A Performance Comparison of Specialised (Industrial) and Non-specialised Real Estate Investment Trusts in South Africa

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Abstract

There is a belief that anything that is specialised tends to outperform the diversified counterparts and this study investigates if this proposition applies in the property industry, specifically the REIT (Real Estate Investment Trust) market in South Africa (SA). The norm is to apply a quantitative methodology when assessing performance but this study follows a qualitative approach in comparing the overall performance between specialised and diversified REITs in SA using non-quantitative metrics.

A mix of specialised and diversified REITs in SA were sampled and a multiple case study analysis was done after interviewing senior management in four REITs. A total of four interviews were done with five respondents across four cases. These cases were then analysed using thematic analysis. The respondents were asked questions relating to the REIT they are working for, industrial specialised and diversified REITs performance and the SA property market as a whole.

The overall findings suggest that diversified REITs may outperform the specialised REITs in SA currently however, this conclusion depends on a lot of factors. These factors include the analysis time of reference, the economic status of the country (for example, recession), the size of the REIT, the company gearing level, how that specific sector is performing at that particular time relative to others and the management efficiency level. The growth of e-commerce plays a vital role as a factor as well because it is said to be replacing the brick and mortar retail industry therefore, its influence affects the specialised industrial sector performance.

For further research, a similar study with a quantitative approach can be considered in order to add to the SA REIT body of knowledge. Furthermore, research on the performance of property companies before and after attaining REIT status could be investigated to determine the REIT status effect on the company. To add on to the SA REIT literature, performance between REITs in different sectors and provinces could be explored.

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Abbreviations

CAPM – Capital Asset Pricing Model

CEO – Chief Executive Officer

CGT – Capital Gains Tax

CISC – Collective Investment Schemes Control

EU – European Union

FSB – Financial Services Board

FSCA – Financial Sector Conduct Authority

IPD – Investment Property Databank

IPO – Initial Public Offering

JSE – Johannesburg Stock Exchange

JV – Joint Venture

OBRA – Omnibus Budget Reconciliation Act

LTV – Loan-To-Value

MPT – Modern Portfolio Theory

MSCI – Morgan Stanley Capital International

NAREIT – National Association of Real Estate Investment Trusts

NAV – Net Asset Value

NYSE – New York Stock Exchange

PLS –Property Loan Stock

PUT – Property Unit Trust

REIT – Real Estate Investment Trust

SA – South Africa

SADC – Southern African Development Community

SAREIT – South African Real Estate Investment Trust

SML – Security Market Line

US – United States of America

UK – United Kingdom

Chapter 1: Introduction

1.1 Introduction

This chapter provides a brief overview of Real Estate Investment Trusts (REIT) and the manner in which they are governed with regards to the South African (SA) listed property sector. A discussion on property portfolio diversification and specialisation will follow which leads to how risk and return are perceived in property portfolio management.

The research problem, proposition and aims will be derived from the literature. The objectives, methodology and limitations of the study will be outlined. This is followed by the structure of the research report.

1.2 Background

1.2.1 Real Estate Investment Trusts (REITs)

A REIT is a company that owns and, in most cases, operates income-producing property. REITs were founded through the Real Estate Investment Trust Act of 1960 in the United States of America (US). Due to its prior strict tax regulations, the Tax Reform Act of 1986 loosened the restrictions and as a result paved way for the US REIT boom of the 1990s which saw the REITs sector grow to be the third most lucrative asset class after stocks and bonds (Brounen and de Koning, 2013). A decade later, all listed REITs in the world were valued at more than $1 trillion. REITs can either be listed or unlisted on the securities exchange in the US but all REITs in SA have to be listed.

Despite the current popularity, two decades into their existence, Graff (2001) argued that REITs failed to deliver returns and stock market liquidity during the 1970s bear markets because REIT managers misused their financial leverage, fading investor appetite in the investment vehicles as cited in Brounen and de Koning (2013). One of the hurdles that REITs encountered in the 1980s was that they could not manage their own properties. In 1986, with the help of the National Association of Real Estate Investment Trusts (NAREIT) in the US, the Real Estate Investment Trust Modernization Act came into play, where the country saw REITs now being allowed to manage their own properties (King, 1998). It was one of the factors that led to the 1990 REIT boom. There was a change in the REIT tax laws which acted as a catalyst to the exponential growth of the companies (King, 1998). In 1993, a restriction was relaxed which prohibited

REIT ownership of five or fewer persons from owning 50% or more of that REIT stock and which contributed to REIT boom (Downs, 1998). This was possible through the 1993 Omnibus Budget Reconciliation Act (OBRA) and it attracted institutional investors (Lin, 2011).

During the last quarter of 1990 in the US, Kimco went public and its initial public offering (IPO) raised $128 million. A year later, Taubman followed with its IPO raising $330 million. REITs now seemed even more attractive and more private companies listed between the years 1993 to 1994 (IPO 'boom') raising a total of $16.5 billion in equity (Brounen and de Koning, 2013). The REIT sector was performing well until a sudden downturn in 1998 where the NAREIT index lost 22% of its net asset value (Brounen and de Koning, 2013). This was soon before the dotcom bubble, where investors now pulled out of the REIT sector to go and invest in the technology stocks with hope to get a better return. A fundamental question was asked by Brounen and de Koning (2013: 200): "Are real estate stocks a reflection of the underlying property portfolio, or are they a part of the broader stock market?"

There are two types of REITs in SA namely, Company REITs which may be internally or externally managed, and Trust REITs which are externally managed. More than 25 countries use the same REIT model such as the US, the United Kingdom (UK), Australia, Belgium, France, Hong Kong, Japan and Singapore (Brounen and de Koning, 2013). Listed Company REITs and Trust REITs are publicly traded on the securities exchange such as the Johannesburg Stock Exchange (JSE) in SA and they qualify for REIT tax dispensation. Among others, a JSE-listed REIT has the following requirements:

- The REIT should own at least R300 million worth of property,
- It should keep its debt below 60% of its gross asset value,
- Should 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, and
- It should pay at least 75% of its taxable earnings available for distribution to its investors each year (South African Real Estate Investment Trust (SAREIT) Association, 2018c).

REIT tax dispensation is one of the benefits that made converting a private company to a REIT seem attractive. Effective from the 1st of April 2013, according to Section 25BB of the Income Tax Act No 58 of 1962, the following changes were made (Republic of South Africa, 1962: 197):

- “Interest distributions by a REIT to resident investors are (relabelled) as taxable dividends, whereas the dividend will remain exempt(ed) from income tax for foreign investors;
- An income tax deduction in the hands of the REIT in respect of qualifying distributions, which in itself can create tax neutrality in the REIT;
- Any allowances relating to immovable property are disallowed in the hands of the REIT; and
- The REIT is exempt(ed) from capital gains tax in respect of the disposal of its immovable property, interests in other REITs or in its property subsidiaries.”

Investors argue that REIT investors are exposed to diversified property portfolios and as a result, enjoy low risk levels (SAREIT Association, 2018d). Furthermore, REITs are a way of safe-guarding one’s investment against inflation through capital growth and income distribution growth. On average, the investment grows by 8% annually and it is the most affordable form of property investment because investors acquire shares instead of direct ownership. For diversified portfolios, REITs provide investors with a lower risk model governed by companies with strict requirements (SAREIT Association, 2018d).

1.2.2 Listed Property

Prior to SA REIT legislation in 2013, there were two forms of listed property investment vehicles in SA, namely; Property Loan Stock Companies (PLSs) and Property Unit Trusts (PUTs) (Ramjee, 2017). Both were able to adopt the REIT Regulations set out by the JSE. PLS Companies and PUTs were not internationally recognised therefore foreign investors were hesitant to invest in the SA Listed Property Sector (Ungerer, 2013). However, the sector has performed well in the past decade, outperforming other asset classes (cash, equities and bonds) in all 3 year, 5 year and 10 year periods (Ramjee, 2017). In 2007, the SA listed property sector market capitalisation (Figure 1.1) was R100 billion and it went up to R425 billion by the end of 2017 (SAREIT Association, 2018d). Listed property produce a better return compared to equities at the same risk level (SAREIT Association, 2018d). This is backed up by monthly rentals from tenants bound by lease agreements and annual escalations (Boshoff and Cloete, 2012).

