europe and Australia are similar in this regard, most of Asia has adopted the external management structure model. Packer, Riddiough, & Shek cites Deng, Hu and Srinivasan (2011) that externally managed REITs qualify for more favourable loan contract terms and softer collateral requirements than internally managed REITs. This suggests that external REITs are viewed as being more transparent and subject to fewer bondholder-manager conflicts than internally managed REITs (Packer, Riddiough, & Shek, 2014)

Another distinguishing feature of US REITs relative to other continental REITs, particularly European REITs (with the exclusion of the UK) is their high level of institutional holdings, however most Asian REITs also share this feature (Packer, Riddiough, & Shek, 2014). The institutional holdings in Asian countries ranges from 30% in South Korea to 40% in Hong Kong and Singapore to around 60% in Japan. French and Belgian REITs have institutional ownership of 25-30%, while Germany is very low with less than 10% (Packer, Riddiough, & Shek, 2014).

Another difference across REITS internationally is in terms of the pricing of Initial Public Offerings (IPO’s). IPOs of REITs in Europe and the United States have been substantially underpriced relative to those in the Asia-Pacific. Chan, Chen, & Wang, (2012 p.7) argue that the reason for the difference in pricing is that European and US REIT Markets are internally managed and more operational in nature, while Asian REITs are externally managed and fund-like in nature. However, there does not appear to be a relationship between the underpricing of REIT IPOs and institutional holdings of REITs.

2.3 REITs in South Africa

Before defining a South African REIT, it is necessary to describe the other types of property investment vehicles available in the South African market and which were the only options prior to the introduction of the REIT Structure. The previous types of property investment vehicles were Property Unit Trusts (PUTs) and Property Loan Stocks (PLS) which are described below.

Property Unit Trusts (also known as Collective Investment Schemes in Property - CISP):

- A PUT is a portfolio of investment properties held in the form of a trust;
- Each portfolio's participatory interests are administered by a manager (almost always an external manager). Management responsibilities include day to day operation of properties and leases and the investment strategy of the trust;
- Value is generated through rental income and the capital appreciation in the value of these properties over time;
- PUTs are governed by the Collective Investment Schemes Control Act. These regulations only deal with trusts and not companies. (Financial Services Board, 2015)

Property Loan Stocks (PLS):

- A PLS derives income from holding a property portfolio;
- It differs from a typical PUT or CISP in that it is a company;
- Management activities are performed internally;
- PLS's are geared at a debt to equity ratio considerably higher than that allowed for CISP's;
- A PLS is governed by the companies Act & JSE regulations. (Johannesburg Stock Exchange, 2010).

These differing structures are problematic in that they are treated differently in terms of tax, have different regulatory bodies and their structure is inconsistent with international REIT structures and therefore unfamiliar to foreign investors.

The South African REIT Association describes a South African REIT as a listed property investment vehicle which is similar to internationally recognised REIT structures from around the world (as described above) (SA REIT Association, 2015). South Africa has two different types of REITs, listed Company REITs and Trust REITs.

Company REITS:

- Shareholders are active participants in a Company REIT. They are protected by the Companies Act and Takeovers Regulations Panel. Shareholders have the ability to vote on specific issues in a general meeting;
- The REIT structure is recorded in the companies memorandum of incorporation;
- The directors of the company are responsible for its compliance with the listing requirements of the JSE's as well as the Companies Act;
- Company REITs can have both external or internal management and/or property administration. (SA REIT Association, 2015)

Trust REIT:

- An existing PUT will become a SA REIT upon application to the JSE, once it has complied with the JSE Listing Requirements and once it is registered with the Registrar of Collective Investment Schemes;
- Investors' interests are protected by a trust deed and the trustee. The trustees role is to make sure that the Trust REIT complies with the Collective Investment Schemes Control Act (CISCA) in addition to safeguarding the investors' assets;
- A Trust REIT must meet all the JSE listing requirements however it is not subject to the Takeovers Regulations;
- A Trust REITs' Trustee must report to the Registrar and must meet all the requirements of the CISCA;
- A Trust REIT needs to have an external asset and property manager in terms of the CISCA. (SA REIT Association, 2015).

A JSE-listed SA REIT must adhere to the following:

- "own at least R300 million of property;
- keep its debt below 60% of its gross asset value;
- earn 75% of its income from rental or from property owned or investment income from indirect property ownership;
- have a committee to monitor risk;
- not enter into derivative instruments that are not in the ordinary course of business;
- pay at least 75% of its taxable earnings available for distribution to its investors each year" (SA REIT Association, 2015)

PLS and PUTs were able to adopt the REIT regulatory framework set out by the Johannesburg Stock Exchange (JSE) effective from 01 May 2013 (SA REIT Association, 2012).

2.4 SA Listed Property Performance snapshot

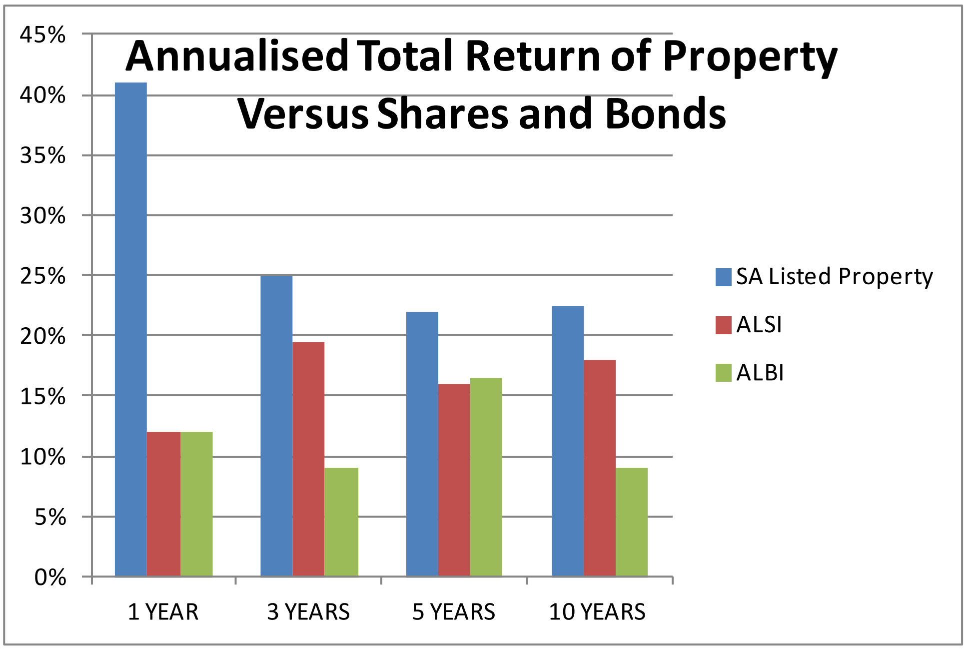

Figure 1 SA annualised property return comparison (Mowlana & Plaut, 2015 p.2)

The decade 2005-2014 has been a very good one for listed property investors in South Africa as can be seen in the above graph which reflects the total return of the property sector compared to shares and bonds over various time periods (Mowlana & Plaut, 2015).

Looking back over the decade from 2005 to 2014, interest rates have declined and stayed low under a very accommodative monetary policy in developed countries and property management teams have been able to add value to their portfolios. On top of this, the resulting tailwind to valuations has allowed listed property companies in South Africa to benefit from earnings-enhancing acquisitions in South Africa and overseas. The return on any investment can be usefully broken down into a sum of the initial dividend yield, the growth in dividends, and the change in rating, or 're-valuation', over time (Mowlana & Plaut, 2015). For clarification, the dividend yield is the latest dividend, divided by the price of the investment. As the price goes up the dividend yield falls, so a lower dividend yield implies a more expensive share. When the dividend yield changes in this way, it is called a 're-valuation': the market changes its mind about how much a rand of dividends is worth. With that being said, the 22% total annual return from listed property in South Africa over the last decade can be broken down into 8.7% from the initial dividend yield, 7.6% from dividend growth and 5.9% from re-valuation (Mowlana & Plaut, 2015). As can be seen in the above graph, SA listed property has outperformed both JSE equities and bonds over the decade 2005-2014 in terms of total annualised returns.

2.5 Residential REITs in a Global Context:

The global REIT sector has grown substantially and is recorded as having a global market capitalisation of $6,100.8bn at 31 December 2014 (Adefuye, 2015). In terms of global sector weighting, South Africa contributes 1.4% towards total retail market capitalisation, 0.5% towards total commercial market capitalisation, 0.8% towards total industrial market capitalisation and ~0% towards total residential market capitalisation. The USA is the largest contributor towards the total global residential market capitalisation, comprising 52.6% of the sector (MSCI, 2014). The residential sector makes up 13% of the total listed US property sector compared to South Africa where it represents only 1.6% (McIver, 2014).

The US market is a developed market which has a diverse and established listed property sector, however there is evidence to support listed residential property playing a significant role in less developed emerging markets.

The sectoral weightings of various global indices are shown in the following figures;

- Figure 2: MCSI (Morgan Stanley Capital International) Global Property Index
- Figure 3: FTSE (Financial Times Stock Exchange), EPRA (Eurpean Public Real Estate Association) and NAREIT (North American Real Estate Investment Trust) Developed index
- Figure 4: FTSE, EPRA and NAREIT Emerging Index
- Figure 6: FTSE, EPRA and NAREIT EMEA (Emerging European Middle East and African) Index

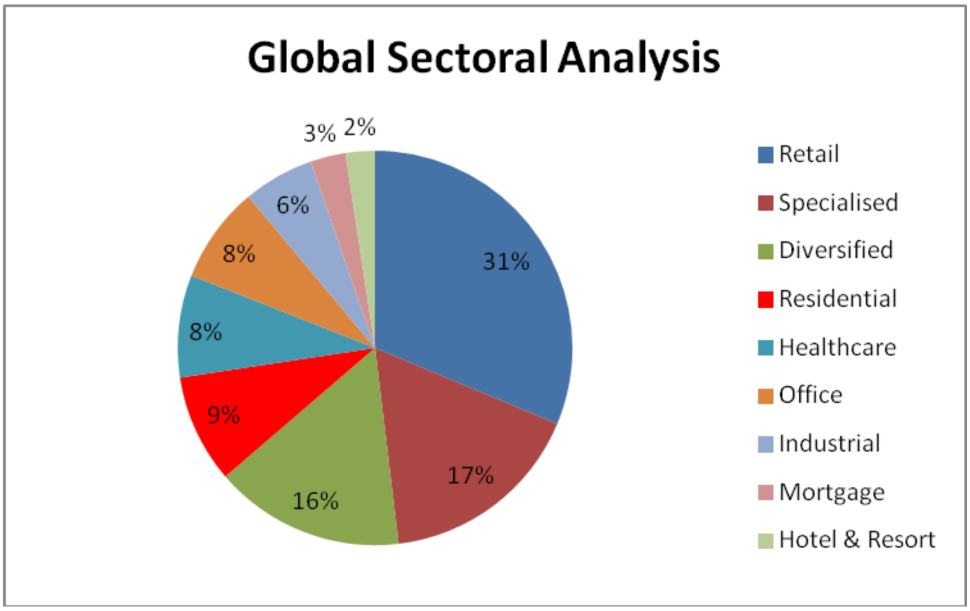

Figure 2 MCSI Global Index (McIver, 2014 p.3

As can be see in the above sectoral analysis of the MCSI global property index, the residential sector comprises 9% of the index whilst retail is the predominant sector.

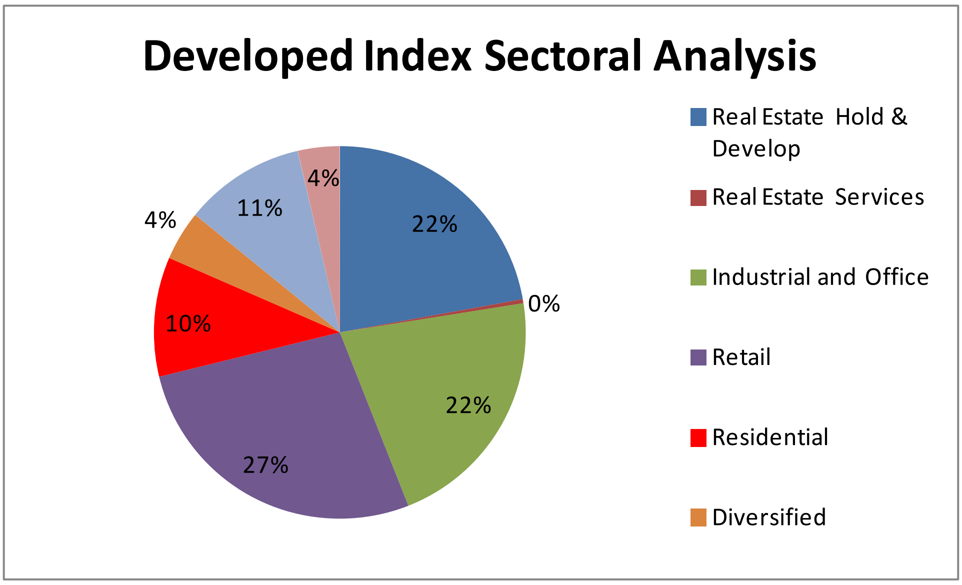

Figure 3 FTSE EPRA/NAREIT Developed Index (McIver, 2014 p.3)

The FTSE, EPRA, NAREIT developed index illustrates the residential sector accounts for ~10% of the index while retail again is the predominant sector.

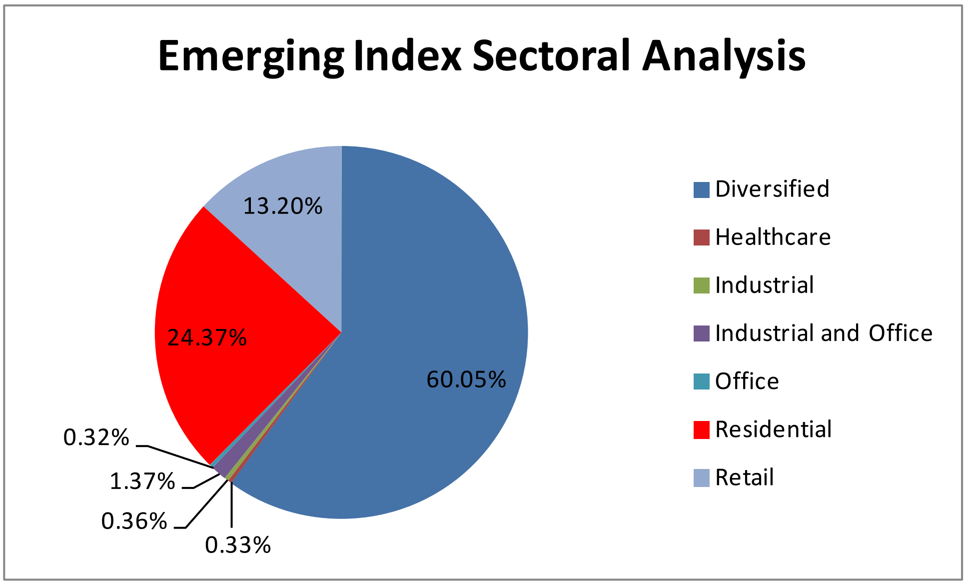

Figure 4: FTSE EPRA/NAREIT Emerging Index (McIver, 2014 p.4)

The FTSE, EPRA, NAREIT emerging index shows that the residential sector comprises 25% of the index, which is significantly higher than the developed index on a relative sectoral weighting basis. The emerging index is obviously much smaller in terms of scale.

