

Presentation to the Finance Committee

4 March 2014

UNLISTED PROPERTY FUNDS
WORKING GROUP



Unlisted Property Funds Working Group - representing....

- Smaller Asset Management Businesses who establish unlisted property funds to take to market once critical mass has been reached
- Property developers who build up unlisted property funds to take to market
- Private entrepreneurs who build portfolios to eventually list the fund
- Estimated to be R20-R50bn in size

Liliane Barnard

- Over 25 years experience in the investment/property industry
- Ex-head of Old Mutual Property Asset Management
- Ex-Independent Non-Executive Director of 3 Listed Property Companies (Emira, Redefine, Pangbourne)
- Ex-Listed Property Manager of the Government Employee Pension Fund (appointed by the PIC)
- Currently owner of Metope Investment Managers (Pty) Ltd (FSB approved discretionary fund manager 2004) – managing listed property mandates on behalf of Pension Funds
- On the investment committee of offshore direct property fund



Overview

- New amendments to Tax - further “define” equity and debt instruments
– we understand the rationale
- However, unintended consequence to Property Fund Industry
- This was acknowledged in the relief given, but only to the big players
- Not only unfair and discriminatory, but small players critical to industry and growth of SA
- Very simple solution – drop clauses in tax amendments that limits relief to big players in section 8F(3)(d) and 8FA(3)(d)



Background to the Variable Rate Property Loan Stock sector

- Principal of income flow through established in the property sector since the 1960's with the listing of Volkskas property trust, Stanprop and the Sage funds CBD and Pioneer Property Trusts in the mid 1970's. Income is taxed in the hands of the investor.
- The restrictions placed on Property Unit Trusts by FSB viz: no gearing allowed, no internal management companies permitted, no shareholder control or voting allowed. These restrictions were not constructive in building a sustainable and outperforming industry. Hence the introduction of Property Loan Stock Sector.
- Variable Property Loan Stock sector established in the mid 1980's, with the listing of Pangbourne, followed by Growthpoint in 1987. That's 30 years ago.



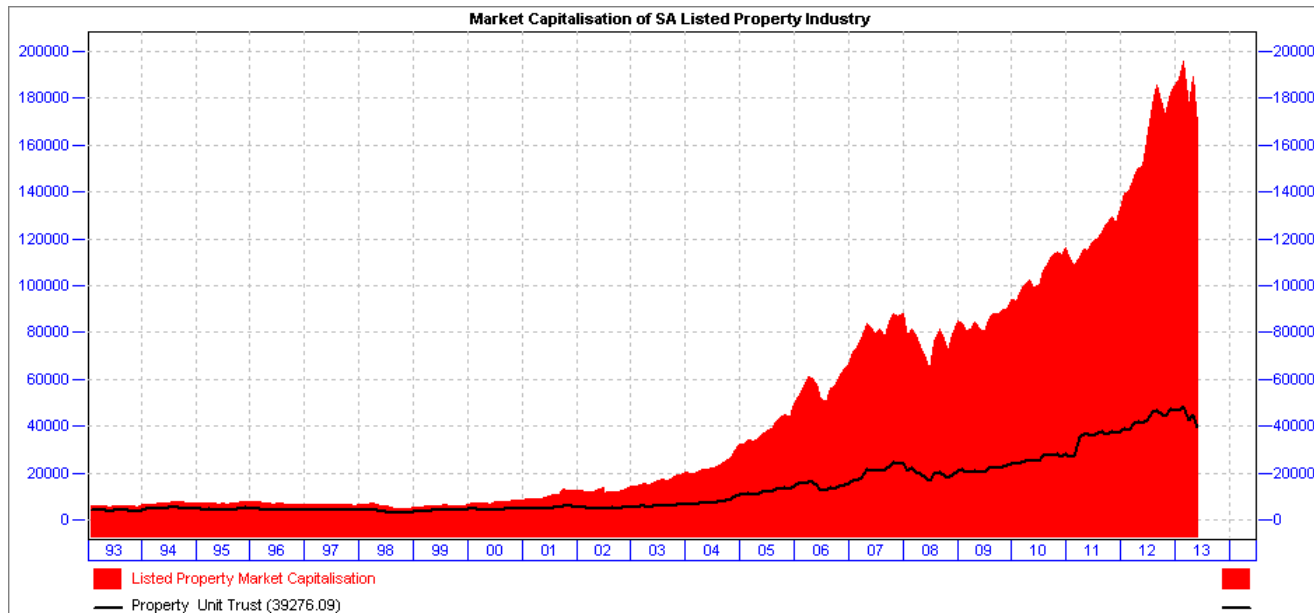
Why is the Flow Through of Income Principle So Important to the Property Industry