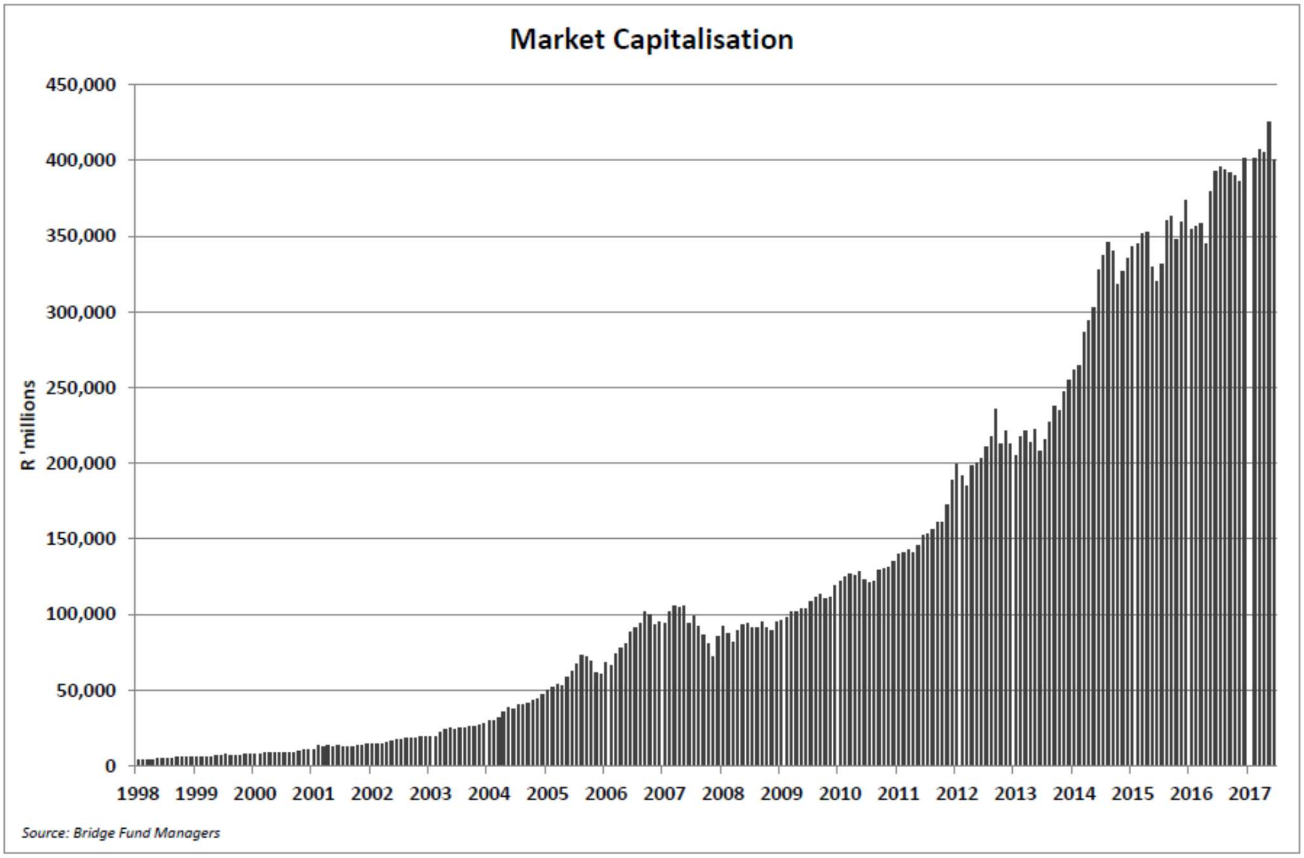

Figure 1.1 - Listed Property Market Capitalisation (SAREIT Association, 2018a: 1)

1.2.3 Specialised and Non-Specialised REITs

Some REITs choose to focus all or the bulk of its investments on one sector while some choose to diversify their portfolio. Capozza and Seguin (1999) proved that property type diversification increases property-level cash flow, general and administrative expenses, borrowing costs and decreases liquidity. Geltner *et al.* (2001) argue that investors rather favour to diversify their portfolios through their specialised REITs because management specialty and cost efficiency are achieved better through specialised REITs. Furthermore, investment property specialists argued that specialised REITs with one or a several property types are easier to understand and analyse (Lin, 2011). As a result, there is a visible change in the US's REIT investment preference towards the year 2000 where REITs moved from property-type diversification to property-type specialisation (Lin, 2011).

According to three REIT CEO's (Chief Executive Officer) in the US, e-commerce is not the only driver of the industrial sector at the moment. Jim Connor of Duke Realty Corp states that one of the drivers includes the growth of food and beverage logistic companies and a sign of this is the recent Whole Foods acquisition by Amazon. In addition there are, on average, 10 000 baby boomers reaching retirement each day and this applies growth pressure on the logistics business of drugs and medical supplies to hospitals. As retailers grow, they require more space for their logistics and supplies as end users now expect same day delivery of their products ordered online (NAREIT, 2018b). Gordon DuGan, CEO of Gramercy Property Trust, argues that the industrial sector growth will also come from the global and US economic growth. DuGan also mentions that “global manufacturers are moving production and automation into the US” and they will require industrial space (NAREIT, 2018b: 1). Lastly, the CEO of DCT Industrial, Phil Hawkins, states that industrial property users such as distributors, now want to occupy buildings closer to the people to minimise delivery time (NAREIT, 2018b).

Industrial REITs are specialist companies that own and manage income-producing industrial properties such as warehouse and distribution centres (NAREIT, 2018c). A specialised industrial REIT in this study should have an industrial property sector split of 60% of the portfolio or more. Examples of REITs in SA that have a large industrial property sector share are Equites Property Fund and Stor-age Property REIT Limited with 98% and 100% respectively (Stor-age Property REIT Limited, 2017; Equites Property Fund, 2018). There is limited literature on this comparison (specialised Vs non-specialised REITs in SA) and this study sought to address it (Boshoff, 2013a).

Industrial property rentals in the US have increased more than 5.5% annually in the years 2016 and 2017 mostly due to the e-commerce boom and it is expected to continue at this rate (National Real Estate Investor, 2017). Furthermore, the industrial sector is experiencing unprecedented times where industrial space is taking over retail space and it is unknown how long this will continue for. This is due to companies such as Amazon in the US and Take-a-lot in SA showing signs of rapid growth and increasing demand for industrial space as they require more storage space for goods sold to end users (Market Realist, 2015). The industrial REIT sector in the US, at a total return of 36%, outperformed the broader REIT index by 21% in the year 2016. Moreover, the sector realised more than 8% year on year rental growth rate since 2014 and less than 5% vacancy level (Seeking Alpha, 2017).

There are seven industrial property types best suited for the SA market, which are:

Table 1.1 - Industrial Property types adapted from Broll (2017)

Industrial Property Type	Description
1. High-tech industrial	Modern buildings with office components accounting for 25% to 50% of the gross market rental.
2. High grade industrial	Eaves height greater than 6 metres with good yard/circulation space.
3. Light manufacturing	Office component accounts for less than 15% of market rental. Eave heights are less than 6m or limited yard/circulation space or restricted access.
4. Warehousing	Eave heights are greater than 6 metres with good circulation, docking space and multiple access portals.
5. Maxi-units	Modular units with a majority of rentable areas being greater than 1,000m² per unit.
6. Midi-units	Modular units with a majority of rentable areas measuring between 500m² and 1,000m² per unit.
7. Mini-units	Modular units with a majority of rentable areas being less than 500m² per unit.

SA's industrial sector outperformed the others (retail and office sectors at 12.6% and 7.6% respectively) at a total return of 13.6% in 2016, despite the decrease (from the previous year's 13.0%) in the SA's Annual Property Index. In addition to that, the sector had a rental growth of 6.2% (MSCI, 2017). Industrial REITs seem like lucrative investments at the moment, but they have risk implications.

1.2.4 Investment Risk and Return

Specialised REITs are said to have a comparative advantage over diversified REITs with regards to management efficiency, therefore resulting in a higher return (Lin, 2011). Ro and Ziobrowski (2011) investigated this proposition and found that diversified REITs actually outperform specialised REITs, though not by a statistically significant margin and specialised REITs have a higher market risk than the diversified REITs. This was, however, during a period when the economy was performing well. Lin (2011) argues that specialised REITs in the UK yield a better return than diversified REITs, for the same level of risk, during an economic recession.

Lee and Stevenson (2005) carried out a study in the UK that investigated if it was better to specialise in a property type across all UK regions or diversify across all property types, within a region. The conclusion was to diversify as it results in a higher return compared to specialisation. A similar study which was undertaken in the UK and the US, investigated whether it is better to change focus of a real estate fund from one property type in one region to mixed property types in one region or mixed property types in multiple regions (Eichholtz *et al.*, 1995). The conclusion was different in each country taking into consideration the economy, population dynamics and city features. In the US, it was dependent upon the property type. The retail sector was efficient when diversified across regions while this was not true for office and residential. In the UK, it was efficient to diversify property types in multiple regions (Eichholtz *et al.*, 1995).