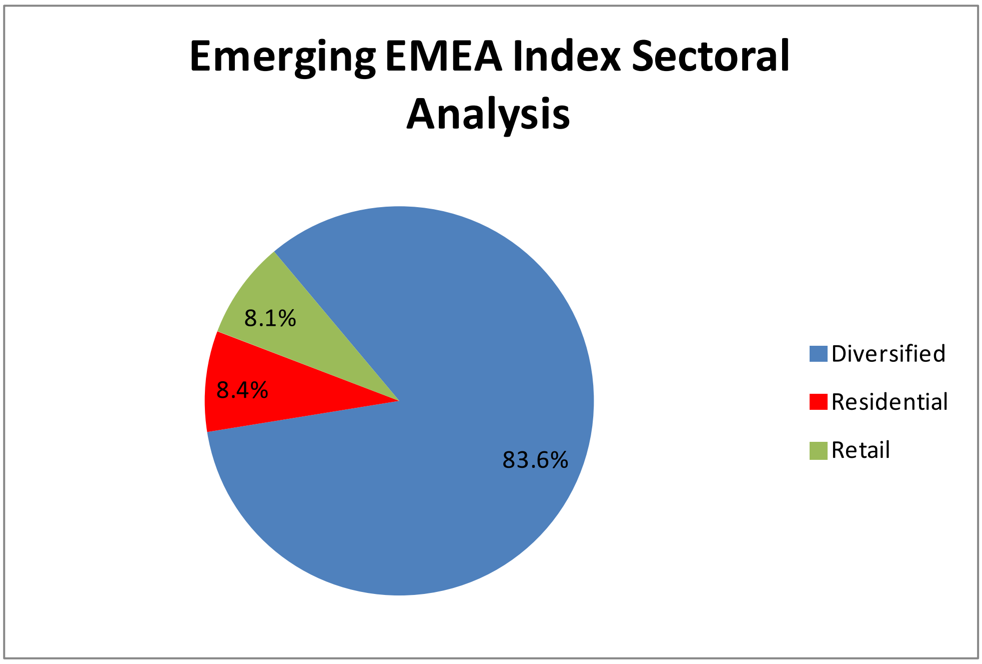

Figure 5: FTSE EPRA NAREIT Emerging EMEA Index (McIver, 2014 p.4)

The FTSE, EPRA, NAREIT EMEA Emerging Index illustrates that the residential sector comprises ~8% of the index. The bulk of the index is dominated by diversified property, followed by the retail sector.

Country	MSCI	DM	EM	EM EMEA
Australia	10.38%	6.75%		
Austria		0.20%		
Belgium & Lux		0.48%		
Brazil			11.90%	
Canada		3.64%		
Chile			0.69%	
China			28.71%	
Czech Rep			0.03%	0.10%
Egypt			0.18%	0.63%
Finland		0.23%		
France	5.96%	1.35%		
Germany		1.70%		
Greece		0.02%		
Hong Kong		8.05%		
India			1.70%	
Indonesia			5.48%	
Israel		0.11%		
Italy		0.09%		
Japan	4.10%	12.23%		
Malaysia			6.17%	
Mexico			5.12%	
Netherlands		3.05%		
New Zealand		0.09%		
Norway		0.06%		
Philippines			6.93%	
Poland			1.15%	4.06%
Russia			3.78%	13.34%
South Africa			11.86%	41.11%
Singapore		4.02%		
Spain		0.14%		
Sweden		1.12%		
Switzerland		0.97%		
Taiwan			0.14%	
Thailand			4.80%	
Turkey			2.13%	7.52%
UAE			9.43%	33.24%
UK	6.03%	6.30%		
USA	68.92%	49.40%		
Other	4.61%			
	100%	100%	100%	100.00%

Figure 6 Indices composition breakdown (McIver, 2014 p.4)

Figure 6 shows the country contribution weighting of the various indices. As can be seen in the EM EMEA composition breakdown, South Africa and the UAE together makes-up approximately 75% of the Index.

2.6 The South African Residential Property Market

A housing shortage is one of the most significant challenges that South Africa has faced since the abolition of Apartheid. Since 1994, the government has undertaken to improve the provision of formal housing and have employed a number of strategies to this regard. Probably the most recognizable initiative to the housing crisis is the Reconstruction and Development Programme ("RDP") implemented post 1994 by the ANC government. The original RDP document stated the following: "The lack of adequate housing and basic services in urban townships and rural settlements today has reached crisis proportions. The urban housing backlog in 1990 was conservatively estimated at 1.3 million units. Including hostels and rural areas, the backlog rises to approximately three million units. Added to this should be an estimated 200,000 new households each year" (SA History Organisation, 1994). "The housing problems created by apartheid and by the limited range of the capitalist housing markets have been aggravated by the absence of a coherent national housing policy" (SA History Organisation, 1994).

A large number of heavily government subsidized RDP houses have been built since 1994 however this initiative has its limitations. In an effort to include the private and non-profit sector into housing solutions, the Social Housing Regulatory Authority ("SHRA") was established in August 2010 by the Minister of Human Settlements in terms of the Social Housing Act (Mclver, 2014). SHRA is intended to regulate and invest in order to deliver affordable rental homes and renew communities. Social housing allows private companies and non-profit organizations to access government housing subsidies, government land and preferential finance to develop low income rental stock. To qualify rentals need to be capped to pre-defined levels and tenants need to earn below a defined income threshold of R1500 to R7500 per month income (Mclver, 2014).

Two well-known organizations that have social housing portfolios are:

1. Johannesburg Housing Company (approximately 4000 units in 33 properties in the Johannesburg CBD).

2. Communicare (approximately 3600 rental units in the Western Cape)

The higher-end residential properties are often either owner occupied or owned by private investors on a buy-to-let basis. Higher income earners have access to affordable bank finance allowing owners to highly leverage property purchases. Rental returns on higher end properties are often quite modest and often falling well short of total monthly costs (servicing debt, bond repayments & levies etc.) however capital returns can be good (McIver, 2014). In this market, property developers build to sell rather than to let, preferring to recycle their capital back into the next development.

Placed between the government subsidised lower income housing and the more formal higher income residential market is a segment of the market who earn too much to qualify for government subsidies but too little to gain access to bank finance. This market is often referred to the “GAP” housing market (McIver, 2014).

The government has made efforts to stimulate the GAP housing market by trying to give people in this segment of the market access to finance as well as supporting developers to provide much needed supply of suitable housing stock. The National Housing Finance Corporation (“NHFC”) is one of several Development Finance Institutions (DFIs) created by the South African Government to sustainably improve on the socio-economic challenges of the country and plays a pivotal role in the development of GAP housing. Due to the availability and high price of land, GAP housing developments are often located on the outskirts of urban centres and thus residents have long and expensive commutes to where there is available work (McIver, 2014).

Of the residential property in the listed property sector, most of it caters to the GAP market. Furthermore these portfolios have the advantage of being located in urban centres and have been built up by entrepreneurs over many years. Two recognized residential portfolios or portions thereof have recently been acquired by listed entities:

1. Afco Holdings founded in 1996
2. Jika Properties founded in 2005

The data below from Afco illustrates how the majority of their tenants are in the LSM 6 and LSM 7 segments, thus supporting the assumption that they cater mostly to the GAP market. The SAARF LSM (Living Standards Measure) has become the most widely used marketing research tool in Southern Africa. It divides the population into

10 LSM groups, 10 (highest) to 1 (lowest). The SAARF LSM is a unique means of segmenting the South African market in that it cuts across race and other outmoded techniques of categorising people, and rather groups people according to their living standards using criteria such as degree of urbanisation, ownership of cars and ownership of major appliances.

	% of Population	Ave. Household income R/month	% AFCO Tenants
LSM 1	1.40%	1480	0.00%
LSM 2	3.60%	2216	0.11%
LSM 3	5.90%	2581	0.17%
LSM 4	11.70%	3178	0.78%
LSM 5	16.90%	4310	8.41%
LSM 6	23.80%	6669	25.13%
LSM 7 low	6.20%	10069	24.35%
LSM 7 High	5.90%	12895	
LSM 8 Low	4.50%	15590	15.43%
LSM 8 High	4.20%	16396	
LSM 9 Low	4.90%	20307	15.21%
LSM 9 High	4.90%	25295	
LSM 10 Low	3.40%	32451	10.42%
LSM 10 High	2.70%	40695	

Figure 7 SA LSM (McIver, 2014 p.6)

Much of the rental stock developed by these companies took advantage of the decline in both the Johannesburg and Pretoria CBD's where buildings were available at low prices. Furthermore, alternative funding models were often used taking advantage of impact investment finance (such as that provided to Jika by Futuregrowth). Impact funds provide funding with a longer investment horizon and which seek to create not only economic value but social value as well (McIver, 2014).

2.7 Residential REITS in a South African Context

Residential property currently plays a very small part in South Africa's listed property sector (Broll, 2014). Until 19 June 2015 when the first residential REIT, Indluplace, successfully listed on the JSE; all residential assets in the sector formed part of diversified portfolio's (McIver, 2014). Listed property in emerging markets typically have a 15% residential weighting by value as opposed to South Africa which has a

1% weighting (Broll, 2014). This corresponds broadly with a Business Day Report which reported that only 2% of investment-grade residential property in SA is listed, whereas about 14% of developed markets and 15% of developing markets' residential properties are listed (Anderson, 2014). The report also notes that there is more investment-grade residential stock available now than 10 years ago when a residential-focused property fund, Habitat, attempted to list. Habitat ultimately found it difficult to accumulate sufficient residential stock necessary to justify a listing (Anderson, 2014).

According to McIver (2014, p.2), the six counters which have residential properties in their portfolios are the following:

- Growthpoint Properties
- Fortress Income Fund
- SA Corporate Real Estate Fund
- Arrowhead Properties
- Premium Properties
- Octodec Investments

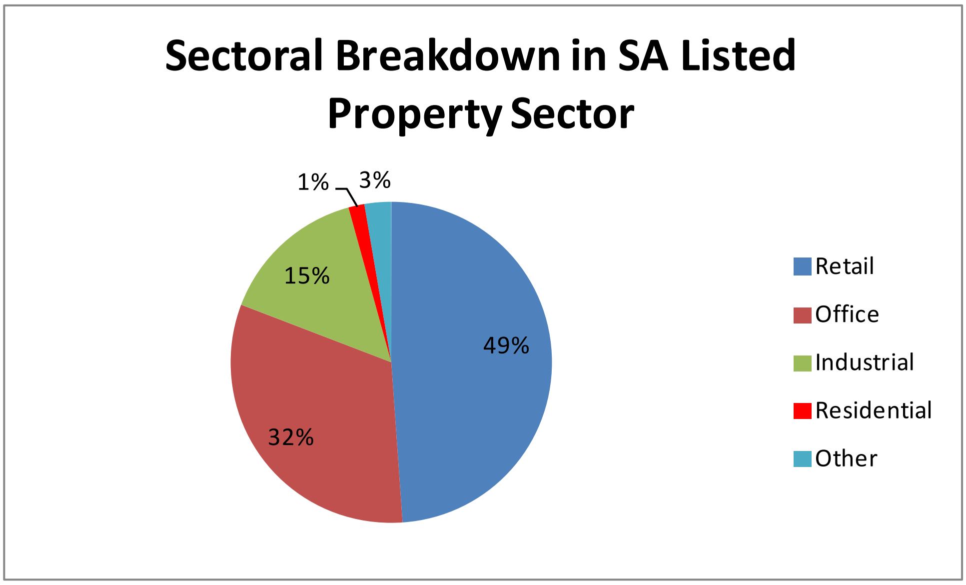

Figure 8 SA property sectoral breakdown (McIver, 2014 p.2)

However there is increasing evidence that the listed funds may diversify into this asset class more in the future. South Africas's largest REIT, Growthpoint, is currently experimenting with residential investment through its 50% ownership of the V&A waterfront which has substantial residential bulk available (Mclver, 2014). This could result in the development of over 100 000m² of residential bulk by 2023 (Economic Information Systems, 2012). This would offer increased exposure through Growthpoint's already diversified fund. Several of South Africa's listed funds have diversified their portfolios to include residential property, namely:

- Premium Properties (30% residential exposure);
- Growthpoint Properties (43 residential properties) and
- Arrowhead Properties who purchased a residential property portfolio for R406 million (Broll, 2014).

In 2014 Anderson (2014) reported that there was evidence to suggest that there was increased interest in the establishment of a residential REIT in the South African market. This was based on the fact that Arrowhead Properties, a Johannesburg Stock Exchange (JSE) listed property fund planned to list the first purely residential-focused REIT as it hoped to cater to pent-up demand for specialised property funds. "Arrowhead has built up a residential portfolio worth about R550m over the past year which is owned by its Arrowhead Residential subsidiary. Arrowhead Properties has indicated that when the portfolio is big enough, they would like to list Arrowhead Residential as a separate REIT (Anderson, 2014). Muller (2015) reported that the JSE's first pure residential real estate investment trust, IndluPlace Properties, was listed on the JSE in June 2015. The share price of the Arrowhead Properties spin-off rallied 11,25% in the first week after listing on June 19 2015. IndluPlace owns a R1,6bn portfolio comprising 3600 flats let mainly to lower income earners and students at below R4500/month (Muller, 2015)

Prior to the listing of Indluplace, Premium Properties, now merged with sister fund Octodec Investments, was the only stock among the JSE's 40-odd real estate counters to offer REIT investors with part exposure to the residential rental market. The listing of a pure rental housing fund has been a long time coming with Arrowhead CE, Gerald Leissner, first trying (unsuccessfully) to bring a pure housing play to the JSE in 2012 which didn't materialise (Muller, 2015). The reason cited for the failure of a pure residential listing at the time was the inability to gather the scale necessary to get the support of institutional investors. The general view was also that the risks associated with the affordable housing market such as tenant delinquencies and onerous housing legislation outweighed the potential returns. However, given the strong trading activity since IndluPlace's listing, coupled with the fact that the prelisting capital raising of R400m was considerably oversubscribed, it appears the market has become more comfortable with housing as an asset class (Muller, 2015).

Stanlib, which is the largest institutional investor in SA's listed property space, has a shareholding of around 8% in IndluPlace. Their head of listed property funds, Keillen Ndlovu, had the following to say: "We like the residential story. Unlike the retail, office and industrial sectors, the affordable housing market still offers huge room for growth as well as diversification, strong and growing tenant demand, low vacancies and low arrears" (Muller, 2015). IndluPlace listed at a forward yield of 8,2% which offered a premium to the sector's average of a 6,5% yield. Muller (2015 p.2) goes on further to report that income-dependent investors are looking for something new and fresh given that traditional retail, office and industrial sectors are reaching maturity. However, some analysts have expressed concerns that the IndluPlace portfolio does not have the necessary scale to appeal to everyone's interest.

The Indluplace counter is 70% held by Arrowhead, which has implications for liquidity and tradability (Muller, 2015). JSE-listed SA Corporate Real Estate Fund, which already owns a R1,3bn portfolio of rental flats (~ 4500 units) in Johannesburg's inner city, plans to separately list its housing interests once its residential portfolio has doubled in size to approximately R3bn (Muller, 2015).

Reynolds (2015, p.21) also notes that for many years listed funds have focused primarily on commercial, industrial and retail premises however lately residential properties have been enjoying a return to favour. There has been further evidence of the growth in appeal of residential property as part of any property investment portfolio through Redefine's acquisition of a 51% stake in student accommodation company ResPublica (Reynolds, 2015). Reynolds (2015, p.21) goes on to note that residential property is being recognised as a rentable commodity by South African listed property and that South Africa's listed property sector is only now starting to catch-up with global listed property in terms of residential property forming a core component of the sector (Reynolds, 2015).

2.8 Focused versus Diversified REITs

There has been a substantial amount of research interrogating the merits of diversified REITS and specialised REITS. Boer, Brounen, & Optveld (2005, p.275) compared the average performance of international top specialists listed property funds with the performance of their most diversified competitors. Their study revealed a pattern in the risk-adjusted stock out-performances, which is stronger for the most specialized clusters of companies in each sample. Their study found that specialized property companies tend to be associated with both the highest historic outperformance and the highest firm-specific risk (Boer, Brounen, & Optveld, 2005).