- Enables pension funds to invest in property funds and **so encourages savings and investment in income generating assets**
- The ability of property funds to gear means pension funds receive enhanced returns and so provides greater pension payouts to beneficiaries - hence less impact on Government to look after the aged.
- Flow through is an internationally accepted principle for property funds. Most developed property markets with bourses have Real Estate Investment Trusts sectors with established rules governing this flow through principle.
- **Very importantly, removing this flow through principle makes property a relatively unattractive investment class.**



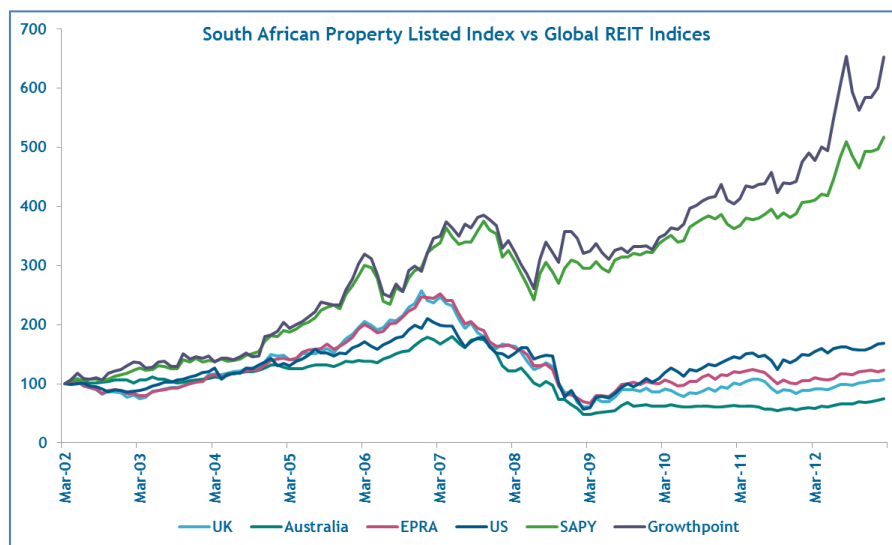
Listed Property Industry has grown enormously

- The market capitalisation of Listed Property ballooned from R10bn in 2001 to R220bn in 2014.
- SA is now the 8th biggest global REIT market – from nowhere 10 years previously.



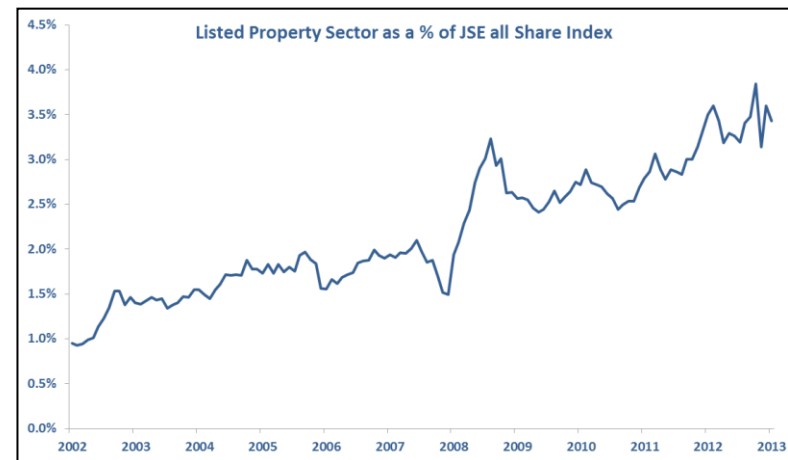
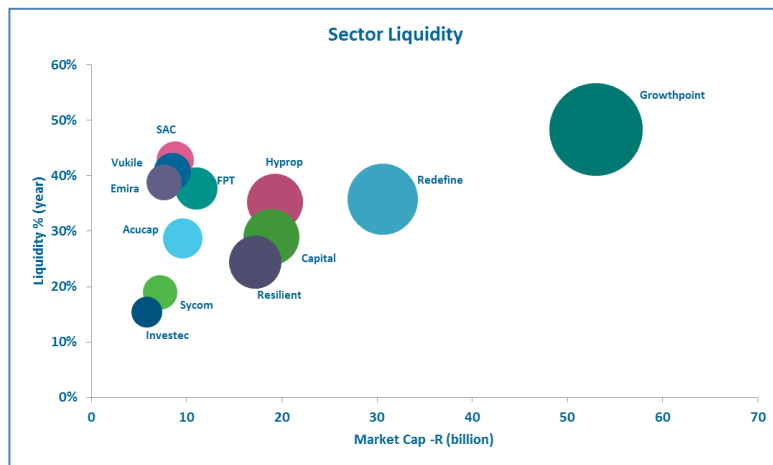
Unlisted Property Funds