Ro and Ziobrowski (2011) argue that between the years 1997 and 2006 in the US, the trend was that institutional investors diversified their portfolios by property type while REITs invested mostly in one property type. Webb and Rubens (1987) and Louargand (1992) show that 61% and 89% of the institutional investors, respectively, diversify their portfolios by property type in order to reduce overall unsystematic risk and maintain the portfolio's return. According to the NAREIT handbooks (1997 to 2006), less than 10% of the REITs diversify by property type. The remaining 90% specialise in one or two related sectors.

Geltner *et al.* (2001), however, state that in the 1980s more than 30% of the REITs in the US were diversified and the number has since then gradually dropped. Geltner *et al.* (2001) state that there are three reasons for the drop:

i. Real Estate Investment Trust Modernization Act of 1986 enabled REITs to now manage their own properties and effective specialisation (by property type) management tactics were developed and adopted;
ii. REIT investment priorities had changed (initially, they wanted passive investment vehicles which was satisfied by diversified portfolios) and investors switched to specialisation by property type which proved to be more lucrative at that point;
iii. It is easier for analysts to understand REITs that specialised in one market segment compared to multiple market segments.

In general business, Lang and Stulz (1994) argue that there is no significant difference between specialists and generalists with regards to systematic risk and return as Cronqvist *et al.* (2001) argue that diversified property portfolios are profitable. Campbell *et al.* (2003) disagreed arguing that geographical specialisation results in a higher return. Empirical studies (Benefield *et al.*, 2009; Sebehela, 2009; Ro and Ziobrowski, 2011) outside SA show that there is no general consensus on the specialisation vs generalisation topic and this study sought to find out if the same applies to SA.

One of the first researchers that investigated the performance of industrial properties was done by Hoag (1980), who argued that the industrial real estate value index is a function of property and market factors. Liu *et al.* (1990) added that there is a risk element that also has to be considered and Wheaton and Torto (1990) believe industrial space production is an investment decision (because it is normally built for owner occupation or a long-term single tenant) based on employment and cost of corporate capital. Furthermore, since industrial properties are normally built for its user, it does not follow the typical real estate cycle but rather follows the macroeconomic cycle. The value and rental level of industrial properties are determined by taking several factors into consideration and these include "building size, office space, dock doors, ceiling height, age, distance to [the] Airport and county of sale" (Dobson and Goddard, 1992: 365). Besides physical factors, there are economic, geographical and financial factors that affect the supply and demand of industrial property sector. The demand factors include industrial cap rate, prime rate, population, infrastructure, labour force, tenant type, and date of sale (if valued for sale purposes) and construction is the main supply factor (Hoag, 1980; Liu *et al.*, 1990; Dobson and Goddard, 1992; Hughes, 1994).

The US measures the industrial space supply using Industrial Construction Put in Place series which was introduced in 2006 by the US Census Bureau (Cheng *et al.*, 2006). As mentioned above, the space supply was shadowing the macroeconomic market movement (market recession and recoveries) because economic impacts normally have the greatest impact. The industrial sector was one of the best performers of the year 2017 in SA. The Durban market ended the year with a 9% year on year rental growth across all industrial property grades (Bizcommunity, 2018). Furthermore, there seems to be an interest in the logistics and distribution properties, including Clairwood Logistics Park, which is said to add 80 000 square metres of industrial space to the market. Johannesburg is said to have 884 000 square metres of industrial space in the pipeline and the interest in high-end modern facilities is driving the rental rates up. Cheng *et al.* (2006) argue that there are three variables that measure industrial space demand and they are manufacturing employment, industrial production and capacity utilisation; and not just industrial production or construction as implied by Hughes (1994). Capacity utilisation is a measure of economic activity defined as the rate at which output levels are being met or used and industrial production is the output of the industrial sector comprising construction, manufacturing and mining. Lastly, manufacturing employment is jobs that create new products from raw materials normally in factories or industrial properties (Focus Economics, 2018; Investopedia, 2018a; The Balance, 2018). "Capacity Utilisation in South Africa increased to 81.8% in the fourth quarter of 2017 from 81.5% in the third quarter of 2017 [and] averaged 81.9% from 1971 until 2017, reaching an all-time high of 86.3% in the fourth quarter of 2005 and a record low of 76.9% in the third quarter of 1992" (Trading Economics, 2018: 1). Furthermore, SA industrial production grew by 2.5% year on year in January 2018 which was the biggest gain since June 2016. "Industrial Production in South Africa averaged 1% from 1974 until 2018, reaching an all-time high of 18.50% in May of 1995 and a record low of -23.20% in April of 2009" (Trading Economics, 2018: 1). Moreover, the REIT industry is performing really well that some companies find it better to specialise by property type. The market realised the emergence of companies such as Indluplace (residential), Campus Key (student residential), Equites (industrial), Capital Property Fund (industrial - bought by Fortress) and Stor-age (industrial) (SAREIT Association, 2018d).

There is very limited literature on REITs in SA and one of the reasons is that REITs are relatively new to the country, having been introduced early 2013. There is, however, some literature on South African PUTs (Property Unit Trusts) and PLSs (Property Loan Stocks) which are listed property investment vehicles which were used prior to the introduction of REITs. Sebehela (2009: ii) argues that an "introduction of PUTs [and PLSs] in a diversified investment portfolio does not necessarily increase returns." The author went on to add that the inclusion of listed property might help diversify the portfolio, thus reduce risk, but it does not increase risk-adjusted returns. Diversification helps investors make minimum losses during negative unanticipated market conditions. Each property type has its own property cycle, therefore a diversified portfolio with a well-balanced tenant mix can maintain a sound cash flow even during unfavourable market conditions (Nsibande and Boshoff, 2017; Ramjee, 2017).

The SA REIT industry is a new market therefore information on the performance of the companies is limited.

1.3 Problem Statement

The problem to be examined in this study can be stated as follows:

There is limited data regarding a performance comparison of specialised (industrial) and non-specialised REITs in South Africa.

1.4 Research Question

The research question that will be answered is stated as follows:

Do specialised (industrial) REITs outperform diversified REITs in South Africa?

1.5 Research Proposition

The research proposition to be tested in this study is:

Specialised industrial REITs outperform non-specialised REITs in South Africa.

1.6 Aim

The aim of the study is as follows:

To establish whether specialised industrial REITs outperform non-specialised REITs, in South Africa.

1.7 Objectives

The research objectives to be achieved are:

i. Compare the performance of a specialised industrial REIT to a non-specialised REIT.
ii. Identify what drives the stock and income performance of a specialised (industrial) REIT and a non-specialised REIT.
iii. Identify drivers for REITs to specialise in the industrial sector.
iv. Investigate the impact of a specialised REIT's structure on its performance.
v. Determine the effect the growing e-commerce industry has on specialised industrial property sector.

1.8 Methodology

The outcomes of the aim and objectives of this study will be achieved through the following:

i. A literature review of studies similar to this study.
ii. Semi structured interviews with relevant personnel working for specialised industrial and non-specialised REITs.
iii. Detailed interpretation of the multiple case study analysis findings.
iv. Conclusions and recommendations presented.

This study will take on a qualitative approach in the form of semi-structured question interviews.

1.9 Limitations

i. The qualitative component of the report relies on semi-structured interviews for data collection and these are subject to bias.
ii. There are very few specialised industrial REITs in South Africa.
iii. Only REITs with offices in Cape Town were selected as part of the sample as these were the most accessible.
iv. REITs in SA were introduced in 2013, therefore there is not much performance data publicly available.

1.10 Structure of Report

The research report will be structured accordingly:

Chapter 2 consists of a critical literature review of the study as it is outlined in the background in Chapter 1. The topics that make part of the study are (but not limited to) real estate investment trusts, listed property, specialised and non-specialised REITs and investment risk and return. Through a critical literature review, the methodology and schools of thought will emerge.

Chapter 3 focused on the research methods applied to this study and the methodology is then justified based on similar research.

Chapter 4 presents the findings from the semi-structured interviews, data collection and analysis in a way in which the research question, aim and objectives are addressed.

Chapter 5 supports or refute the research proposition based on the data analysis findings in Chapter four. A conclusion will then be drawn on whether specialised industrial REITs outperform non-specialised REITs.

1.11 Chapter Summary

This chapter has given an overview on REITs, listed property, specialised and non-specialised REITs and investment risk and return. The research problem, question, proposition, aims and objectives have been clearly set out. The research methodology and limitations have also been simply outlined.

Chapter 2: Literature Review

2.1. Introduction

This chapter serves to provide a critical analysis of the literature related to the specialised industrial and non-specialised REITs in SA and their respective performances, as represented by Figure 2.1.