Brounen & de Koning (2012, p. 214) look at the importance of investment strategies within REIT portfolios by measuring the level of property-type (retail, office, industrial and residential) diversification amongst other measures. Their analysis includes data from 210 REITS from Asia, Europe and North America and the time series is spread from 1990 to 2010. The results are in line with Boer *et al.* (2005) and indicate that managing a REIT portfolio that is scattered over different types of real estate destroys value (Brounen & de Koning, 2012). Their research concludes that specialised REITS offer the highest stock out-performance.

Chong, Krystalogianni, & Stevenson (2012, p.1091) highlights that the arguments in favour of a focused strategy are that those REIT managers should have a superior understanding of specialist markets and sectors. Chong et al (2012) cites Benefield et al (2009) who note that any benefits to a REIT achieved through diversification may be offset due to the additional costs incurred in pursuing such a strategy. Ro and Ziobrowski (2011) researched if there are any benefits in following a focused versus diversified strategy and ensured that the research was undertaken on an equally weighted basis. They controlled for differences in the property sectors which the diversified and focused REITs invest in and controlled for possible differences in capital structure. Their findings are that focused REITS do not out-perform diversified REITs by any statistical significance nor is their evidence that the converse is true (Ro & Ziobrowski, 2011).

Young (2000, p.19) reports that the correlation between property-type focused REITS increased during the period 1993-1998 and that investors would be better off adopting a property-type neutral investment strategy. Chong et al (2012) notes that it appears that the REIT sector is behaving more homogenously than previously and that the differences in the performance of subsectors is increasingly of a relative rather than absolute nature. Their research considers the time varying nature of the correlation between specialist REIT sectors over the period 1990 through 2008. The findings of Chong et al (2012) do imply that the sector has become more homogenous over the last two decades. However, the report emphasises that the argument in favour of focus is based on the view that monetary gains from diversification are largely offset by increased costs remains (Chong, Krystalogianni, & Stevenson, 2012). There remains debate as to whether a focused REIT is advantageous from a returns perspective and if investor preference exists.

2.9 Conditions for the introduction of residential REITS:

It is necessary to understand why residential REITS are popular in some markets like the US but have yet to be established in other such as South Africa. Jones (2007, p.385) researched the challenges facing the introduction of residential REITs into new markets. The research looked at the successful case of the US REIT market and the unsuccessful case of the Australian REIT market through which it attempts to infer those challenges applicable to the introduction of residential REITs to the United Kingdom. Jones (2007, p.386) notes that the existence of successful REITs (non-residential) in a country does not necessarily mean that they will be harnessed for residential investment whilst citing the return profile of other property sectors relative to the residential sector as a key determinant. Newell et al (2009, p.133) found that for the US residential REIT market, residential REITs showed lower risk adjusted returns than other property subsectors but outperformed stocks over the 14 year period of 1994-2007. Their research highlights that there has been increased institutional investor interest in residential REITs with an optimistic outlook for the supply and demand side for apartments, particularly in the context of concerns for the other property subsectors (office, retail and industrial) (Newell & Fischer, 2009).

The demand side in the South African context is strong. Due to massive urbanisation (expected to reach 70% by 2030), the housing backlog in South Africa is increasing (PWC Africa Real Estate, 2015). “Demand for affordable housing continues to outstrip supply for low- and middle-income families. In 2012, the housing backlog was estimated at 2.1 million units. By 2014, the backlog stood at 2.3 million units, a figure that is estimated to grow by 178 000 units each year. Since 1994, the government has been able to provide 2.68 million units” (PWC Africa Real Estate, 2015 p.32).

Furthermore, in South Africa the Living Standard Measure (LSM) 6 and LSM 7 segment of the market earn between ZAR6500 and ZAR13000 and account for over 30% of income earning households in South Africa, all of whom dont qualify for a housing subsidy yet can't afford to buy (McIver, 2014).

However a high demand and insufficient supply environment, resulting in a flourishing private rental sector are not sufficient conditions for the establishment of a residential REIT (Jones, 2007). This is illustrated through the fact that in both the US and Australia, private rental sectors represent over a fifth of the housing sector yet investor demand is significantly less in Australia (Jones, 2007).

The research points to supply side implications and the need for the existence of large commercial owners (as in the case of the US) as opposed to numerous private landlords (as in the case of Australia) (Jones, 2007). Jones (2007, p.395) also provides argument that in order to attract large-scale landlords such as REITS, investors require local rented markets with depth and which are established.

2.10 Conclusion:

The purpose of the literature review was to canvass existing research related to the subject of REITs and specifically residential REITs. Through the literature, various themes emerged as being critical to this research, namely:

- Globally, residential REITs form a significant part of both developed and emerging REIT markets;
- South Africa is well below global developed and emerging markets in terms of residential representation in the REIT market and only one specialised residential REIT exists (as of June 2015);
- There appears to be an increased interest by the South African listed property sector in investing in residential property
- Focused verse diversified REITs has been a debated topic over the last 10 years;
- Various conditions need to exist for the successful introduction of residential REITs, which conditions vary for the two different markets on which there is existing research.

The literature review confirms that there is a gap to better understand the challenges facing the introduction of residential REITs into new markets, and specifically in this case, the South African REIT market.

CHAPTER 3: Methodology

3.1 Overview:

The purpose of this research is to assess whether a place exists for residential REITs in the South African REIT market. The research attempts to better understand why the South African REIT market is so underrepresented in terms of residentially focused REITs and to better understand the challenges facing the establishment of residentially focused REITs in the South African REIT market. Given the nature of the research topic the research approach adopted consisted of qualitative research which is exploratory in nature and which was conducted in the form of in-depth, semi structured interviews. According to Saunders & Lewis (2012, p.152) interviews are used to either explore what is happening and to gain new insights or describe what is happening and identify general patterns.

3.2 Exploratory Research:

According to Saunders & Lewis (2012 p.110), exploratory studies aim to seek new insights, ask new questions and assess topics in a new light. Hence the method followed was a series of in-depth interviews undertaken with various industry specific professionals and investors chosen in terms of their relevance to the research question, market capitalisation and accessibility.

Adopting an in-depth interview approach was appropriate for the purpose of this research in order to develop a deeper understanding as to the following:

- Are local REIT managers and Investors aware of how South Africa's sectoral diversification compares to that of international REIT markets, with particular focus on South Africa's residential weighting?
- What are the challenges cited by existing REITs and REIT investors in investing in the residential sector?
- Is there interest from existing SA REITs and REIT investors in investing in the residential sector?
- What are the challenges facing the establishment of residential REITs in the South African market?

- Do existing REIT Investors have a preference for investment via a focused REIT as opposed to a mixed REIT?
- What scale needs to be achieved in order to successfully list a residential REIT?

The interview process was as follows:

Interview Breakdown:				
Phase	**Objectives**	**Data Collection Method**	**Sampling Technique**	**Sample Size**
Phase 1	Exploratory Research	Semi-structured Interviews	Snowball	2
Phase 2	Pilot Interviews	Semi-structured Interviews	Purposive	1
Phase 3	In depth interviews	Semi-structured Interviews	Purposive	10

Figure 9 Interview breakdown

Berry (1999, p.1) cites Patton (1987 p.113) who puts forward three basic approaches to undertaking qualitative interviewing:

3.2.1 The informal conversational interview:

The style of type of interview resembles a discussion, during which the interviewee may occasionally forget that they are being interviewed. The majority of the questions asked will flow from the immediate context. These types of informal conversational interviews are useful for exploring interesting topic/s for investigation.

3.2.2 The guided interview:

When applying this approach to interviewing, an essential checklist is prepared in order to ensure that all relevant topics are covered. This approach still allows the interviewer the freedom to explore and ask questions he or she feels interesting or relevant to the research. This interview approach is effective in eliciting information about specific topics and allows for in-depth probing whilst still permitting the interviewer to keep the interview within the parameters of the study.

3.2.3 The standardised open-ended interview

This approach requires the interviewer to prepare a set of open-ended questions which include specific wording and which are arranged for the purpose of minimising variation in the questions posed to the interviewees. As a result, this method is often preferred for collecting interviewing data when more than one researcher is involved in the data collecting process.

Saunders and Lewis (2012, p.151) notes that the semi structured interview is particularly useful where you are unsure of the answers the respondents will give, the questions are complicated or you need to vary the order of questions or the actual content of the questions asked.

With the above in mind, the most appropriate type of qualitative in-depth interviewing given the objectives of this research was the guided interview / semi structured interview. This provided the interviewer with the flexibility to explore the subject matter in significant depth whilst remaining within the pre-defined framework.

3.3 Population:

There were two separate populations of relevance to this research. The first consisted of the 26 REITs listed on the Johannesburg Stock Exchange (JSE). The objective of this research was to interview eighty percent (80%) of the REIT market by market capitalisation. The following REITs were approached:

- Growthpoint
- Redefine
- Resilient
- Fortress B
- Capital
- Hyprop
- Arrowhead

- Indluplace
- Investec Property Fund

The target interviewees were those employees of the management company which were involved in the management of the REIT at a strategic level and who influence the investment decisions of the REIT. This included non-executive and executive directors. The companies listed above represent approximately 73% of the REIT market in South Africa by market capitalisation at the time of writing this research (September 2015).

The second population consists of specialist REIT fund managers who invest in the REITs listed on the JSE and who typically have a holistic view of the sector. The following fund managers were approached:

- Coronation
- Sesfikile
- Alternative Real Estate Fund
- Afrifocus (Analyst)

3.4 Sampling Approach:

Given that the number of REITs which had a current interest or which may have had a future interest in the residential sector was unknown, nor were all the investors in the South African REIT sector known, non-probability sampling methods were adopted.

Phase 1 of the exploratory research involved snowball sampling. According to Saunders and Lewis (2012, p.139), snowball sampling is used when it is difficult to identify members of the population in question and who may be difficult to reach. Alternatively a population may include senior individuals who are difficult to reach and which snowball sampling may enable you to gain access to.

Referrals from various industry professionals provided the opportunity to interview relevant industry professional who either had an interest in the subject matter of this research or who were particularly knowledgeable about the residential sector of the industry through their professional or academic experience. Interviewing these professionals provided referrals to other useful industry specific individuals who were then approached and interviewed.

Phase 2 and 3 involves purposive sampling. According to Saunders and Lewis (2012, p.138) a researcher should adopt a purposive sampling method when using their judgement to actively choose those who will best be able to answer the research question. Purposive sampling is appropriate when a researcher needs to ascertain what is happening in order to make logical generalisations (Saunders & Lewis, 2012).

Hence purposive sampling was adopted in order to interview management at those REITs which were perceived to be particularly representative of the REIT market in terms of scale or how well appraised they were with the subject matter. Similarly, specific corporate investors were approached based their investment quantum in the REIT market or how much influence they held. The ability to reach the various target REITs and REIT investors in different geographic locations and within the time constraints available were also a factor.

Three interviews were conducted in Cape Town and seven were conducted in Johannesburg.

3.5 Data Analysis

The data obtained has been analysed inductively and categorised as themes and patterns emerged from the various interviews. Descriptive statistical analysis has been used via tables, bar charts and pie charts in order to analyse and illustrate the categorical data obtained.

3.6 Preliminary testing and interview refinement:

The exploratory research was conducted in order to gain insights into the South African REIT sector and to better ascertain the following:

- Who the key players were at the most prominent REIT counters;
- Which REITs were experimenting with increased exposure to the residential sector;
- Were there any REITs considering a Residential REIT listing
- What were the key issues / ‘hot topics’ related to the residential sector and the establishment of a Residential REIT;

- Who the major investors were in the REIT sector and who were the best people to speak who represented these investors;

3.6.1 Pilot Test

Saunders and Lewis (2012, p.158) notes that a pilot test is important in order to check that your interview and interviewing technique is likely to be understood, and importantly, will provide you with the data you require.It is also important to ensure that your recording equipment works properly and that you are able to take sufficient notes while interviewing.

Hence, the Pilot interview was conducted in order to test the content of the questions in the questionnaire as well as the order of the questions asked. It was also used in order to obtain an indicative gauge as to the likely length of the interview process based on the questionnaire, to test equipment and to practice the actual conducting of the interview.

The above two processes enabled the improvement and refinement of the interview questionnaire to help optimise my time with the various interviews who I had limited access to given their busy schedules and the logistical challenges which were present. It also assisted in familiarising myself with the interview questions and the confidence with which I could discuss the various sub-topics.

3.7 Data Collection Method:

According to Saunders & Lewis (2012, p.155) it is important to ensure that you ask questions carefully, using appropriate and unbiased language, and listen attentively to the answers given in both semi – structured and unstructured interviews.

Saunders and Lewis (2012, p.155) citing Kvale and Brinkmann (2009) identified various question types to used in interviews. These include:

- Introductory – starting a new topic;
- Probing – searching for more detail;
- Specifying – more detail on a specific topic;
- Direct – you are after information which applies directly to the participant;
- Indirect questions - you are after information which applies to others;

- Structuring – you want to indicate that questions on a specific them have been completed;
- Interpreting – used in order to check that your interpretation is correct.

The interviews for this research were conducted using face to face interviews. Saunders and Lewis (2012, p.158) recommend the following steps in conducting face to face interviews:

1. Ensure that both consent forms and interview checklists are printed;
2. Contact potential participants, explain the purpose of the research and provide a clear indication as to the likely duration of the interview;
3. Arrange a mutually convenient appointment and place to conduct the interview;
4. Arrive punctually for the interview and ensure you have everything necessary;
5. Ensure you undertake the following during the interview:
    - Thank the participant for attending;
    - Explain the purpose of the research;
    - Request permission to record the interview;
    - Request the participant to sign the consent form;
    - Remember to take notes.
6. Thank the participant for their participation;
7. Word process your notes at your earliest convenience.

There are several important characteristics of conducting in-depth interviews. These include the following:

- The questions should be open-ended so that the participants are encouraged to expand on the topic;
- The interview should be comprised of some pre-planned questions, whilst allowing for natural conversation and questions;
- Investigate for a more in-depth understanding from the participant throughout the duration of the interview;

- The interview should be conversational in style, but your role as the interviewer is that of a listener;
- Record observations which are non-verbal in nature in order to supplement and contextualise the audio tape. (Guion, 2006)

3.8 Data Analysis:

The data analysis approach is inductive in nature. Saunders and Lewis (2012, p.109) notes that with inductive reasoning, you begin with specific observations and measures and then begin to observe patterns and occurrences which are investigated to develop some general conclusions or theories.

Given the above approach, the various interviews were recorded and transcribed into printed documents. These were then analysed and interpreted in accordance to the research objectives of this study. The predominant themes which emerged were organised according to the relevant research questions. Any interesting or relevant results which emerged and which were not specific to a particular research question were noted as ‘Other Noteworthy Findings’.

3.9 Notes on the interview process:

The following points are noteworthy:

- Many of the interviews took on their own organic structure once the initial discussion was initiated. In multiple cases the respondent dived into their perspective on many of the issues without prompting;
- All but one of the interviewees were comfortable with the interview being recorded;
- All interviewees were very generous with their time and the knowledge which they had on the subject matter;
- It was very useful to have a questionnaire template with which to take down notes as and when the various sub-topics came up;
- It was critical to have a back-up recording device as technology and unpredictable external factors impacted on the recordings.

CHAPTER 4: Research Findings:

4.1 Introduction:

This chapter presents the key themes and responses which emerged following the semi structured interviews which were undertaken with interviewees representing the nine REITs and the four fund managers. In all interviews, the interviewees' general perception of the level of existing diversity within the REIT sector was obtained before probing into the residential sector specifically. An inductive research approach was undertaken.

4.2 Overview of REITs and investment professionals interviewed:

Figure 10 below presents a breakdown of the various REITs in terms of their approximate market capitalisation, investment focus and exposure to residential property.