- Unlisted property market probably bigger than the Listed Sector, if include pension funds and banks, short term and long term insurers, private investors and government.
- Smaller unlisted funds: estimated between R25-50bn plus, an important catalyst for the development of new listed funds, increased competition, governance and diversification of industry players.



Size Counts

This is important for South Africa, because increasing its property market size will increase liquidity in the sector and attract foreign investment. This in turn will result in funding of new developments and greater infrastructure development for the country.



Section 8F and 8FA

- Dual linked structures been around for at least 30 years. It is a common structure for property funds and has been the catalyst for the impressive growth of the industry over the past 15 years.
- SARS proposal denies deduction of interest, but gives relief to the big players (pension funds, short term and long term insurers). **We think that is patently unfair.**
- The Listed Sector now has REIT legislation in place which recognises the flow through of income principle. **Unlisted property funds receive relief, only if they have pension funds, short or long term insurers who hold a minimum of 20% interest in the company.**
- What about those companies who don't have pension funds, short or long term insurers as investors, or who may hold less than 20%? The relief provided in Sections 8F(3)(d)(i) and 8FA(3)(d)(i), **we believe to be discriminatory.**



The Negative Impact of Section 8F(3)(d)(i) and 8FA(3)(d)(i)

- Smacks of protectionism – crowding out smaller businesses/funds.
- Existing players seriously affected by these changes. After tax returns no longer competitive and funds will lose investors and struggle to bring new ones on board.
- Existing investors who may have geared themselves, now find they cannot no longer offset income earned against interest payable.
- In the current environment incubator funds very difficult to set up and bring to market/listing



Incubator Funds= SA Property Industry and SA REIT Growth

- Estimate minimum of R10bn of incubator funds currently affected. Will be difficult to keep current investor base, never mind attract new monies given the changes to Tax Act.
- If the flow through of income is removed, property loses it's investment appeal. This is because income growth is capped at annual rental escalations, and therefore it is hard to compete against normal companies (equities) with growth well above 10% per annum.
- We need the establishment of new funds eg: Residential Property Funds and Medical Property funds amongst others.
- We need to enable small business to be become big businesses of the future.
- Growthpoint had a market capitalisation of just R30m in 2001. Today it is R45bn! Rebosis was listed just less than 3 years ago. The merger with Delta and Ascension will see it catapulted into the top 10 largest funds. Let have more such companies.



Why is property so critically important to a country like SA?

- The stimulation and ease of undertaking property development results in increasing the nation's wealth
- The ability to finance property= creation of wealth
- Wealth=increased GDP= higher taxes = development of the nation
- Property portfolios=store of the nations savings= further creation of long term wealth for pension funds, NHI, individuals
- Please, please... provide an environment to encourage savings and investments in new property portfolios



What is the Unlisted Property Funds Working Group asking for?

To level the playing field between pension funds and non pension fund investors and remove clause 8F(3)(d)(i) and 8FA(3)(d)(i) from the Act.

In the interim, we give our undertaking to work hard to find a mutual satisfactory way of keeping the flow through of income principle for unlisted REITS with appropriate regulatory rules to maintain the required protection for investors.