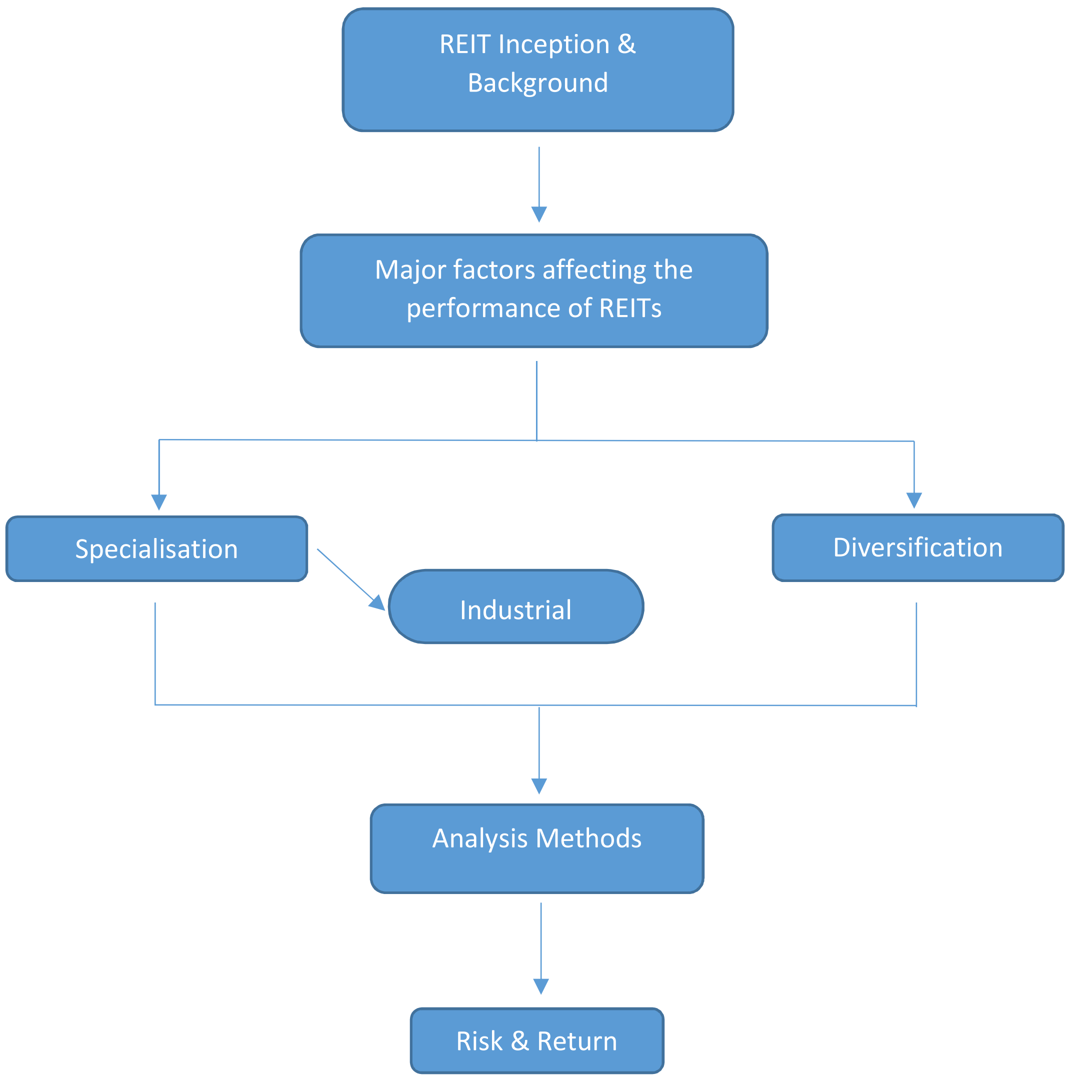

Figure 2.1 - Literature Review Flowchart

2.2. Real Estate Investment Trusts (REITs)

2.2.1. Background

According to Leković and Stanišić (2017: 358), REITs are "financial intermediaries who carry out capital aggregation of individual and institutional investors, and invest thus associated funds in real estate." Likewise, Krewson-Kelly and Thomas (2016) agree that a REIT is a company that owns and manages income-producing properties and disburses dividends to its shareholders periodically. These investment vehicles were first legally enabled in the US by the Real Estate Investment Trust Act of 1960 and a decade later New Zealand, the Netherlands and Australia followed where they were known, until recently, as Listed Property Trusts (Australia). A few countries only introduced REITs three decades later and these are Brazil (1993), Canada (1994), Spain (1994) and Belgium (1995). Furthermore, the Asian market countries such as Japan (2000) Singapore (2002) and Hong Kong (2003) introduced REITs after the millennium along with France (2003), UK and Germany both in 2007 (Stevenson, 2013).

Early studies, in the US, compared the performance of REITs to other financial asset classes but some findings emanating from these studies gave contrasting results. Some literature argued that REITs have a higher risk and low/comparable returns compared to common stock (Smith and Shulman, 1976; Kuhle *et al.*, 1986) while other authors disagreed, arguing that REITs actually have a low systematic risk and yield higher/comparable returns (Davidson and Palmer, 1978; Brueggeman *et al.*, 1984; Zerbst and Cambon, 1984). Furthermore, similar studies were conducted on portfolio diversification as a result of the inclusion of REITs to a common stock or mixed-asset portfolio and they too had contrasting results. Kuhle (1987) argued that the addition of REITs to the investment portfolio (diversification) improves portfolio returns and lowers the total portfolio risk. Moreover, Hartzell *et al.* (1986) and Grissom *et al.*(1987) added that combining property type, SMSA (standard metropolitan statistical areas) population growth rate and lease maturity results in a more efficient portfolio diversification.

2.2.2. Types of REITs

There are three types of REITs in the US, namely; Equity REITs, Mortgage REITs and Hybrid or Diversified REITs (Leković and Stanišić, 2017). Equity REITs are direct owners of the properties and they manage their income-producing properties. Mortgage REITs do not own or manage any real estate and their income comes from financing property developments through mortgage loans. Lastly, Hybrid REITs have features from both Equity and Mortgage REITs. Equity REITs can be further sub-divided into Specialised REITs (which focuses mostly on one sector) which are addressed later on. Most of the market capitalisation, valued at approximately $2 trillion of real estate assets, belongs to Equity REITs in the US which is made up of over 200 000 properties in all 50 states and the District of Columbia (NAREIT, 2018d). SA only has two (2) types of REITs which are Company REITs and Trust REITs shown by Table 2.1.

Table 2.1 - Types of SA REITs adapted from SAREIT Association (2018b)

Company REIT	Trust REIT
• Governed by the SA Companies Act and Takeovers Regulations Panel that allows the Company's shareholders to vote (Republic of South Africa, 1973).	• An existing PUT will become a REIT upon successful application to the JSE and registration with Registrar of Collective Investment Schemes.
• The Company has a REIT structure included on its memorandum of incorporation.	• The REIT is run by a trustee protected by a Trust Deed, who has to ensure compliance with the Collective Investment Schemes Control (CISC) Act (Republic of South Africa, 2002).
• The Company's directors are responsible for its compliance with JSE requirements and the Companies Act.	• The REIT is not subject to the Takeovers Regulations, only JSE requirements CISC Act.
• The Company can be managed internally or externally and/or property administration.	• Trustees report to the Registrar and must meet all the requirements of the Collective Investment Schemes Control Act.
	• Must have an external asset and property manager in terms of the Collective Investment Schemes Control Act.

2.2.3. REIT Structures

Different types of REITs operate under different structures. There are three forms of REIT structures that are commonly used, namely: Traditional, Paired-share and Paperclip REIT structures (Beals and Singh, 2002). Under a Traditional structure, the REIT owns the property (for example, hotels, apartments and office buildings) and leases it out to the lessee who deals with management and franchise agreements which is illustrated by Figure 2.2.