COMPANY BREAKDOWN			
Company	**Portfolio Description**	**Residential Exposure**	**Market Capitalisation**
A	Diversified	Yes	R 76 000 000 000
B	Diversified	Yes	R 54 500 000 000
C	Diversified	No	R 38 000 000 000
D	Retail	No	R 31 000 000 000
E	Diversified	No	R 26 000 000 000
F	Diversified	Yes	R 22 000 000 000
G	Diversified	No	R 16 000 000 000
H	Diversified	No	R 8 000 000 000
I	Residential	Yes	R 1 600 000 000

Figure 10 Participating REITs characteristics breakdown

Figure 11 presents a breakdown of the REIT investment funds which the interviewees represented in terms of the approximate size of the funds and if they had exposure via their current REIT investment.

Company	Investment Size	Residential Exposure
J	R 14 000 000 000	Yes
K	R 3 000 000 000	Yes
L	R 642 000 000	Yes
M	N/A	N/A

Figure 11 REIT investment funds breakdown

Figure 12 presents a breakdown of the title of the interviewee representing the various REITs and REIT investment funds: ("*House View" refers to three funds with common/overlapping management.)

INTERVIEW INFORMATION BREAKDOWN			
Company	**Interviewee**	**Location**	
A	Director	JHB	
B	Manager	CPT	
C	MD	JHB *	* House View
D	Director	JHB	
E	MD	JHB *	
F	MD	JHB *	
G	CEO	JHB	
H	COO	JHB	
I	COO	JHB	
J	Fund Manager	JHB	
K	Fund Manager	CPT	
L	Fund Manager	JHB	
M	Analyst	CPT	

Figure 12 Interviewee details

4.3 Research Question 1:

Are local REIT managers and Investors aware of how South Africa's sectoral diversification compares to that of international REIT markets, with particular focus on South Africa's residential weighting?

4.3.1 Response from REIT Managers:

Company A

Company A commented that there was very little differentiation:

"A lot of your European countries aren't nearly as sophisticated in terms of REITs and listed property as we are. With the exception of most probably Hyprop, there hasn't really been a differentiation. So the only difference really is in terms of size but not assets". ".. There really is very little, from an asset class point of view very little differentiation."

Company A noted that South Africa is underweighted in residential assets compared to the United States, Australia, Canada and the United Kingdom and cited scale issues:

"South Africa and Australia, America and Canada, you know, those are major players in the REITs space. Our problem when you talk about product differentiation and you're talking about residential, is that part of the problem is that if you today list with a market cap of less than five billion, you're just setting yourself up to be taken out"

Company B

The interviewee had international experience and was aware of South Africa's relative standing:

"I worked overseas, in the States for a long time, I worked there for ten years, so I'm very aware of what they call in the States, multi-family, which is the residential market there, which is a very, very large component of the investment cycle in the States."

"Compared to international markets, I would say we are well, well below the kerb. I mean, I think we only have one or two listed funds that have substantial residential exposure."

Company C, E & F

The 'house view' from Company C, E & F was that they were very aware of how the South African market faired relative to international markets:

"If you compare us to say the Americans and the Europeans, and I spend a lot of time going to the NAREIT Conferences or the Kempton Conferences, no, we're still early, very, very early in the REIT structure type of business"

They commented on the market capitalisation of the South African REIT sector as a percentage of the total stock exchange market capitalisation:

".. if you take a look at REITs as a percentage of the market, I think we represent about five percent of the total listed value of stocks. In a lot of the developed markets, that figure is as much as ten percent."

The company representative indentified new sectors which are likely to become more established, including residential REITs:

“..there is still place for probably medical REITS to come in, yes, residential REITs will come in, there’s probably an opportunity for funding type of REITs as well. So it is still early days, but you’ll see more and more of these types of things coming into the market.” “We’ve got small residential stuff.. it’s very, very new in our country. “But residential in South Africa is different to a lot of the residential offshore markets.”

Company D

Company D noted the need for other specialised REIT offerings in the South African market:

“The Office, Retail and Industrial sectors are well developed.”

In terms of our residential weighting, the US, Europe and Australia were noted as having a heavier weighting and a lack of demand and scale in South Africa was cited as the reason for our lower weighting.

Company G

Company G mentioned the following in terms of the South African REIT market relative to global markets:

“When you’re looking at Europe and you’re looking at US and you’ve got office, retail, industrial focus, storage REITs, healthcare REITs, residential REITs, and within residential your various categories. The South African market doesn’t have the depth or size to offer that type of specialisation”

In terms of our specific residential weighting, Company F offered the following:

“I think it’s less than two percent in South Africa, around about two. It’s a lot bigger weighting in the US and it’s a lot bigger weighting in Europe and other developed countries.”

“I think it’s been a function that the institutional investor base didn’t really understand, the asset class, and there were no real investors, or let’s call it promoters who had pursued the asset class and for a long time the economics didn’t make sense in terms of yield.”

Company H & I

The interviewee was aware of South Africa's status relative to other global REIT markets, particularly the US:

"The residential sector before we got involved was probably only represented by Octodec and it was probably around one percent of the sector. Our competitors and ourselves have doubled it, probably to two percent. It's nowhere. I mean it's tiny. And we expect to see that growing, and we can see that from all the interest from the guys in the listed space."

"We foresee it becoming a major part of the listed sector. I think it's roughly ten to fifteen percent in North America, and North America is considered the most developed biggest market, REIT market. And we see no reason why it shouldn't become that big here."

4.3.2 Response from REIT Investment Funds:

Company J

The interviewee was acutely aware of the South African market and it's residential weighting relative to other global markets:

"The SA market sectoral breakdown is as follows: 52% retail, 30% Office, 12-15% industrial and the balance hotel/residential and hospital. Investors can only gain access to these sectors via diversified REITS for the most part. The global emerging and developed markets have much more diversity and specialisation. SA's residential weighting is roughly 1.5% of the market. The residential weighting in the US and Asia is much higher."

Company K

The interviewee noted the following:

Minimal specialisation exists in the South African market due the inability to obtain critical mass and the limited ability scale new sectors. The challenges experienced by those trying to launch a self-storage fund is an example of how it is difficult to achieve the scale necessary to warrant a listing.

The residential weighting in the South African REIT market is well below that of Europe and the US due to the buy to own psychology which exists in SA and which doesn't exist to the same extent in the US and Europe.

Company L

The interviewee had the perspective that the South African REIT sector consists primarily of diversified funds which have the largest weighting in retail, followed by office and then industrial properties.

"From a South African perspective you've got primarily the retail, office and industrial sectors represented. Most of the funds are diversified funds, they're not specifically focused. That's generally the blend. Obviously each fund has a slightly different mix."

The interviewee was aware of the residential weighting in South Africa's REIT market:

"South Africa's residential weighting is approximately 2% and much lower than overseas markets."

Company M

The interviewee was very aware of how the SA market compares internationally:

"South Africa is a relatively large REIT market. I think we're the ninth or tenth biggest REIT market, although we've just moved into a REIT structure quite recently."

"We have got a couple of really big counters which account for most of the sector and we have mostly diversified companies. There's very, very few that have specialised."

The interviewee noted the following in respect of the residential sector:

" We are set at about one and a half to two percent. I haven't done the numbers lately but it's probably going to be more than two percent exposure, so that's if you include Indluplace which is the only specialised one."

4.4 Research Question 2:

Is there interest from existing SA REITs and REIT investors in investing in the residential sector?

4.4.1. Response from REIT Managers:

Company A

Company A has minimal residential exposure which it is currently experimenting with. It commented that it will likely retain that existing exposure but not increase it unless it has to.

"We would only pursue residential as a last resort where you've got a declining office market and the building is imminently converted into residential specifically for student accommodation."

Company A also commented on why investor demand hadn't previously existed:

"We don't have a kind of tradition of being lifelong renters of accommodation."

Company B

The interviewee responded that investor appetite will develop over time and that they were currently "testing the waters" with residential investment:

"I don't think there's huge appetite at this point. I think it's something that will develop over time and something that will mature."

"I think we've kind of dipped our feet into student housing to see how it goes. If we were presented with an opportunity that was scalable I think we would look at it, but to date we haven't seen any substantial residential investments that would provide us with the kind of scale that we need to take on."

Company C, E & F

The house view from Company C, E & F was that they did not have an interest:

"We'll divest of our current residential exposure" "We're not interested because of the growth issue and the social issue which is attached to it"

However they did comment that they believe there is demand for residential REITS:

"Yes, residential REITs will come in"

Company D

Company D gave an affirmative response:

"I think as our cities kind of morph and our cities redesign in response to, call it the apartheid legacy, I think that there will definitely be increased demand and scope for residential assets to be put into a vehicle like residential REITs."

"I think from an investor point of view there's definitely room for other specialised REITs to come into the market, like a residential, like a storage REIT"

Company G

Company G commented that institutional investors still need to understand the residential sector relative to commercial:

"I think the institutions have still got to understand the respective asset classes and how they differ from commercial property which is their bread and butter in what they understand. Residential property has...it's a totally different animal. It's a cash flow and it's an income stream but how you value it, how you're pricing the risks etcetera is very different to commercial"

Company G also commented on the current demand supply status within the sector:

"There is a shortage of accommodation with urbanisation, albeit 2 or 1 ½ or 2 ½ percent, however you look in terms of the next five years in terms of forecasts, GDP growth, you know, it's not expected that there's going to be a massive growth around urban centres. But I think as an asset class, and this is on a relative basis, I think growth is expected to be better than in the commercial space, and that's why the guys are chasing it"

"I don't think our fund would invest into residential." "Whilst we are diversifying in terms of commercial, we don't want to further skew that in terms of investing in residential"

Company G did indicate that outside of the fund in question, other divisions within the group may have an interest:

"..with the intention either to offload or to use that as a seed portfolio to create some kind of residential vehicle"

Company H & I

The interviewee had strong conviction that an interest exists:

“We made our announcement to go into residential and since then we’ve really built up quite a lot of stock and its happened quite quickly.”

“What we have seen though, is that all of our competitors and literally every second company is trying to find a way to get into residential.” SA Corporate’s followed us. Redefine’s followed us. Towers followed us. Equites followed us. Growthpoint’s made a few comments about looking at residential. I know they’re doing high end apartments at the Waterfront. But I’m not talking about that. I know that they’ve been trying to meet with people in the sector. I heard the Resilient stable is looking. Dipula’s put in some sort of announcement that they were looking. Loadstone put in their prospectus that they were looking. And I’m sure I’m leaving out quite a few names.”

4.4.2. Response from REIT Investment Funds:

Company J

Company J is invested in the sector and gave an affirmative response:

“The residential sector seems to be less sensitive to economic cycles, so I think that’s why the demand from fund managers is higher now than it has been since we joined the sector. It’s because people are looking for an income stream that kind of grows agnostic to what’s happening in the general economy. Generally, residential demand is more about demographics, more about migration of people than it is about, you know, whether GDP is three percent or five percent.”

Company K

The interviewee responded that their fund is invested in all REIT counters which have residential exposure.

Company L

The interviewee commented that he is interested personally in the sector and believed that there was growing interest in the sector.

Company M

The interviewee noted that the sector is growing:

"You've got Indluplace which is the only specialised residential REIT which just listed. Then you have the Octodec and the SA Corporate residential portfolios which are seeking to grow and a couple of counters with residential property within their broader portfolio."

4.5 Research Question 3:

What are the challenges cited by existing REITs and REIT investors in investing in the residential sector?

4.5.1. Response from REIT Managers:

Company A

The following criteria were identified:

- **Legislation:**

"There's legislation that goes against you.. you can't throw somebody out on the street"

- **Management Intensity:**

"Its management intensive, its high turnover, in terms of tenants"

"First of all you've got the Consumer Protection Act which now the individual who is a commercial tenant is protected by in the same way. You've got Business Rescue which makes it difficult and then assuming that you can get passed all of those you have to go through the legal system which is very close to being broken. So you're just not effectively getting to a position where you can evict tenants"

- **Requires Specialised Skills:**

"We view it as a specialised field and it takes a completely different management model to what ours is, you need to be on the ground."

Company B

- **Management Intensity:**

"I think first thing is it's highly management intensive. So you've got to have a very, very specialised management team, very hands-on. I mean, the type of assets we're looking for, just forget residential for a second, is that we are looking for more passive investments."

- **Scale:**

"The second one we mentioned was obviously the scale."

- **Cashflow unpredictability:**

"Thirdly I think is just the unpredictability of cash flow growth. There's no forecastability, it's very difficult for our FD or our CFO / CEO to say listen, we're going to get eight percent growth out of this portfolio, because it's an unknown. You've got no contractual obligation for forecasting."

Company C, E & F

The following criteria were identified:

- **Culture:**

"We've got a different culture to a lot of the Europeans and Americans, which is where these listings sit". "There's a big culture in South Africa of property ownership"

- **Market depth**

"The next thing is that clearly the demand for residential accommodation in South Africa is the low end of the market and not the upper end of the market. So if you look at a lot of the American listings, as 'One Bay' and those types of things, they tend to be middle market as opposed to lower end of the market"

- **Legislation**

"I think the legislation in South Africa is very, very poor and the legal system is very, very poor to cope with a lot of success for residential listings going forward."

"..in foreign markets the legal system is a lot quicker and there are avenues to sort that out. In this country we don't have that."

- **Politics:**

"..also in this country obviously politics will form part of it.. you've got huge, huge social issues, and somewhere along the line I wouldn't be surprised if government enforces rent control, or stricter rent control type of issues"

- **Rental Growth Limitation:**

"My research on the lower LSM is that rentals are very, very inelastic. Yes. So if you have to take the rental and you're going to escalate it by five percent, people will move. They'll just pickup and they'll go somewhere else. So it's not a market that's going to give you a huge amount of growth"

"The funds are growth models. Residential in this country I don't think falls in that model"

- **Management intensity:**

"Ten percent of your gross income goes towards management. Hugely, hugely intensive. Credit vetting, take backs, day to day management, hugely intensive."

Company D

Company D identified a lack of supply:

"It may be a supply issue. If you look at the large percentage of the population living in informal settlements, which is part of our history, maybe you could argue that that's one of the reasons why, from a residential point of view, we've never kind of got there"

Company G

Company G cited the following criteria:

- **Management intensity**

"Totally different in terms of management" "versus commercial it's the quantum that you're dealing with and the intensiveness."

"Collecting from individuals versus collecting one cheque from a corporate at the end of the month is a lot more intensive."

"Your facilities and your repair and maintenance provisions as well as the intensity of maintaining the buildings are a lot more intensive."

- **Legislation**

"The legislation around collections, so the administration thereof, default, managing recoveries, accessing or putting in place judgements. So the legalities around dealing with defaults is a lot more intensive than commercial, and there really hasn't been that expertise in the sector or anyone who is doing it at a sizeable scale"

- **Investor Perception:**

"I think also just investors, or getting their mind around pricing diversification versus the covenants of the tenants. So where you're dealing with an individual versus a corporate obviously you're relying on the credit covenant of the corporate in terms of the sustainability of that cash flow and their ability to collect your rental, versus residential provided that you've got a portfolio which is large enough in terms of scale, well then you've got diversification which is your mitigating risk factor versus looking through to the credit covenant of the underlying tenant, and how do you price that. So one of the other challenges is the short-term nature of the leases. So with corporate tenants you're looking anywhere from three to five years or five to ten years, depending on the sector, and therefore again, with that covenant and with the contractual escalation you have visibility in terms of future cash flow. Whereas with residential, anywhere from monthly to twelve month leases, so the sustainability of that cash flow and also the ability to escalate or to grow that cash flow'

Company H & I

The interviewee indentified various challenges but also provided examples of how they had / could be overcome:

- **Investor Perception:**

"I think it (residential) was unknown, and I think that there was this perception in the market that it's hard to collect rentals, it's hard to get non-paying tenants out, and those sorts of things that management is very intensive and it's something that perhaps is not sustainable, or just something unknown. I think what's happened is that investors have been investing abroad, in residential properties and they have got comfortable with the asset class."

- **Management:**

"I think the most critical element in the residential sector is property management. And you if you don't have a good property management team behind your property, there's a chance you will struggle."

  - **Letting:**

    "To me what's important is having the ability to be able to let vacant units on a residential basis. You don't market them the same way as you would office retail and industrial. So the one element is being able to let vacant space.

  - **Evictions:**

    "The second one is being able to get non-paying tenants out. That is absolutely critical. You've got be able to fill those units and then when a tenant doesn't pay you have to have the ability to get those tenants out."

"To me those are primarily, if you can do those things, you're in a fantastic position."

4.5.2. Response from REIT Investment Funds:

Company J

Company I identified the following:

- **Rental Growth Limitation:**

"The office sector is much more sensitive to the economic cycle than 'resi', but having said that, another difference that I think with residential is also a rental cap, in that, I think you know, in the office sector guys say they can grow their leases at eight percent as long as they've got a tenant they can do it for five, ten years, whatever. But also in retail guys can do it, but in 'resi' I think that there's an affordability cap"

- **Management Intensity:**

"It's must more management intensive, so if you don't have the right team in place your collections could just be a problem. Your collections and also your outgoings on the rates and taxes. You have to have a proper handle on that. So management is much more intensive, hence, it's more expensive right. Commercial property managers charge between three and four percent. Resi managers charge between eight and twelve percent of the gross rate"

- **VAT:**

"The second challenge is the VAT issue. The residential guys can...so when you have a rental yield of let's say ten percent, you have to take off the fourteen percent VAT. So your actual yield is eight point six as opposed to the ten. In commercial property it's different, because you're not charged that VAT on it. That's an issue that the sector has been battling with the tax authorities"

- **Legal:**

"There's the PIE Act...Prevention of Illegal Eviction Act. So the PIE Act basically says that you can't evict someone unless you have a court order, and to get a court order you have...first of all to get a court order takes between twelve and eighteen months."

"So, it's a problem I can see from the operator's perspective to say this guy hasn't been paying me six months rent, and it's going to take me another twelve to eighteen months to get him out. I lose two years of rent. And invariably the person who doesn't pay the rent is also messing up the place."

Company K

The interviewee listed the following:

- Lack of management skill in South Africa;
- Investor Perception - risk previously seen as high;
- Inability to recover rates and taxes
- Previously lower yields (than commercial properties) and higher risk, however yields are now acceptable in the lower LSM market.

Company L

The interviewee identified the following:

- **Risk in terms of lease length:**

“A big part of the property sector is having a five year lease or a ten year lease with a big name, which is what gives your property substance. So having lots of little leases is a big risk. So that’s one element of it.”

However, the interviewee did note that he thinks investors are now more comfortable with the short-term nature of residential leases.

“I think the market has realised that the short-term leases or the yearly lease deals are not such a risk as long as you have demand for your assets because if one tenant can’t pay, you kick him out to get a new one.”

- **Political:**

“What I do think is a big risk, is as the funds get more residential exposure (Indluplace is now a residential REIT) and more profitable, the Government or Competition Commission, may intervene given the housing shortage and say you can’t exploit the masses.”

- **Rental Growth Limitation:**

“With residential you are at market all the time essentially because it’s month to month or year to year and the ability to escalate becomes very much market driven rather than contractual. So you’ve got maybe five or six percent kind of escalations that can be demanded. The guys are struggling to get more than eight percent. The days of when you just could demand a ten percent rental escalation on a residential property is long gone. The tenants are struggling. So you can see that there’s a lot of pressure.”

- **Earnings growth if developing:**

“Octodec I think one year didn’t deliver much growth because they did a development and it takes about twelve months to build and then you have to rent it out which takes about six months. So in the six month period while you’re filling it, it’s not yielding much, but once it gets filled, then it’s actually quite a powerful yield, its giving a lot of growth. So there’s a balancing act. Whatever you are expecting, you better deliver, otherwise your share price is going to be hurt”

- **Management Intensity:**

"Property management costs, collecting the rent from a hundred tenants versus collecting from one tenant is much more costly, much more operationally intensive."

- **VAT:**

"The VAT story I think is a bit of an issue. I'm not technically advanced on all of the tax issues, but there is a VAT issue given that you can't recover that on rent."

Company M

The interviewee identified the following:

- **Availability of quality stock:**

"Quality stock is one of the things that is difficult finding, especially if you're acquiring buildings. It's difficult to find good quality portfolios, because one of the key things is we want buildings to scale, because of your cost structure, because it takes specialised management and there are specific types of costs. It's difficult to find buildings that are at a sufficient scale in order to reduce maintenance costs with those types of things."

- **Management Intensity:**

"You've got thousands and thousands of tenants billing, that's the important part of it, understanding risk profiles of tenants, collections of money, making sure you deal with maintenance issues.."

- **Risk in terms of lease length:**

"You've got less security in terms of your leases so, because it's not a five year lease, you just don't know when you could have a whole lot of people moving out at a point."

- **Earnings growth if developing:**

"The other side of it is if you are developing, which is probably a better place where you can add more value, but the difficulty with that is it becomes dilutionary to your yield in some respects and so it makes your earnings growth lumpy."

4.6 Research Question 4:

What are the challenges facing the establishment of residential REITs in the South African market?

4.6.1. Response from REIT Managers:

Company A

The main challenges identified were:

- **The lack of rental stock available:**

"There's no supply. So if you look at where you did have that supply, they're sectional titled, so all of those are sectionalised ownerships, all of those units have been sectional titled. So there is no more rental stock. The only place I think where you may find that there's a gap is where the universities need substantial housing and they don't want to buy it themselves anymore and they will do an underwriting deal with a developer and those can be, can stand on their own feet from a developer's point of view."

- **The location of rental stock:**

"It possibly detracts from the desirability of the share is that those are invariably all in the inner cities. I'd rather have the share than have the physical property in the CBD, but you know, you can slice and dice it anyway you want to, but the CBD of Johannesburg and the CBD of Pretoria ain't nice places to be in."

Company B

- **Sectionalisation:**

"I think the big difference in South Africa is that the sectionalisation market here has run, I mean, it's happened, its occurred, it's very difficult to setup very large pockets of A grade, multi-family or residential units in an area like Sea Point for argument sake, where we would have interest in something like that because of the location and the quality."

- **Scale:**

"It goes back to scalability and the amount of inventory that one can buy. If you had an investor market ten years ago in an immature property market, there'd be more scope and more assets to buy, but it just doesn't exist today. So I think that historically has been a limiting factor on the scope of residential REITs."

- **Conversion Costs:**

"If you look at the rate per square meter that you have to come in for a refurbishment on residential, you have to be buying at two and a half, three thousand a square meter of offices for it to work. There are very few assets outside of your existing markets that are further apart that you can buy something like that and make it work on a REIT sort of basis."

Company C, E & F

The main challenge identified was the lack of growth (rental / income):

"Growth. I don't think there's growth in these models" "I think in my opinion that's your biggest single issue, is trying to maintain growth, certainly in an environment like ours."

Company D

The only comment offered was as follows:

"The only think I would wonder about is whether the demand exists and whether you can get to any kind of critical size."

Company G

The main challenge identified was the lack of supply / availability of stock to obtain scale and liquidity:

"I think it is difficult to pick up large parcels of individual residential real estates, you know, anywhere, a hundred to two hundred million" So, I think the time it's going to take to get portfolios of decent size and scale and the cost to get there. So I think for smaller funds even residential coming to the market the flurry of liquidity that you had over the last few years is not necessarily there, and in order to get any potential IPO away, it's got to be attractive in price and it's got to have sufficient scale so that there's liquidity and the liquidity's got to be there in the market."

Company H & I

The interviewee identified investor perception as the main challenge as detailed above under Question 3.

4.6.2. Response from REIT Investment Funds:

Company J

- **The main challenge identified was the difference in risk perception between investors and portfolio owners and the resulting pricing:**

"The market sees 'resi' as a high risk asset. So the listed market looks at 'resi' as high risk because you are dealing with three hundred individuals. There's a lot of management and time involved and then these guys who are sitting on a portfolio saying, well my portfolio doesn't track the general economy. I've had low vacancies for the last ten years in respect of my stuff which is lower risk than your office building that you think is low risk. And I think there's a pricing mismatch between buyer and seller as opposed to that there is no stock."

- **Linked to this was the issue of investor psyche:**

"I think perceptions need to be challenged. And the problem is that people that are allocating capital all kind of have one mindset. So we see anything outside Sandton, Rosebank or the areas we drive around as risky, but it's actually not risky, or we certainly need to challenge that stuff"

- **The customer psyche was also identified as an issue:**

"We don't have a big rental culture in S.A. in that people see rental psychologically as a steppingstone to something, they don't see it as long-term. In a lot of European countries they rent. It's just what they do. It's not an issue. It has nothing to do with their income or their circumstances. They just rent. I don't think we've got a high-end renting market really. Certainly not a big one."

Company K

The interviewee identified the following:

- the ability to bring scale to the market;

- the market / investors are still determining how to price residential offerings in the REIT sector.

Company L

The interviewee believed the fundamental issue was the lack of scale and the time it takes to build scale:

"We don't have the spread or ability to have too many specialist funds available because there just isn't enough property and those that have been built up have been built over numerous years". "Where you see more specialised funds are often funds that have come out of other funds which have been built over time."

Company M

The interviewee identified the following issues:

- **Stock Constraint**

"I think the main constraint is stock, availability of stock. There seems to be some but very little quality stock. So it's the ability to achieve the right scale."

- **Management**

"The other issues are the challenges with management in having the necessary infrastructure and skills to manage the portfolio which is why the 'outsource model' is the only one that really exists. The argument is that they can then try and accumulate from multiple places and so outsourcing it allows them to invest in different locations. But you are quite vulnerable to the decisions of that management company which manages that portfolio."

4.7 Research Question 5:

Do existing REIT Investors have a preference for investment in the residential sector via a focused REIT as opposed to a mixed REIT?

4.7.1. Response from REIT Managers:

Company A

Company A commented made reference to the performance of an existing focused REIT in SA:

“If you look at their yields, the market is definitely prepared to pay a premium and they like the fact that they are a focused REIT.

They think a focused REIT is preferred:

“I think the investors, your institutional investors like the idea that they can make a punt on a specific sector without being tied in specifically into what they view is an under-performing sector”.

Company B

The interviewee believed there was a preference but cited income unpredictability as an issue again.

“I think residential is unique enough and specialised enough to have its own separate allocation. Investors do seem to like the specialised nature of it.”

“The problem is that as soon as you put in unpredictability it messes up the investors financial models.”

Company C, E & F

Their view was inconclusive. The following comment was offered:

“It’s a very difficult question to answer...” “Where you’ve got diversification, obviously where things move in cycles, your clear issue is that as one thing goes out of a cycle something else will come into it” “So, you know, you have that protection” “there certainly are guys who do like the specialisation.”

Company D

Their view was inconclusive:

“It’s very difficult question to answer.“ “I suppose the best people to answer that would be the analysts.”

Company G

The response was affirmative. The following comment was offered:

“Definitely focused. I mean, the institutions will have their own view on an asset class and typically in commercial property they’ll have their own determinant where they are in the cycle and then where office, industrial and retail trades within their cycle and very similarly residential. So you've got a corporate exposure versus a consumer exposure or an individual exposure. And depending on where they think you are in an economic cycle, they want to make that decision themselves."

Company H & I

The interviewee believed that there was a preference:

"I think that if you ask all our investors who never invested, I wouldn't say all, majority, they all believe that there should be a standalone residential fund, and more of them. They like focused funds, and I think they back the concept."

4.7.2. Response from REIT Investment Funds:

Company J

Company J noted that there definitely was a preference:

"The thing is, underlying companies always want to talk about diversity and more diversified, but we as fund managers can do that ourselves. We prefer specialisation because what it's shown most of the time as specialist funds, they probably show better operational earnings to the diversified funds and also trade at a premium, most of the time. Well, not all the time, but there is a bit of a premium for specialisation we think."

Company K

The interviewee's response was inconclusive. The interviewee believed it depended on the objectives of the investor and whether such investment was as part of a broader fund or a property focused fund.

Company L

The interview commented that there definitely was a preference and that he personally preferred a focused REIT, having the option to choose. He commented he was interested in a focused residential REIT.

Company M

Company M noted that there definitely was a preference:

"For investors its much nicer for them to balance their portfolio around...if you look at the cycles we'd rather be in this sector...you can then choose to be under weight or over weight in offices, underweight, or overweight in retail. So you can balance your portfolio how you like it."

"There's definitely an appetite towards specialisation."

4.8 Research Question 6

What is the perceived scale required in order to successfully list on the South African REIT market;

4.8.1. Response from REIT Managers:

Company A

The interviewee believed that it had to be greater than R3bn;

"If you list today with a market cap of less than five billion, you're just setting yourself up to be taken out. You need to have critical mass and I think that that level really is north of five billion."

Company B

The interviewees' response was inconclusive:

"It depends what you want to achieve. I think you would have to have quite a bit of appetite, quite a bit of scope to create a substantial REIT that most institutions would invest in. I mean, ideally what you're looking for if you list, you're looking for yield compression. So you're looking to list at a yield compression and then you've got your equity or your value. If you are an investor you've got to have substantial critical mass to do that."

Company C, E & F

The interviewee believed nothing under R2bn was worth listing:

"I wouldn't do anything under two billion."

Company D

The interviewee believed the successful listing of Indluplace at R1.6bn was evidence that that was sufficient for new offerings.

Company G

The interviewee believed the necessary figure was around R2bn:

"For the smaller funds where there's no liquidity in the share, you know, they kind of get stuck. You get to forty percent loan to value, you can't access the equity markets, you kind of just sit there and then investors are going, ok well, you're not growing organically, there's no liquidity in the share, so really my only exit is corporate action"

Company H & I:

The interviewee believes you need to aim to get into the SAPI (South African Property Index) but believes interest from the large investor's starts at around R2bn.

"I think we need to get to a kind of a two billion free float before it starts to sound interesting to the bigger guys. To get into the index is four to five billion of free float, currently. Once you're in the index, you'll be invested by every single investor. Most of the guys track the index pretty much."

4.8.2. Response from REIT Investment Funds:

Company J

The interviewee believed that it had to be greater than R3bn:

"I think now in our sector below three billion market cap...okay, below four billion in assets, two and a half to three billion market cap it probably isn't advisable because you don't have a sufficient free float and ability to attract a lot of the big institutions. So Indluplace is still under represented because a lot of institutions just couldn't get enough stock, that it almost becomes pointless to buy."

Company K

The interviewee believed that R2-3bn was the necessary scale required.

Company L

The interviewee believed the minimum scale was R3bn - 4bn.

"Generally, the listed space does not get very excited for less than about three or four billion. If you in the index, day one, you're fine. If you're just below the index day one, you're okay but anything substantially less is questionable."

Company M

"You want to be coming in at at least two to three billion now; personally I think that would be sufficient. You want some liquidity and your balance sheet needs to be able to grow. If you're a small fund, you need to be able to raise capital. That's the whole point of coming to list, is to get access to more capital."

4.9 Other Noteworthy Findings:

4.9.1. Response from REIT Managers

Company A

The interviewee noted that due to new legislation, evicting a commercial tenant is not necessarily easier than evicting a residential tenant:

"First of all you've got the Consumer Protection Act which now the individual who is a commercial tenant is protected in the same way. You've got Business Rescue which makes it difficult and then assuming that you can get passed all of those you have to go through the legal system which is very close to being broken. So you're just not effectively getting to a position where you can evict tenants."

Company H & I

The interviewee had the following insights as to market competition, future growth, how perceived management intensive challenges can be overcome and how low average vacancies are.