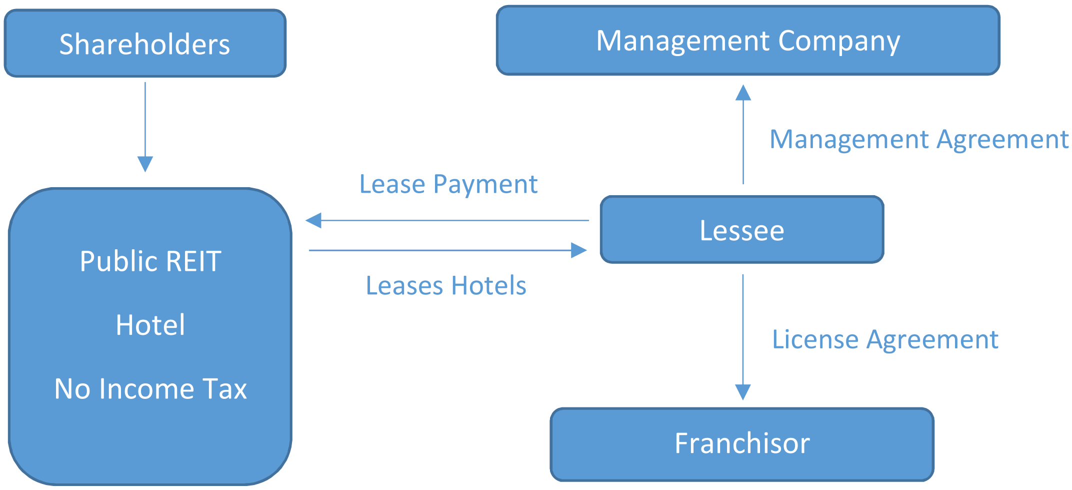

Figure 2.2 - Traditional REIT Structure adapted from Beals and Singh (2002)

Under a Paired-share REIT structure, the REIT forms a joint venture with a C-Corp which is then operated as one company which is illustrated by Figure 2.3 (Beals and Singh, 2002). A C-Corp is an organisation formed, separate from its owners, under the state and federal law. Its shareholders elect directors who in turn elect corporate officers who deal with the company's day-to-day duties (Beals and Singh, 2002). The Paired-share REIT appeals to the investors because "leakage" is avoided. Leakage is the costs that would have been lost to the lessee which are re-captured by the C-Corp (which is in a joint venture with the REIT). A Paperclip REIT structure is similar to a Paired-share REIT structure. The only difference is that "paired-share REITs trade the shares in the REIT and the C-Corp as one integrated share [and] a paper-clip REIT trades shares in the REIT and the C-Corp separately" (Beals and Singh, 2002: 21).

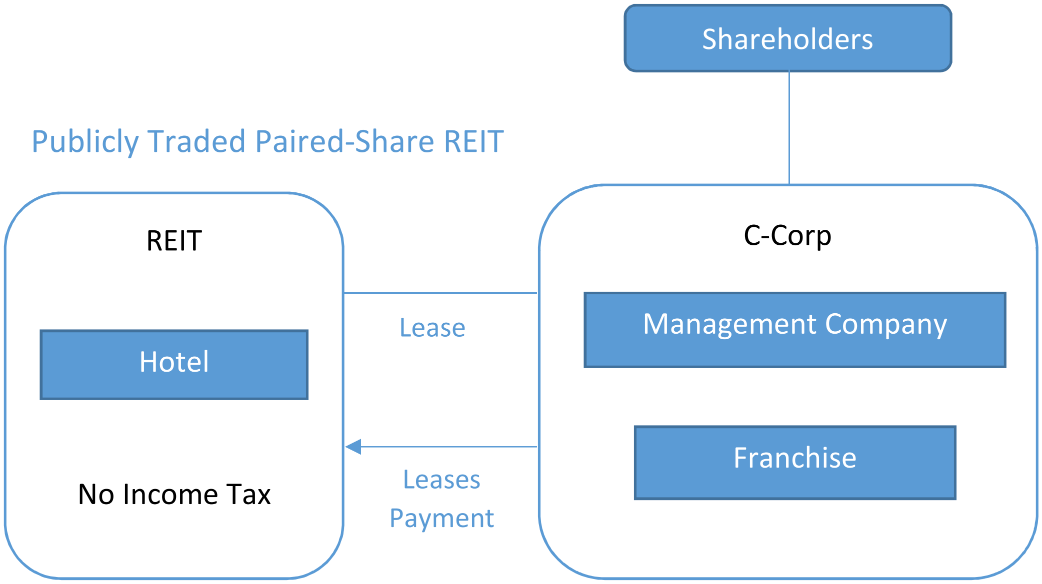

Figure 2.3 - Paired-share REIT structure Adapted from Beals and Singh (2002)

2.2.4. REIT Taxation

One of the most appealing features about REITs to investors is the special REIT tax dispensation that encourages broad investment into real estate. Unlike in SA, it is not a requirement for a REIT to be listed in the US but it is, however, a requirement for a US REIT is to have a minimum of 100 shareholders. Moreover, not more than 50% of the value of a US REIT's shares can be owned by 5 or less individuals during the last half of the REIT's taxable year (KPMG, 2013). A REIT, under US legislation, must distribute a minimum of 90% of its earnings, excluding its capital gain, to its shareholders annually (KPMG, 2013). The UK REIT regime was enacted on the 1st of January 2007 under the Finance Act 2006 (PricewaterhouseCoopers (PwC), 2017). The legislation requires a REIT to distribute a minimum of 90% of their rental income, after finance costs, overheads and tax depreciation are deducted, to their shareholders annually. It is worth highlighting that the legislation does not explicitly advise that the REIT should distribute its capital gains (PwC, 2017).

As mentioned above, prior to 2013, SA's listed property investment vehicles were made up of PUTs and PLS. These were governed by different legislation which is one of the factors that deterred foreign investors. PUTs were governed by the Financial Services Board (FSB – now Financial Sector Conduct Authority) and the PLS Company by the Companies Act but they both had to meet the same JSE listing requirements (Republic of South Africa, 1973; Republic of South Africa, 2002; Ungerer, 2013). The listed property prior to 2013 was taxed differently which was another reason why foreign investors were hesitant to invest in SA listed property at that time. Only net capital gains were included in taxable income and trusts were taxed at 26.7% on only 50% (inclusion rate) of the income (Republic of South Africa Treasury, 2012; Ungerer, 2013). Furthermore, the companies' tax rate (28%) applied to the PLS because it was treated as a company.

One of the reasons why the REIT system was delayed in SA and other countries is due to the risk of tax evasion and related abuses (Leković and Stanišić, 2017). For example, a foreign investor will not get taxed in the country where the REIT is registered but where he is a citizen or registered legal entity. Similarly, investors were required to pay taxes on dividends received from REITs and as a way to defer paying taxes, they owned their REIT shares in a tax-deferred account (such as a retirement account) and they would only pay tax once they withdraw money from that account (SEC, 2011). A REIT is not a pass-through entity, meaning the REIT cannot pass any tax losses to its investors. Prior to REITs being introduced in SA (before 2013), foreign investors were reluctant to invest in the listed property vehicles used at that time (PLS and PUTs) because they were not familiar with their legal and regulatory legislation (Ungerer, 2013). The REIT legislation was introduced with a tax dispensation aimed at providing clarity on the SA listed property taxation. The SA REIT industry was introduced to align it with the international standard with respect to the legal and structural aspects. The SA REIT tax is governed by section 25BB of the Income Tax Act and SA REITs must pay 75% of its taxable earnings to its shareholders as dividends annually (Republic Of South Africa, 1962; SAREIT Association, 2018c). Section 25BB of the Income Tax Act (REITs Taxation) ensured the following:

- Interest distributed by REITs to resident investors are changed to taxable dividends and foreign investors dividends will be exempted from income tax[1];
- An income tax deduction in the hands of the REIT in respect of qualifying distributions, which in itself can create tax neutrality in the REIT[2];

[1] Section 25BB(6) and section 10(1)(k)(i)(aa) of the Act
[2] Section 25BB(2)

- Any immovable property allowances[3] are disallowed in the hands of the REIT[4]; and
- The REIT is exempted from capital gains tax in respect of the disposal of its immovable property, interests in other REITs or in its property subsidiaries[5] (Republic Of South Africa, 1962; Boshoff and Bredell, 2013; Ungerer, 2013).

Table 2.2 lists the NAREIT and SAREIT Association requirements for a company to be a qualified REIT. Note that all REITs in SA are listed on the JSE, therefore the SAREIT Association and JSE requirements are similar (KPMG, 2013).

Table 2.2 - REIT Requirements Adapted from NAREIT (2018a) SAREIT Association (2018c)

NAREIT	SAREIT Association
• Invest at least 75% of its total assets in real estate	• Keep its debt below 60% of its gross asset value
• Derive at least 75% of its gross income from rents from real property, interest on mortgages financing real property or from sales of real estate	• Earn 75% of its income from rental or from property owned or investment income from indirect property ownership
• Pay at least 90% of its taxable income as shareholder dividends each year	• Pay at least 75% of its taxable earnings available for distribution to its investors each year
• Be an entity that is taxable as a corporation	• Own at least R300million of property
• Be managed by a board of directors or trustees	• Have a committee to monitor risk not enter into derivative instruments that are not in the ordinary course of business.
• Have a minimum of 100 shareholders	
• Have no more than 50% of its shares held by five or fewer individuals.	