<u>Competition:</u>

"I think what you're also seeing now is that over the last couple of years, and it's becoming more and more true each year, that there's more and more competition coming to the listed property sector and its becoming quite competitive in terms of pricing of assets."

<u>Areas for future growth:</u>

"People are starting to look for growth in other areas. What are the other areas people have looked at? Offshore and Africa. I think it doesn't necessarily mean that if you've gone offshore you're going into Africa, and doesn't mean if you've gone into Africa you're going offshore. So that's why I distinguish between the two. But people have gone to America, Europe, Australia and then quite a few investors into Africa. And I think that the next big thing for the sector is residential"

Evictions:

"I think you could do it...good guys can probably do it in three or four months. But it can take up to six months. If you look at our portfolio, you'll probably find that if we've had more than a handful in a year, a year and a half of tenants that we've had to take to get evicted, it would be a lot."

Management:

"Well, you have good building managers that put pressure on tenants, and you're constantly at them. You can remove the ability to be able to come into buildings...access control. So there are certain things that you can do. And the other thing is that I think that if you're managing it right, you've got a month's deposit. We're fairly well covered from those aspects."

4.9.2. Response from REIT Investment Funds:

Company K

Company K commented on rental escalation within the residential sector:

In terms of the issue of limited escalation possibilities within the residential sector, the interviewee noted that ~25 percent of commercial portfolios have lease reversion every 3-5 years which results in the loss of a month or two of rental. In the residential sector vacancies are very low given the high demand and it is possible not to miss a month of rental which equates to approximately 8% (1/12). This characteristic of residential property counters the limitation in escalations relative to commercial to some extent.

CHAPTER 5: Discussion of the Research Findings:

5.1 Introduction:

The purpose of this chapter is to interpret and analyse the findings presented in Chapter 4 given what has already been recorded on the subject matter as presented in the literature review.

5.2 Research Question 1:

Are local REIT managers and Investors aware of how South Africa's sectoral diversification compares to that of international REIT markets, with particular focus on South Africa's residential weighting?

5.2.1. Findings from the research:

a) All interviewees interviewed were aware that the South African REIT market is significantly less diversified than global REIT markets. The global REIT markets which were referenced and used as comparables were:

- United States;
- UK;
- Europe;
- Australia.

b) All interviewees interviewed were aware that the South African REIT market was significantly under-represented in terms of its' residential weighting compared to global REIT markets;

c) 60 percent (60%) of interviewees were acutely aware that the South African REIT market's residential weighting was only at circa 2%. All but one of these interviewees represented REITs or Investors who had exposure to the residential sector via the South African REIT market. In conclusion it is apparent that the majority of REIT managers and investors are aware of how South Africa's sectoral diversification compares to that of international REIT markets, with particular focus on South Africa's residential weighting.

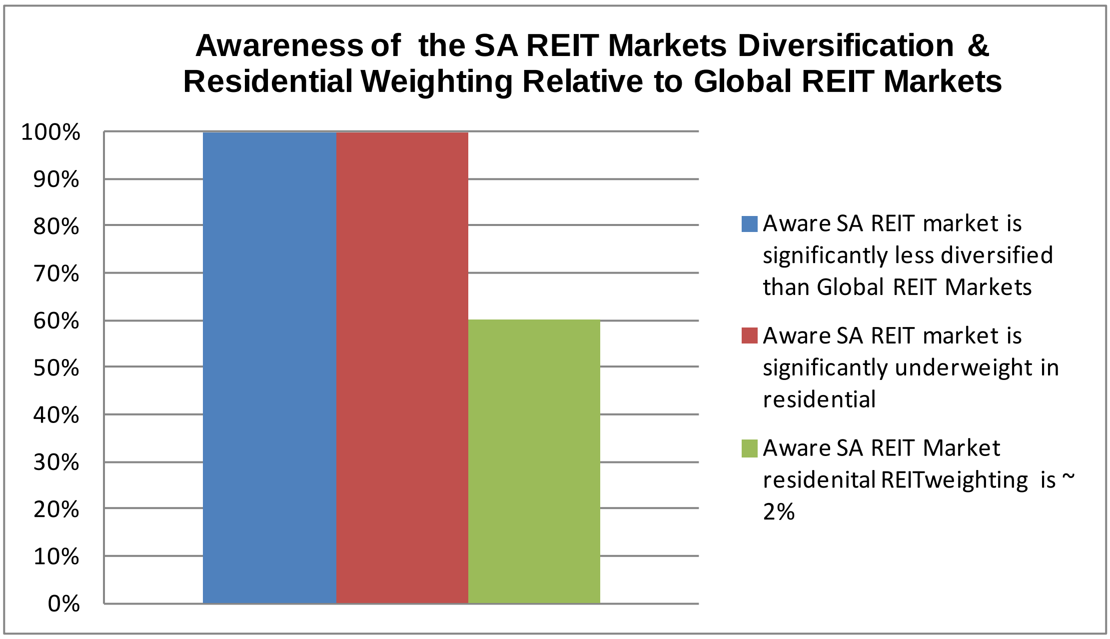

Figure 13 The SA REIT markets awareness of how SA's residential weighting compares globally

Important points from the literature review:

The literature review highlighted how low South Africa's residential weighting is relative to both developed and emerging markets:

South Africa contributes 1.4% towards total retail market capitalisation, 0.5% towards total commercial market capitalisation, 0.8% towards total industrial market capitalisation and 0% towards total residential market capitalisation. The USA is the largest contributor towards the total global residential market capitalisation, comprising 52.6% of the sector (MSCI, 2014). The residential sector makes up 13% of the total listed US property sector compared to South Africa where it represents only 1.6% (Mclver, 2014).

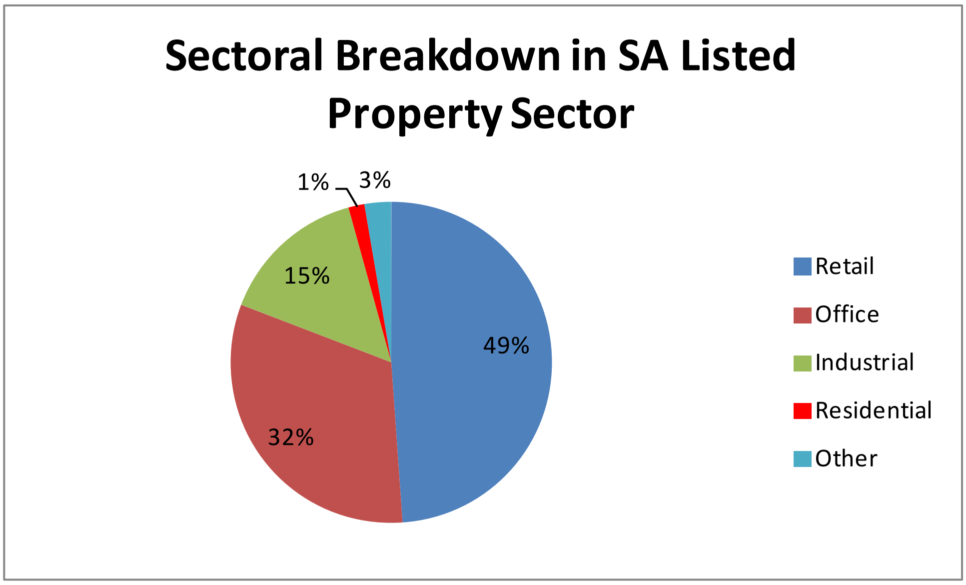

Figure 14 SA property sectoral breakdown (McIver, 2014 p.2)

5.2.2 Conclusion:

Given the data which exists on the sectoral weighting of global REIT markets and based on the findings recorded in chapter 4, it is reasonable to conclude that the South African REIT market has a reasonably accurate understanding of both how its level of sectoral diversification and residential weighting compares internationally.

5.3 Research Question 2:

Is there interest from existing SA REITs and REIT investors in investing in the residential sector?

5.3.1. Findings from the research:

This question was answered from two points of view:

1) From the point of view of the REIT manager / investor which the respondent represented (referred hereafter as 'view 1' and ;

2) The respondents view/ perception of the market (referred hereafter as 'view 2').

5.3.1.1 View 1:

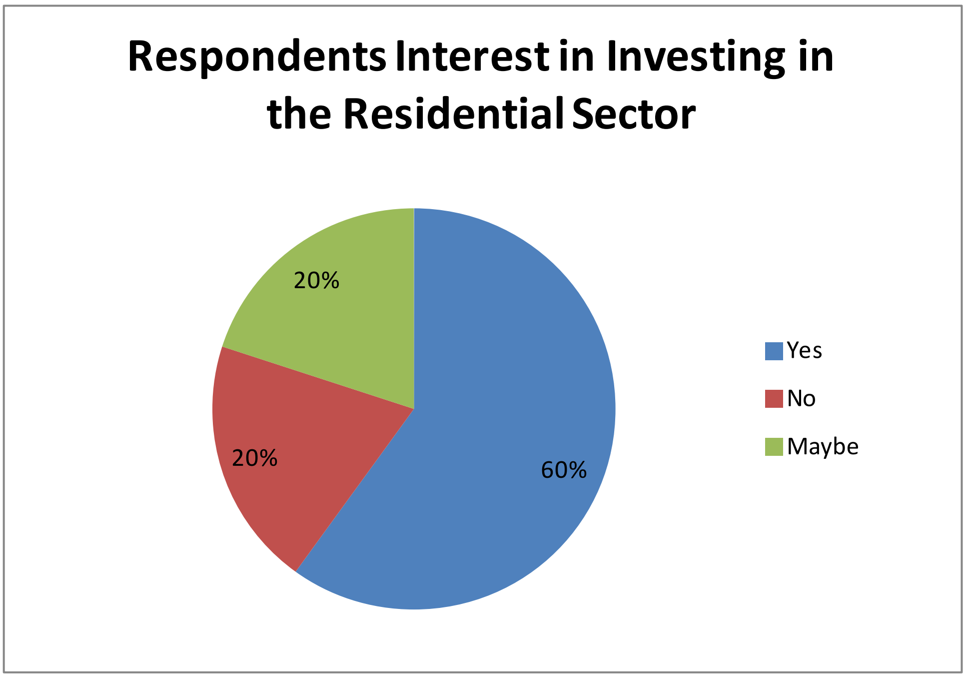

Figure 15 Interviewee interest in investing in the residential sector

The interviewees responded as follows:

- Sixty percent were interested and were currently invested in the residential sector;
- Twenty percent were potentially interested;
- Twenty percent were not interested. The reasons cited by these respondents were:
  1) They did not possess the necessary mandate, which mandate was not going to change for the foreseeable future;
  2) They did not believe the sector provided sufficient rental income growth potential.

5.3.1.2 View 2:

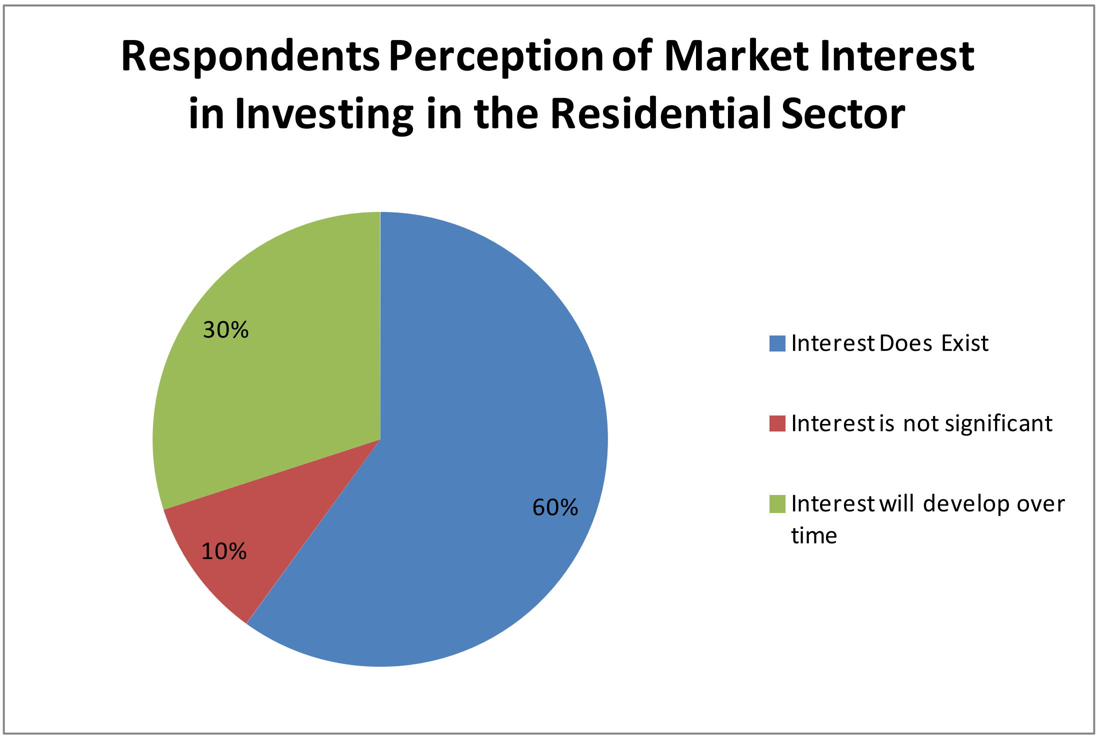

Figure 16 Perception of market interest in investing in the residential sector.

The interviewees responded as follows:

- Sixty percent believed interest currently existed;
- Thirty percent believed interest was currently small but would develop over time;
- Ten percent believed that the level of interest was insignificant.

5.3.2. Important points from the literature review:

The literature review noted that investor interest is not automatically created by an environment in which there is high demand and insufficient supply (per below excerpt):

However a high demand and insufficient supply environment, resulting in a flourishing private rental sector are not sufficient conditions for the establishment of a residential REIT (Jones, 2007). This is illustrated through the fact that in both the US and Australia, private rental sectors represent over a fifth of the housing sector yet investor demand is significantly less in Australia (Jones, 2007).

5.3.3. Conclusion

Based on the above findings, it is reasonable to conclude that the majority of the respondents currently have an interest in investing in the residential sector. It is worth noting that the respondents represent approximately seventy three percent (73%) of the REIT market. Furthermore it appears reasonable to conclude that the majority of respondents perceive that market interest in investing in the residential sector does currently exist and will continue to develop. Per the findings in the literature review, a high demand environment does not automatically guarantee a successful residential REIT environment.

5.4 Research Question 3:

What are the challenges cited by existing REITs and REIT investors in investing in the residential sector?

5.4.1. Findings from the research:

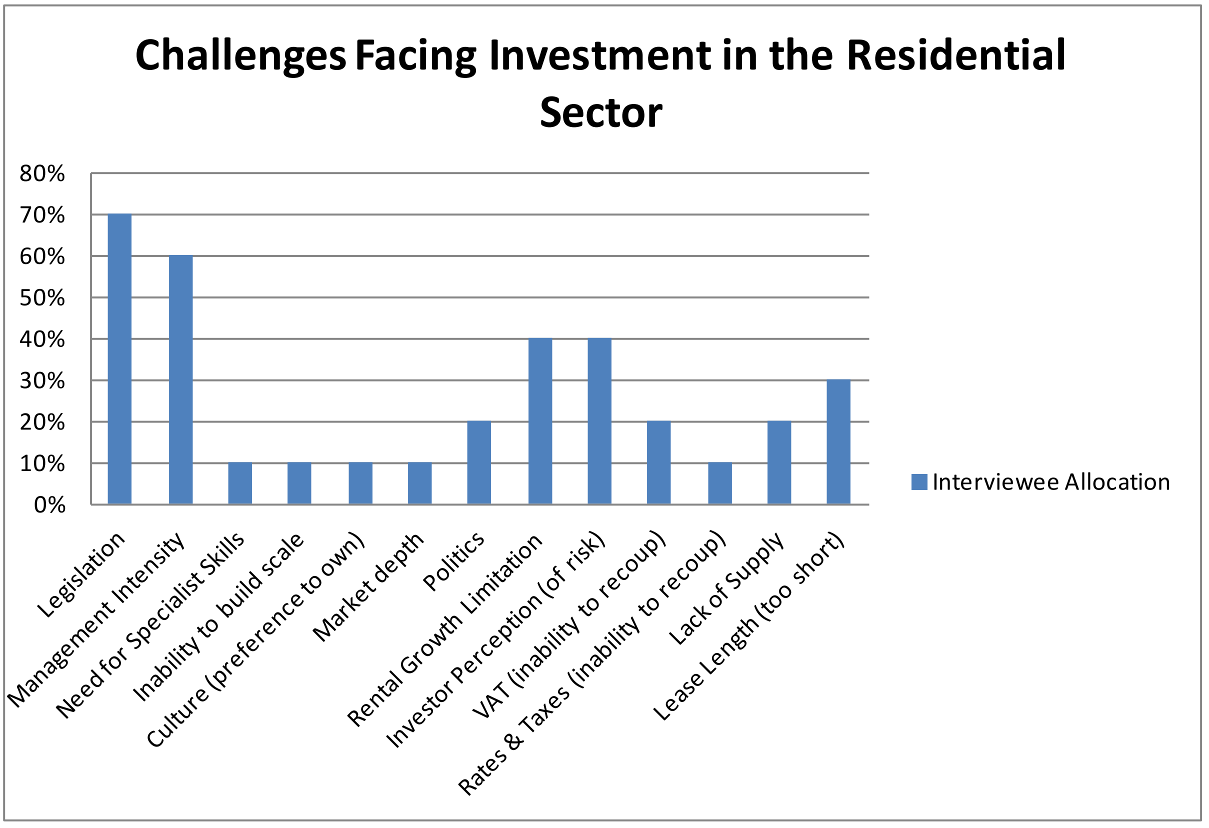

Figure 17 Challenges identified with investment in the residential sector

The findings for this question are varied. Altogether, 14 different reasons were cited. Per the above diagram, the most significant reasons cited were (in order of magnitude):

- Legislation (70%)
- Management Intensity (60%);
- Rental Growth limitation (40%) and
- Investor Perception (of risk) (40%).

The weighting of the various challenges identified is as follows:

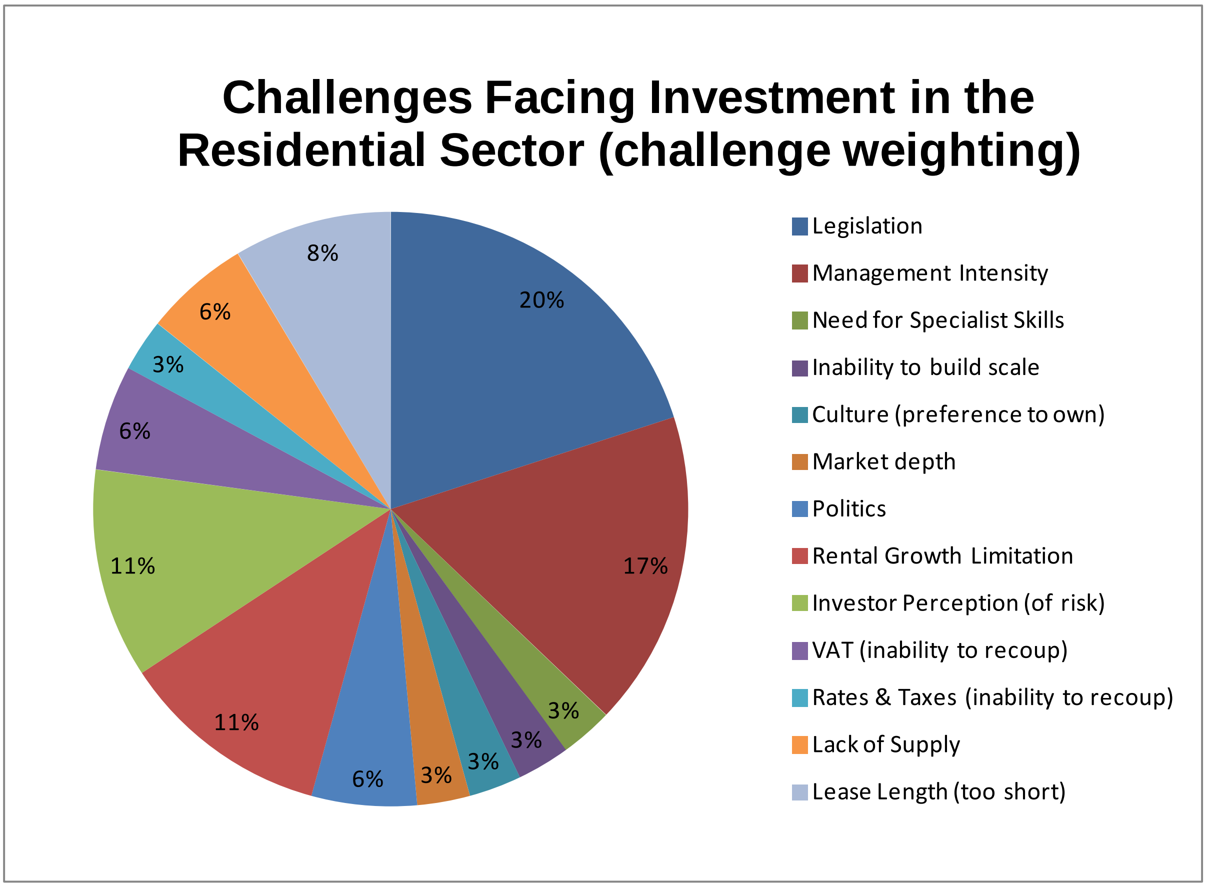

Figure 18 Weighting of the various challenges identified with investment in the residential sector

5.4.2. Important points from the literature review:

The literature review highlighted previous concerns expressed by the market as shown by the below excerpt:

The general view was also that the risks associated with the affordable housing market such as tenant delinquencies and onerous housing legislation outweighed the potential returns. However, given the strong trading activity since IndluPlace's listing, coupled with the fact that the prelisting capital raising of R400m was considerably oversubscribed, it appears the market has become more comfortable with housing as an asset class (Muller, 2015).

5.4.3. Conclusion:

Based on the above findings, it is apparent that there are numerous and varied challenges which the respondents identified in investing in the residential sector. However, it is apparent that many of the challenges felt by some, are not felt by others. There appears to be only four main challenges with significant commonality (equal to or greater than 40% percent), namely:

- Legislation (70%)
- Management Intensity (60%);
- Investor Perception (40%) and
- Rental Growth limitation (40%).

It appears that the above four challenges are the greatest concern for prospective investors in the residential sector. Lease length (30%) was also a notable concern.

5.5 Research Question 4:

What are the challenges facing the establishment of residential REITs in the South African market?

5.5.1. Findings from the research:

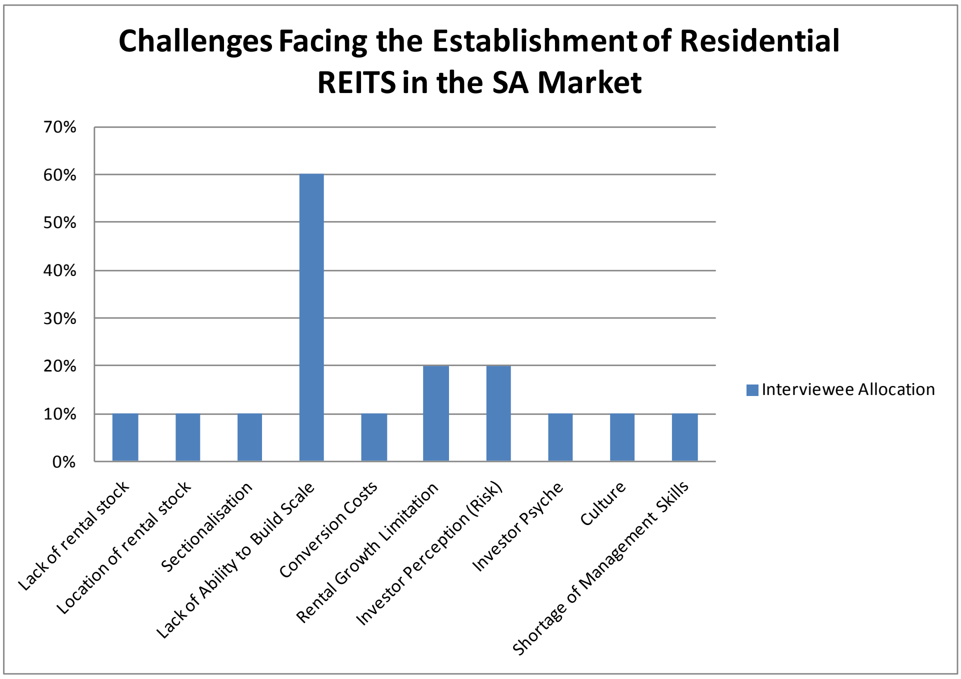

Figure 19 Challenges identified in establishing residential REITS in SA

The findings for this question are varied however there was one clear common perception of the main challenge facing the establishment of residential REITs in the SA market. This main challenge was the perceived inability to acquire the sufficient quantum of residential rental stock properties necessary to successfully list on the JSE. Sixty percent of the interviewees held this view. However, it is noteworthy that the respondent who represented the only residential REIT on the JSE, strongly held a contradictory view. Also of relevance is that the perceived market capitalisation necessary to list on the JSE is greater than R2 billion, per research question six below.

The next two most significant challenges identified were only held by twenty percent of the respondents and were as follows:

- Investor Perception (Risk)
- Rental Growth Limitation

Altogether, 10 different reasons were cited.

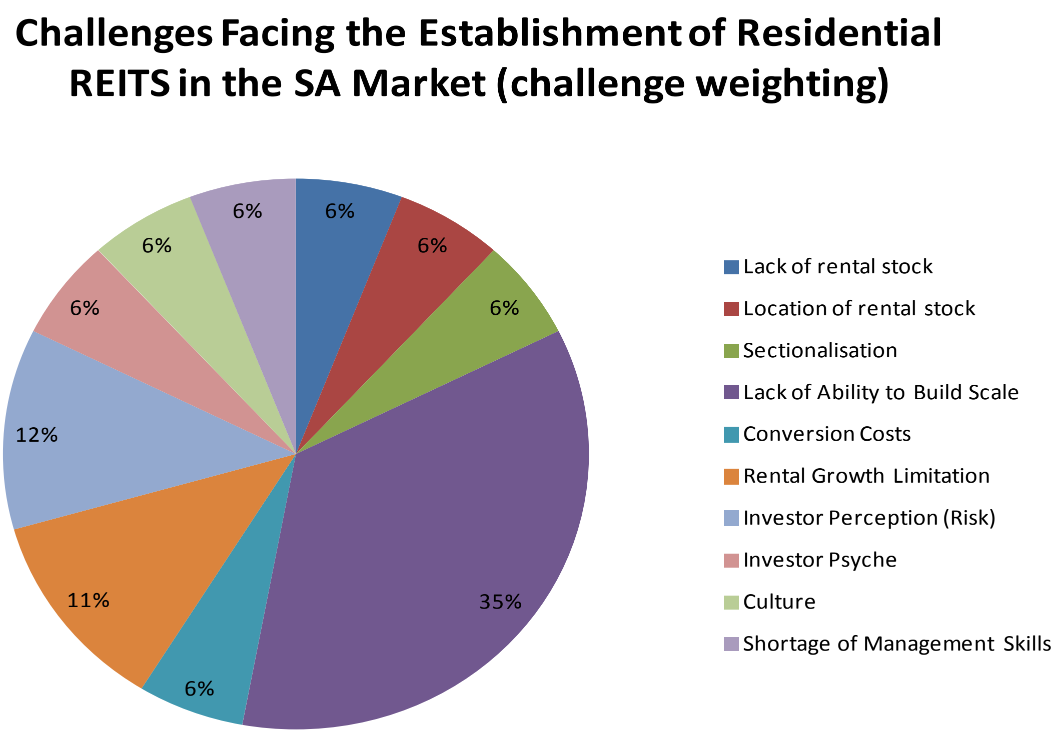

Figure 20 Weighting of challenges identified in establishing residential REITs in SA

The above diagram illustrates the weighting allocated across all challenges cited by the interviewees. It further illustrates the dominance of the main challenge discussed above as well as the next two significant challenges.

5.5.2. Important points from the literature review:

The literature review provided evidence that ability to generate scale and the existence of large commercial owners of residential stock were key challenges to establish a strong residential REIT sector:

The research points to supply side implications and the need for the existence of large commercial owners (as in the case of the US) as opposed to numerous private landlords (as in the case of Australia) (Jones, 2007). Jones (2007, p.395) also provides argument that in order to attract large-scale landlords such as REITS, investors require local rented markets with depth and which are established.

5.5.3. Conclusion

It is clear from the respondents that the single biggest perceived challenge facing the establishment of residential REITs in South Africa is the availability of stock and the ability to generate sufficient scale in order to list (>R2 billion). Again, it is worth noting that management of the only listed residential REIT on the JSE held a contrary view on the availability of residential rental stock for purchase. Twenty percent of the respondents believe that investor perception of risk and the inability to continuously escalate rental returns (as can be done with commercial tenants) are also challenges facing the establishment of residential REITS in South Africa. These perceived challenges are consistent with the relevant findings in the literature review, particularly the requirement for large commercial owners of residential rental stock.

5.6 Research Question 5:

Do existing REIT Investors have a preference for investment in the residential sector via a focused REIT as opposed to a mixed REIT?

5.6.1. Findings from the research:

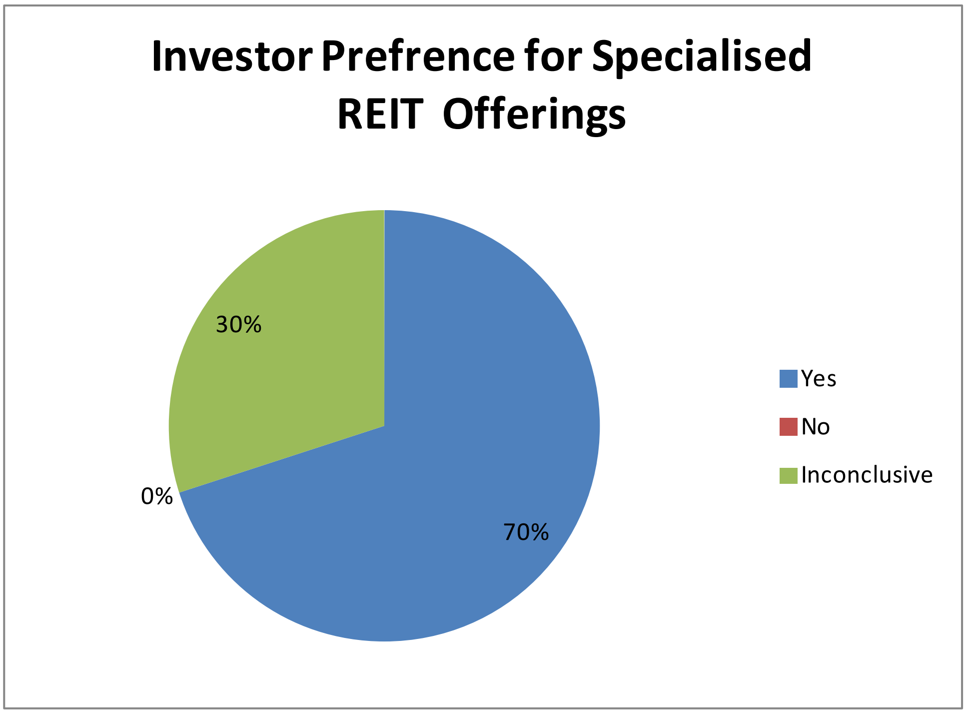

Figure 21 Investor preference for specialised REIT offerings breakdown

The findings for this research question were relatively straight forward. Seventy percent of respondents had a clear perception/belief that investors preferred the option to invest in the real estate sector via a specialised REIT. Thirty percent of respondents were unsure and believed that the question was difficult to answer as it depended on other factors such as the objective of the investor and the type of fund in question.