[3] These allowances include section 11(g) (leasehold improvements), section 13 ("Deductions in respect of buildings used in a process of manufacture"), section 13bis ("Deductions in respect of buildings used by hotel keepers"), section 13ter ("Deductions in respect of residential buildings"), section 13quat ("Deductions in respect of erection or improvement of buildings in urban development zones"), section 13quin ("Deduction in respect of commercial buildings") and section 13sex ("Deduction in respect of certain residential units") of the Act.
[4] Section 25BB(4) of the Act
[5] Section 25BB(5) of the Act

2.2.5. Benefits of investing in REITs

Besides tax dispensation, REITs have several other advantages. They are liquid which enables investors to sell their shares of the funds quicker than if they were to sell direct real estate. REITs are secure which is achieved through sector diversification and they also act as an effective hedge against inflation because their dividends usually grow faster (capital investment and regular income distributions) than the inflation rate. Compared to direct real estate investment, REITs are affordable and easier to invest in and investors do not need to manage the properties themselves as there are professionals employed to manage the portfolio. Investors benefit from economies of scale the REIT has which ultimately reduces costs and the REIT exposes the investors to the multiple real estate markets including offshore investments. REITs have both the equity and private property market features and most rental leases have an annual escalation rate of 8% on average. Diversified REITs normally have a low portfolio risk and all SA REITs offer transparency because they are publicly listed which means their information is in the public domain (NAREIT, 2018e; SAREIT Association, 2018d).

2.3. Major Factors Affecting the Performance of REITs

There are many factors that affect the performance of REITs, such as: the size of fund; source of data or where the fund is located; time periods used on the data for analysis (for example, monthly, quarterly or annual returns); and the fund's leverage or gearing level (Eichholtz *et al.*, 1995; Lee and Stevenson, 2005; Benefield *et al.*, 2009; Lin, 2011; Ro and Ziobrowski, 2011). The size of the fund is said to be the most important factor when assessing the risk-adjusted performance of a REIT because they have comparative advantages over the small funds. These advantages include economies of scale (cheaper overhead costs) and superior bargaining and negotiation power (investment opportunities) (Lin and Yung, 2004; Morri and Lee, 2009). The large funds' growth, however, is restricted by the market size which would lead to a drop in the returns eventually while the small firms' growth is restricted by the small portfolio they have (Mueller, 1998).

The source of data plays an important role as it can give different results on the same study due to different dynamics at each location. Eichholtz *et al.* (1995) as enumerated in Chapter 1, investigated whether it was more profitable to change focus of a real estate fund from one property type in one region to mixed property types in one region or mixed property types in multiple regions. The conclusion was different in each country due to factors such as the economy, population dynamics and city features. For example, in the US, it was dependent upon the property type. In the addition, the retail sector was efficient when diversified across regions while this was not true for office and residential while in the UK, it was efficient to diversify property types in multiple regions.

Data from a short time period can be a disadvantage because it is normally associated with small sample bias. Authors, however, have a way in which they can bypass this perceived disadvantage. Furthermore, Grinblatt and Titman (1989) prove that shorter time periods can be as efficient as longer time periods when assessing performance rating. Vinod and Morey (1999) also suggest an adjusted Sharpe Ratio also known as "Double" Sharpe Ratio which eliminates small sample bias.

Lastly, the amount of leverage a fund has affects the performance significantly (Lin, 2011; Ro and Ziobrowski, 2011). Some authors (Benefield *et al.*, 2009; Morri and Lee, 2009) ignore the potential leverage effect on their studies which could significantly bias their findings. Riddiough *et al.* (2005) proved that adjusting for leverage altered returns by over 2% annually and Lin (2011: 14) also argues that REITs that "leverage heavily tend to have a non-normal return distribution" which could potentially bias the study's results.

2.4. Risk and Return

The Modern Portfolio Theory (MPT) by Markowitz (1959), addresses the risk and return relationship in portfolio investment. Markowitz argues that for a given level of risk, an investor can construct a portfolio to maximise the expected return. Some of the tools that can be used to analyse risk and return are the Efficient Frontier, Capital Asset Pricing Model (CAPM) and Security Market Line (SML) Theory. Market risk is inevitable because it is based on the ever-changing economic activity, interest rates, unemployment, population growth, economic growth and inflation (Brown, 1991; Cho, 1997). However, specific risk can be eliminated through diversification.

Morri and Lee (2009) discussed elements that affect risk and return characteristics of a fund and tested them in multiple factor Sharpe ratio regressions. These elements include risk (beta or standard deviation), expenses (to test management efficiency of the fund), size, fund age, regional and property type diversification and the impact of geographical concentration. Beta and standard deviation are used to measure the performance of equities (Lin, 2011). Beta measures the systematic risk of a fund relative to the market (Morri and Lee, 2009). A high beta value indicates that the fund's systematic risk is close to the markets relative to the low beta value (Chen and Peiser, 1999). Standard deviation reflects the volatility or difference of the return relative to its mean return. Morri and Lee state that expenses are made up of property management costs (operating properties costs over total property value) and management efficiency ratio (fund expenses over total assets). The size of the fund affects its performance because large sized funds have advantages over the small ones such as economies of scale and bargaining power (Morri and Lee, 2009). The study revealed the effect (to minimize risk) the manager or analyst has on a portfolio with regards to risk and return.

2.5. Diversified and Specialised REITs

2.5.1 Diversified REITs

REITs may choose to focus on one or two sectors (specialise) or they may invest in several sectors (diversify) of the real estate industry. Other authors define specialised REITs as a pure-play REIT with no exposure to any other real estate property type or sector (Geltner and Kluger, 1998; Lin, 2011). A more scientific definition is a REIT comprised of 75% or more of the same property type within its portfolio (Ambrose and Linneman, 2001; Benefield *et al.*, 2009). This study, however, considers specialised REITs in SA to be made up of 60% or more of the same property type in its portfolio due to the reason that SA does not have a lot of specialised REITs. Out of a total of twenty-six (26) REITs, four (4) are specialised REITs and out of the four according to the 60% split threshold, only two (2) are industrial specialised REITs (Invest South Africa, 2018). Transcend Residential Property Fund and Arrow Properties are focused on the residential sector while Stor-age Property REIT Limited and Equites Property Fund are focused on the industrial sector.

The US has a broad variety of specialised REITs classified into the following: office (business facilities), industrial, retail, hotel or lodging, residential, timberland (forest wealth), health care (institutions for providing health care), self-storage (warehouses and storage areas), infrastructure (industrial infrastructure) (Leković and Stanišić, 2017).

A REIT investing in a combination of at least two facilities, areas or infrastructure, is considered a Diversified REIT. There are two traditional types of real estate investment diversification: property type and geographical location of the properties (Eichholtz *et al.*, 1995). A debate about the most efficient type of REIT diversification is on-going. Miles and McCue (1982) regressed the return to risk ratio against variables which represent the diversification extent by property type and geographic location and the results proved that diversification by property type is more efficient when using a sample of REITs. Two years later, Miles and McCue (1984) found that correlations on portfolios among returns of properties differentiated by property type were significantly less than those on portfolios differentiated by region and the conclusion was still the same, property type was a more efficient diversification type.

Hartzell *et al.* (1986) later on argued that there are more ways to diversify a property portfolio. The authors considered five ways: geographic region, property type, property size, metropolitan statistical area (MSA) and lease maturity. The US was divided into four regions for the study. The study found that correlations between the returns in the four regions were usually low for the study period 1973 to 1983 and they concluded that there is a need for more detailed diversification types. Regional diversification was also supported by Grissom *et al.* (1987) when they used the standard four regions to prove the existence of industrial real estate markets. The study also argued that systematic risk and relevant factors differ for properties in different regions. Regional diversification was then fine-tuned to using economic factors rather than basing it on only political and geographical boundaries. Hartzell *et al.* (1989) refined the analysis of regional diversification by using both economic and geographic factors. The US was divided into eight regions and the study concluded that the eight region diversification yields more benefits than the four region diversification. However, Hartzell *et al.* (1993) argued that regional diverse investments are not necessarily economically diverse but Mueller (1993) went on to prove that the four region classification was the least efficient, and the eight region classification was better while his own classification which is solely based on economic factors gave the best risk adjusted returns. The conclusion is that there are mixed results regarding which diversification type is more efficient but it is better to consider both the economic and geographical factors as far as regional diversification is concerned.

There are two main approaches normally used by researchers to investigate diversification: Efficient Frontiers according to the Modern Portfolio Theory (MPT) and the clustering techniques (Lee and Stevenson, 2005). Diversification was introduced in the nineteenth century to help investors lower risk and maximise return on their investment portfolios (Markowitz, 1952; Sharpe, 1964). The Portfolio Theory was then revolutionised by Markowitz (1959) in 1959 which is continued to be used by researchers and analysts today as the Modern Portfolio Theory. The MPT is used as a tool to lower systematic risk and maximise returns of a portfolio of assets such as properties, stocks and bonds through diversification (Lintner, 1965; Elton and Gruber, 1977). An efficient frontier is formed when using MPT to find a “set of optimal portfolios that offers the highest expected return for a defined level of risk or the lowest risk for a given level of expected return” (Investopedia, 2018b: 1). The relationship between risk and return will be addressed later in this chapter.