5.6.2. Important points from the literature review:

The above exerps from the literature review illustrates the continuing debate as to whether focused funds are preferential to diversified funds. The findings from the research show that investor preference in the South African REIT market is similarly divided with a leaning towards prefering a focused REIT offering:

Brounen & de Koning (2012, p. 214) look at the importance of investment strategies within REIT portfolios by measuring the level of property-type (retail, office, industrial and residential) diversification amongst other measures. Their analysis includes data from 210 REITS from Asia, Europe and North America and the time series is spread from 1990 to 2010. The results are in line with Boer *et al.* (2005) and indicate that managing a REIT portfolio that is scattered over different types of real estate destroys value (Brounen & de Koning, 2012). Their research concludes that specialised REITS offer the highest stock out-performance.

The findings of Chong et al (2012) do imply that the sector (REIT) has become more homogenous over the last two decades. However, their report emphasises the argument in favour of a focused strategy based on the view that monetary gains from diversification are largely offset by increased costs (Chong, Krystalogianni, & Stevenson, 2012).

5.6.3. .Conclusion

South African REIT investors appear to have a preference for investment in REIT's which provide a focused offering in terms of the type of property sector it invests in.

5.7 Research Question 6

What is the perceived scale required in order to successfully list on the South African REIT market?

5.7.1. Findings from the research:

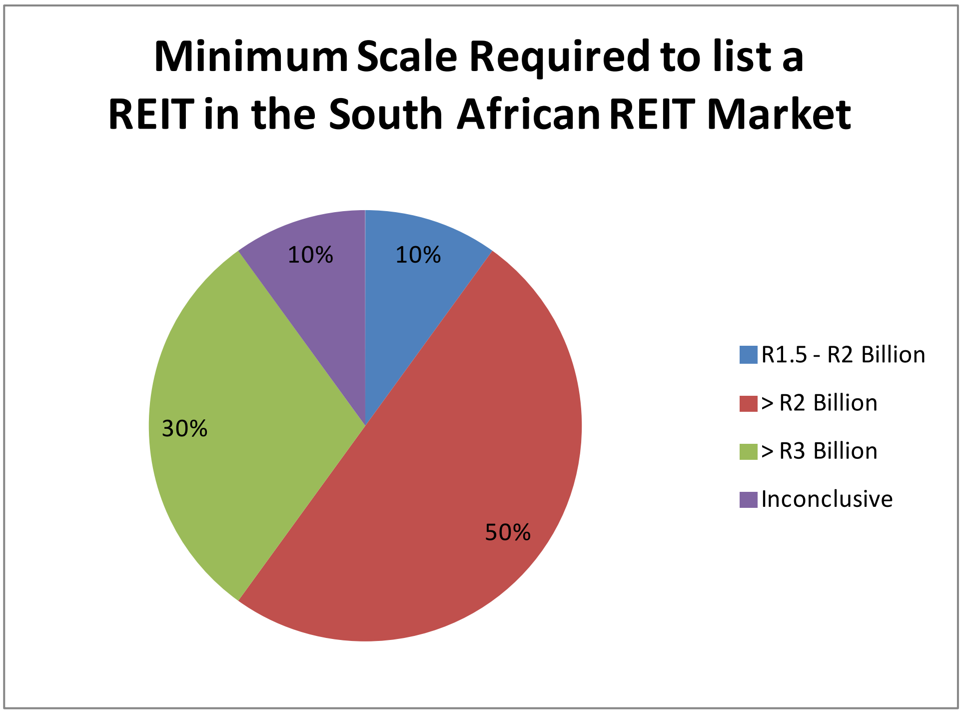

Figure 22 Perceived minimum scale required to list on the JSE

The majority of the respondents believed that the scale necessary to successfully list a new REIT offering needs to be greater than R2 billion. Ten percent were unsure and ten percent believed R1.5 – R2 billion was sufficient. The main reasons cited for the need to list at a market cap greater than R2 billion was the need to achieve sufficient liquidity to attract investor interest and to avoid being acquired by a larger fund.

5.7.2. Important points from the literature review:

The literature review contains the following relevant points regarding scale:

The report Broll (2014) also noted that there was more investment-grade residential stock available now than 10 years previously when a residential-focused property fund, Habitat, attempted to list. Habitat ultimately found it difficult to accumulate sufficient residential stock necessary to justify a listing (Anderson, 2014).

The listing of a pure rental housing fund has been a long time coming with Arrowhead CE, Gerald Leissner, first trying (unsuccessfully) to bring a pure housing play to the JSE in 2012 which didn't materialise (Muller, 2015). The reason cited for the failure of a pure residential listing at the time was the inability to gather the scale necessary to get the support of institutional investors.

5.7.3. Conclusion

Based on the above findings, it is evident that eighty percent of the respondents believe that the scale of a new REIT offering needs to be larger than two billion Rand. Thirty percent believe that the scale necessary needs to be greater than three billion Rand. Ten percent believed a figure of R1.5 – R2billion was sufficient and 10 percent were inconclusive. The issue of sufficient scale necessary to successfully list is an important issue given the overwhelming perception of the interviewees that the inability to build sufficient scale (>R2bn) is the number one challenge facing the establishment of residential REITs.

5.8 Other Noteworthy Findings:

5.8.1. Findings from the research:

Other interesting findings were as follows:

5.8.1.1 Management intensity – defaulting tenants:

Some of the perceived challenges expressed by the majority of respondents with investment in the residential sector have already been over-come by the respondent most active in the residential sector. In particular there is an example of this with regards to the onerous management requirements and dealing with defaulting tenants. One respondent had experience of overcoming this.

5.8.1.2 Vacancy levels:

There is very little data on the residential sector given the under-representation of residential property in the listed space. However, despite the many challenges recorded, the vacancy levels communicated by the respondent representing the only pure residential REIT are low (two-four percent).

5.8.1.3 Limited rental escalation opportunity relative to commercial rentals:

Interestingly, one of the REIT investment specialist noted that 25% of commercial leases have rental reversions, which typically result in vacancies and the loss of a month or two’s income. The demand is so high in the residential sector that it is possible to maintain very low vacancies. This contrasting characteristic offsets, to some extent, the limited ability to continuously escalate rental escalation in the residential sector relative to the commercial sector given that a month's loss of income is equivalent to a typical years escalation (eight percent). It is unknown how material this observation is.

5.8.1.4 Ease of evicting commercial tenants relative to residential tenants:

One respondent pointed out that the difference in terms of the administration involved in evicting a residential tenant versus a commercial tenant is reducing due to legislation. The reasons cited for this is that the Consumer Protection Act which protects the individual, can also protect a commercial tenant in the same way. The Business Rescue process was also cited as making it increasingly difficult to evict commercial tenants and then assuming that you can get passed all of those, there is the South African legal system which was described as being very close to being broken.

5.8.2. Important points from the literature review:

N/A

5.8.3. Conclusion

In concluding this sub-section there is some evidence which hints that current perceptions, particularly of those who are not active in the residential sector, may be dated and examples may exist which proves that some pre-conceived issues are surmountable.

CHAPTER 6: Conclusion:

6.1 Review

Before commencing with the concluding chapter, it is useful to include a brief review of the scope and objectives of this research.

This research attempts to better understand why the residential sector is significantly under-represented in the South African REIT market. It also seeks to understand what the main challenges are in the establishment of pure residential REITs in South Africa and attempts to gauge market interest in investing in residential rental stock.

A sample of ten decision makers was selected by means of purposive sampling representing approximately seventy three percent (73%) of the REIT market by market capitalisation and some of the specialist REIT investors.

Semi- structured, in-depth interviews were conducted in-person in Johannesburg and Cape Town respectively.

The interview recordings and notes were transcribed, the data analysed inductively and the key findings presented in conjunction with relevant excerpts from the literature review.

This chapter gives a final conclusion to the research project, comments on the relevance of the research and suggests areas for further study on related issues.

6.2 Research Results – Main findings:

The findings are reasonably clear from each of the six research questions in testing the hypotheses developed. The hypotheses appear correct based on the research findings and are included below for ease of reference.

6.2.1. The reasons why the residential sector is significantly under-represented in the South African REIT market are:

(v) the level of management intensity involved with residential property is too high;

(vi) investors' perceive that there are increased risks associated with residential investments and that these risks are too high;

(vii) the limited ability to continuously escalate residential rentals and

(viii) a legal environment favouring tenants to the detriment of landlords.

6.2.2. The reason why the South African REIT market has only one pure residential offering is the perceived inability to build sufficient scale due to a shortage of available residential rental stock.

6.2.3. Summary of Findings:

- Based on the responses from the various interviewees, it is apparent that the REIT sector has a reasonably accurate understanding of both how its' level of sectoral diversification and residential weighting compares internationally. REIT managers/leaders are aware that South Africa is well below its international counter-parts in terms of residential offerings in the listed property space..

- Existing REIT managers and investors highlighted many challenges with investment in the residential sector. However the four main challenges common to the respondents were:

    - Legislation (70%);
    - Management Intensity (60%);
    - Rental Growth limitation (40%) and
    - Investor Perception (of risk) (40%)

  These challenges were evident; however there were views and examples of how these challenges could be over-come. As time goes-on and more data exists on the above challenges specific to residential property, perceptions on the risk related to such challenges may change.

- There is a definite interest in the residential sector from the South African REIT market and an over-riding sentiment that interest in the sector will grow.

- The main perceived challenge impacting the establishment of residential REITS in the South African REIT market is the inability to generate sufficient scale. Sixty percent of the respondents hold this view and believe the lack of large single residential portfolio owners is a contributing factor. A contrary view was held by the representative of the only pure residential REIT on the JSE and a couple of the other respondents.

- The majority of respondents believe that the scale of a new REIT offering needs to be larger than two billion Rand (eighty percent). This perceived minimum requirement ties-in with the main perceived challenge of the inability to build sufficient scale to successfully establish a pure residential REIT.

- It appears that investors do have a preference for investment in a specialised REIT as opposed to a diversified REIT.

Given the above findings it appears that there is a place for residential REITs in the South African REIT market. The interest in the sector does exist, however the perceived challenges are the main deterrent. There appears to be conflicting views as to both the extent of these challenges and the associated risks. One possible reason for the conflicting views is the immaturity of the residential sector in the South African REIT market and the limited data available on such risks.

6.3 Limitations to the research

There are various limitations to this research given the scope, time and geographic limitations:

1. It was not practically possible to interview all the existing REITs in the SA market.

2. Due to time and logistical constraints, it was not possible to interview management at all of the REITs with current residential interest / exposure. Most notable of these are Octodec and SA Corporate, both of whom possess specialist knowledge on the subject matter.

3. It was not possible to gain access to the most senior decision makers/ strategist at each REIT included in this research.

4. It was not possible to meet with all the REIT managers who were most knowledgeable on the subject matter.

5. Similarly, it was not possible to interview all major specialist REIT investors to gauge their perception and interest in investing in a residential REIT. The specialist REIT investors interviewed do not collectively represent the majority of the market. The most notable omission is Stanlib.

6.4 Recommendations for Further Research:

A number of related questions / topics arose around this research topic during various stages of the research process. As illustrated above, the residential sector within the South African REIT market is still in its infancy and there is insufficient data available in multiple areas.

The below topics warrant further research as there is very little literature available on these topics, particularly in the South African context.

- What are the supply-side issues impacting the creation of residential rental stock in South Africa. What role does sectional title ownership and the need for developers to recycle capital play in preventing single ownership of large portfolios of residential rental stock?

- How does the rental growth model of residential property compare to that of commercial property?

- What role does consumer psychology play in the creation of residential rental stock in the South African market? Does home ownership take preference to long term leasing?

- How does the eviction process of commercial tenants compare to that of residential tenants on both a time and cost basis?

- What are the key economic drivers which drive rental growth in the residential sector (not necessarily residential property prices)? How elastic is the residential rental market to these factors and is there an identifiable cycle?

- How do residential rental escalations in South Africa compare to other international residential markets?

- How much depth exists within the residential sector in the South African market? How many different sub-sectors exist within the residential rental market and what is the scale of these sub-sectors?

- What role should government play in incentivising the supply of affordable residential rental accommodation and how might this impact the establishment of residential REIT's?

6.5 Concluding Remarks

It is evident from Chapter 1 that whilst much research has been conducted on various aspects of commercial property within the REIT market, there are still many unknowns about the residential sector and the residential sector in the South African REIT market.

It is apparent from the respondents in this research that that the REIT sector as a whole has a good understanding of how under-represented the residential sector is in the South African REIT market. There are common perceptions as to why this under-representation exists and what those challenges are. It is also apparent through the conflicting views of respondents with varying knowledge of the residential sector, that a lack of information may exist as to the level of risk associated with such challenges and what is required to overcome such challenges. Due to the lack of information and existing data on the residential sector within the South African REIT market, a lack of understanding of the sector by investors may exist.

Growing interest in the residential sector appears to exist. The South African REIT market appears to be reaching maturity in the retail, commercial and industrial sectors. The REIT market appears to be looking for new, differentiated offerings. Offshore opportunities, both in Africa and in other international markets, together with opportunities in the residential sector appear to be very relevant considerations at the time of this research. The recent announcement (01 November 2015) of the intention to list a self-storage REIT is a further indication of the markets desire for new, unique specialised offerings.

During the course of this research process, the first pure residential REIT offering was listed on the JSE, which offering was over-subscribed (Muller, 2015). This could be viewed as an indication of the markets improving comfort-level with investment in the residential sector. However, it appears that the residential sector still needs time to mature in order for the necessary data to be available to answer the unknowns which still exist for REIT managers and investors alike. This in-turn will determine the speed and magnitude of the sectors growth and the associated skills. It appears that there is a place for residential REITs in the South African REIT market.

APPENDIX A – REFERENCE LIST

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APPENDIX B – QUESTIONNAIRE

Qualitative Questionnaire for REIT Fund Managers:

1. Please can you describe your view of the South African listed property sector in terms of the existing diversification of REIT offerings?
2. Are you aware of how of SA's residential REIT weighting compares to that of other developed and emerging REIT markets?
3. In terms of the underlying demand which drives the growth of the various different property sectors in South Africa, how do you view the residential sector relative to the other 3 sectors namely retail, office and industrial?
4. Do you have an interest in investing in the residential sector?
5. What do you perceive as the main challenges with investment in residential rental property?
6. Please can you provide your view on the following aspects of investing in residential rental property;
   - The level of management intensity required:
   - The ability to recover costs (rates & tax's and utilities):
   - The legal rights protecting tenants:
   - Political influences:
7. Do you believe there is a lack of supply of investment grade rental stock in South Africa, and if so, why?
8. What do you perceive as the main challenges facing the establishment of residential REITs in the South African REIT market?
9. What type of scale (market capitalisation) do you think needs to be achieved for the succesful establishment of a REIT in the South African market?
10. Do you think that sufficient diversification of residential rental stock (i.e student housing, retirment villages, townhouses) exists within the residential sector?
11. How important do you think sufficient diversification within the residential sector is in attracting investment?

12. In your view, do investors have a preference for investing in residential property as part of a diversified REIT or as a focused REIT?

Gordon Institute of Business Science
University of Pretoria

Dear Lloyd Anderson

Protocol Number: **Temp2015-01246**

Title: **A Place for Residential REITs in the South African REIT Market**

Please be advised that your application for Ethical Clearance has been APPROVED.

You are therefore allowed to continue collecting your data.

We wish you everything of the best for the rest of the project.

Kind Regards,

Adele Bekker