Cluster analytic techniques are used on the returns of property markets, for example towns, to establish the extent to which the market clusters by property type or region (Lee and Stevenson, 2005). Furthermore, this means that if returns in that market are more determined by the region then "standard" regions will be formed and vice-versa; if returns in that market are more determined by the property type then property type sectors will be formed. Studies in the UK, using the cluster analytic technique, found that the industrial and office sectors seem to be clustered according to region while the retail was clustered according to the sector (Hoesli *et al.*, 1997; Hamelink *et al.*, 2000). For example, the central London office market performs differently from the Southeast and the rest of the UK. Lee and Stevenson (2005) came up with a three-by-three (3x3) classification for the UK real estate market. The property market can be divided into three main sectors, office, retail and industrial across London, the Southeast remainder and the rest of the UK.

Some authors argue that a diversified property portfolio trades at a discount when compared to its specialised counterparts (Lang and Stulz, 1994; Berger and Ofek, 1995; Comment and Jarrell, 1995; DeLong, 2001). Diversified firms create a larger and more efficient internal capital market and allocation of resources is handled well internally versus externally (Weston, 1970). Additionally, Majd and Myers (1987) argue that diversified firms with a loss in one segment will be more tax efficient than the specialised firms. There are, however, studies against diversification discount. Graham *et al.* (2002) are against diversification discount mainly due to selection bias issues such as a specialised firm being compared to a systematically different segment of a multi-segment firm in the same industry. Several authors found that diversified firms were trading at a discount before they acquired additional business segments (Hyland and Diltz, 2002; Villalonga, 2004). A study controlled for the sample selection bias by using Heckman (1977) inference techniques of instrumental variables and two-stage regressions and the diversification discount disappears when compared with similar firms with similar diversifications levels (Villalonga, 2004). Capozza and Seguin (1999) argue that diversification actually increases borrowing costs, has a positive impact on property-level cash flows, and has an offsetting negative impact on general and administrative expenses. Furthermore, diversified portfolios are less transparent and more difficult to monitor and value which ultimately reduces the firm's value. Xing and Anderson (2003) argue that there is a diversification premium found when using the coefficient of determination from a market model regression as the appropriate measure of diversification. There are mixed results on the diversification discount or premium debate (specialised vs diversified REITs).

2.5.2 Specialised REITs

2.5.2.1 Growth

During the 1980s in the US, it was reported that diversified REITs made approximately 30% of the NAREIT index but this has since gradually decreased due to the emerging specialised REITs (Pagliari *et al.*, 2005). According to the NAREIT Handbooks (NAREIT, 1997-2006), less than 10% of the US REITs in the equity REIT sector diversified by property type (in terms of either market capitalisation or number of REITs) while the remaining 90% specialised by one or two closely related property types. Geltner *et al.* (2001) suggest three reasons for this change:

- REITs became actively managed where effective management styles that specialised by property type were developed,
- Investment strategies changed from passive investment satisfied by diversified portfolios to investors (especially institutions) making their own diversification decisions,
- It was easier to understand and analyse REITs focusing on one or two sectors (specialised) compared to REITs investing in multiple segments (diversified).

Capozza and Seguin (1999) argue that diversification (even within a single industry) reduces the REITs value because it increases expenses[6] (and decreases liquidity) which off-set the high positive cash flow. This was established in their study which investigated REIT specialisation effects by examining how property type specialisation, cash flows and real estate property values relate. Capozza and Seguin also mention that a diversified REIT is less transparent and more difficult to value and monitor which is highly likely to increase borrowing costs. Miles and McCue (1982) also argued that diversification results increased cash flow and the study focused on REIT comparison and diversified real estate funds.

2.5.2.2 Industrial Sector: Supply and Demand

One of the first authors to investigate industrial property performance is Hoag (1980), who developed an industrial real estate value index as a function of property and market factors. Wheaton and Torto (1990) then developed an investment model that defines industrial space production as an investment decision which depends on expected levels of future output and cost of capital. Wheaton and Torto (1990) also add that industrial space demand comes largely from the manufacturing and distribution sector. This is seen lately from the emergence of the e-commerce sector as a result of technological growth. In addition, industrial property sale prices and rentals depend on the property attributes such as building size, office

[6] Management, administrative and interest (from borrowing funds) expenses.

space, and other physical characteristics (Ambrose, 1990). Other authors argued that there are more factors that affect industrial property prices and rentals. Changes in real estate prices are due to monetary base and industrial construction or industrial property supply (Atteberry and Rutherford, 1993). In addition to Hoag (1980) and Ambrose (1990) to physical attributes, Fehribach *et al.* (1993) investigated the effect of financial economic variables on the industrial property prices. Hughes (1994) also added the following factors to the literature: labour force, infrastructure and population, while Lockwood and Rutherford (1996) added market conditions and local factors to industrial property value determinants.

Industrial space supply in the US is measured by Aggregate Industrial Construction[7] and industrial space demand is measured by manufacturing employment, industrial production, and capacity utilisation, factoring in property depreciation overtime (Wheaton and Torto, 1990; Cheng *et al.*, 2006). Physical decay, building age and location and functional obsolescence of industrial properties are some of the factors that lead to property depreciation (Struyk, 1975; Erickson and Wasylenko, 1980). Furthermore, from an economics perspective, the interaction of industrial space demand and supply of a particular point in time, results in the vacancy level of the industrial space at that specific time. Cheng *et al.* (2006) also added that flow of funds in and out of the market affect the performance of REITs. An inflow of funds is represented by net purchases of shares and the net increase in REIT equity. This data is shown by the Flow of Funds Accounts of the U.S. from the Federal Reserve Board.

According to Rich and John (2012), industrial properties are a relatively less capital intensive, stable and predictable sector. The authors believe that the respective sector, in North America, has had six main drivers in 2012: Strong supply and demand, foreign direct investment, global supply chain trends, e-commerce, solid US connectivity and infrastructure and the Panama Canal expansion project. The market had a healthy demand and strong supply of quality industrial space which led to a drop in the national vacancy level to 9.1%, a level last reached in 2009. The demand for the “big box” space pushed the vacancy level even lower and led to speculative industrial property developments. A big box building is an industrial building with an area of 200 000 square feet or more, be used primarily for distribution, have ceiling heights of 28’ clear or greater and be a pre-cast or tilt-up concrete construction. Foreign investors such as Goodman Group were expected to invest $1.5 billion (or approximately R19.2 billion) across North America as they saw the growth the sector was showing. The industrial sector volume grew from $10.9 billion in 2009 to $35.1 billion in 2011 (Rich and John, 2012). The US has a broad customer base globally

[7] National, non-residential, private, seasonally adjusted, annualised construction put in place series introduced by the U.S. Census Bureau.

and companies want to be as close as possible to their customers to improve courier costs, delivery time, customer service and risk reduction. Physical presence in the US is becoming more important for companies (geographic diversification) and this translates to a demand increase in warehouse, distribution and manufacturing space. One third of the “big box” space demand is from e-commerce retailers which has been growing rapidly since 2009. Retailers are finding more ways to sell their products, like using the internet and technology, besides the conventional approach of opening up more brick and mortar stores. Demand for space from these companies calls for an increase in the supply of warehouse and distribution centres. The US also has a well-structured supply chain infrastructure (port, highways, rail and airports) which is one of the key pull factors for industrial companies. They need to be easily accessible for easy movement of their goods from storage to the customers. Lastly, the Panama Canal went through a $5.2 billion expansion to allow for a better traffic flow and be able to accommodate bigger vessels. More industrial properties to house the cargo were developed (Rich and John, 2012).

The European industrial property market had three (3) major macroeconomic events that reformed its supply and demand structure in the past two decades: the shifting of manufacturing and distribution activities from the west to the east of the continent, the rise of manufacturing and distribution models from the early nineties and the reduction in consumption levels which occurred during the last economic crisis in 2008 (Bhutta and Migliorelli, 2015). The start of the production shift dates back to the collapse of the Soviet Union and has been gaining momentum with the years as the European Union (EU) grew. The move was initiated by the search for lower production costs, especially labour. Unspecialised industries were very sensitive to the shift, moving faster than highly specialised industries which are shifting at a relatively slower rate. West European countries such as Spain, Italy, Portugal and Greece have experienced significant declines in productions volumes while eastern European countries such as Poland, Romania and Bulgaria experienced an increase in industrial production output. The past decades have seen a gradual change in the manufacturing practices and an in introduction of distribution models to keep up with the rising demand. The introduction of e-commerce, for example, resulted in the birth of innovative industrial properties in order to be able to service the building occupier. Lastly, the decline in the demand of consumer consumption products in the South European countries after the 2008 crisis led to high vacancy (Bhutta and Migliorelli, 2015).

2.5.2.3 E-commerce

In the past three years, e-commerce in the US has grown rapidly and companies are competing by offering same-day or next-day deliveries to their end user customers (Colliers International, 2017). As a result the demand for big boxes near airports, harbours and highways increased. The e-commerce sales grew by 16% during the third quarter in 2016 compared to the third quarter in 2015 and the industrial property rent grew by 7.5% in the last quarter of 2017 relative to the same time in 2016. National vacancy rates went further down to an all-time low of 5.3% during the first quarter of 2017 compared to 6.1% in 2016 (and a five year historical average - 8.3%) while the US industrial market absorption rate dropped by 14.4% to 53.8 million square feet (approximately 5 million square metres) in the 2017 first quarter compared to the 2016 first quarter but still surpassed the average quarterly absorption of 40.6 million square feet (approximately 3.8 million square metres) registered during the last two economic cycles (Cushman & Wakefield, 2017). The Conference Board's Consumer Confidence Index increased in March 2017 to 125.6, which was its highest in more than 16 years, and this means that consumer spending will increase, which will benefit industrial property demand (Cushman & Wakefield, 2017). The current positive economic fundamentals will help fuel demand for industrial property market, especially warehouse and distribution segments. By the end of 2017 the vacancy rate went down again to 5.1% despite the 243 million square feet (approximately 22.6 million square metres) supply that was completed in 2017. According to Colliers International (2017), there is a new trend where smaller industrial properties between 50 000 to 200 000 square feet (approximately between 4 700 and 18 600 square metres) are requested by the tenants to focus on a specific product and increase delivery speed to the customer. This could potentially lead to a decline in the demand for bigger warehouses and distribution centres (Colliers International, 2017).

2.5.2.4 South African Market

The SA real estate industry is experiencing consistency in the industrial sector as it has proven to be a safe investment in the past few years (SAREIT Association, 2017). There is a worldwide trend which involves retail properties converting to industrial mainly due to the growth in the e-commerce industry (NAREIT, 2018b). Modern multipurpose (normally office and industrial space) manufacturing and warehousing facilities, strategically located in close proximity to airports and harbours are being established to offer generous stacking heights, environment friendly (green buildings) and convenient access points (Smith, 2017). Distribution giants such as Take-a-lot in Cape Town, SA have custom built their own high-tech warehouse in order to satisfy the growing demand. Durban's industrial property market experienced rental growth across all grades in 2017, mostly due to the annual escalations with Grade A recording a yield of 9% year on year (Property Wheel, 2018). Furthermore, Johannesburg experienced a relatively low vacancy rate with the modern high-tech manufacturing and distribution facilities pushing the rental upwards. According to Imrovon Group's Jorge da Costa, despite the national high vacancy rates, the industrial sector is still experiencing growth in demand for the newly custom built properties and the vacancy is associated the low quality and old buildings (Colliers International, 2016; Smith, 2017).

Rod Harris from Sheldon Harris Properties mentioned that the SA economic output has shifted over the years relying less on heavy manufacturing and more on warehousing and distribution, thus increasing demand for such properties (Hinton, 2015). Furthermore, contrary to Rich and John (2012), Harris argue that the industrial properties are often avoided as an investment because it can be relatively exhausting due to the sector's dynamics and requirements. Harris adds that potential investors should remember the following: identify the property, select the right node, compare buying and building the property and consider the sale-and-leaseback option (Hinton, 2015). The property to match the demand would be a warehouse with a portion of office space, ample yard space to accommodate delivery vehicles and docking points. The property normally has high stacking heights and the modern technology to be able to move the stock. The tenant usually signs a long-term lease of between 10 to 15 years. The property has to be strategically located close to an airport or a harbour in an industrial node as such properties are in great demand and it is easier to secure a long-term tenant. The investor should also consider building, buying or renovating an existing property provided it is located in a prime area. Owner-occupiers have the option to agree on a sale-and-leaseback contract in order to unlock funds for expansion. This is where the owner-occupier sells the property to an investor then remains the tenant but paying rent to the new owner or buyer (Hinton, 2015).

During the first half of 2016, the political instability in SA decreased the investor confidence, resulting in an unattractive economy (Colliers International, 2016). According to the SA Reserve Bank, the country's economic growth dropped to 0.1% and inflation remained stable at 6.1% but that did not significantly affect property rentals. Furthermore, due to SA's investment and financial links with the UK, which made SA vulnerable to the UK's decision to leave the European Union (Colliers International, 2016). The Rand performed poorly relative to most developing countries markets after the Brexit vote which was a reflection of SA's links with the UK. The downgrade of SA's credit rating by Moody's to 'Junk Status' (two levels above non-investment grade) contributed to the drop in the investor confidence. The GDP dropped by 1.2% in the first quarter of 2016 and the IMF cut SA's growth forecast from 0.6% to 0.1% versus 1.5% at the same time of the year in 2015 (Colliers International, 2016). As a result, the industrial sector growth was slowed down together with economic activity because developers take on a project based on demand and not speculation. Trading activity (logistics) in the industrial sector is a driver of demand and the Rand volatility (due to political events) has reduced trade activity and in turn increasing vacancies. Despite the vacancies (of older industrial properties), the national demand and rentals have shown an improvement with the Western Cape outperforming other provinces in 2016.

The IPD (Investment Property Databank) South African Annual Property Index revealed that the property investment sector had an ungeared total return of 11.6% in 2016 which was a decline from 13.0% in 2015 (MSCI, 2017). The income return was unchanged at 8.3% and the capital return dropped from 4.4% in 2015 to 2.6% due to a negative yield effect. The industrial sector outperformed others at a total return of 13.6%, followed by retail and office at 12.6% and 7.6% respectively (MSCI, 2017; URERU, 2017). The primary and secondary sectors of the economy have been performing poorly while the tertiary sector showed growth. Mining and production activity has dropped in the past five years due to the fall of commodity prices and the steel prices fell by close to 50% due to oversupply. The agricultural sector was also affected by the drought since 2015 which caused a 15% decline (URERU, 2017). Furthermore, the IPD South African Annual Property Index outperformed the MSCI SA Index and JP Morgan's Bond Index (7-10 year) over 1, 3, and 10 year periods. The top performing segments are the High Tech Industrial property and Neighbourhood shopping centres at 18.1% and 20.3% respectively. The Managing Executive at Nedbank CIB Property Finance, Robin Lockhart-Ross, mentioned that the low GDP growth economy seems not to have a significant negative impact on the SA property index performance (MSCI, 2017).

2.5.3 Diversified Vs Specialised REITs

Some authors argue that diversified REITs outperform property-type specialised REITs while others disagree and the debate has been ongoing for decades. Eichholtz *et al.* (2000) sampled equity REITs in the US from 1990 to 1996 and concluded that specialised REITs outperform diversified REITs. Brounen and Eichholtz (2000) also state that larger REITs that specialise in retail property development have a higher risk and return level than diversified REITs. Other studies find that diversified REITs outperform specialised REITs but the margin is not statistically significant (Benefield *et al.*, 2009; Ro and Ziobrowski, 2011). Furthermore, there are several factors which should all be taken into account when investigating the REITs' performance and these are: source of data[8], sample time period[9], method of analysis[10], REIT leverage level adjustment[11], internally or externally managed and the size of the REIT. Xing and Anderson

[8] The country from which the data was sourced.
[9] The analysis time period, normally in years.
[10] For example Quantitative approach (Jensen Alpha, Sharpe Ratio, Treynor Index, Security Market Line (SML) Theory and Capital Asset Pricing Model (CAPM)) or Qualitative approach (verbal interviews, observation and surveys).
[11] The amount of leverage used as gearing.

(2003) add that diversified REITs trade at a premium relative to the specialised REITs, rather than a discount.

A test for the existence of diversification discount on REITs was done by Benefield *et al.* (2009) using the Jensen's Alpha, Treynor Index and Sharpe Ratio. A sample of 70 equity REITs was analysed for the period 1995 to 2006 and it was concluded that diversified REITs significantly outperformed the specialised REITs. Risk and return factors are considered in performance analysis and appropriate tools to assess risk and return relationship are the SML and CAPM. Sharpe (1964) argues that the portfolio manager might not have direct control over the returns on investment but the manger can control the risk.

2.6. Stock and REIT market relationship

Several authors agree that the real estate equity market is similar to the stock market. Liu *et al.* (1990) conclude that the REIT equity market is segmented from the stock market and Liu and Mei (1992) argue that REIT returns are more predictable than stock and bonds. Gyourko and Keim (1992) argue that REIT returns and stock returns are positively correlated and Ambrose *et al.* (1992) conclude that mortgage REITs performance has some similarity to the general stock market. However, Mueller and Pauley (1995) notes one difference between the REIT and stock market performance. The authors argue that REITs are negatively correlated to interest rates in falling interest rates periods and the REITs' share price have no significant change when the interest rate rises.

2.7. Analysis Methods

Most research undertaken within this area of performance comparisons have taken on a quantitative approach. These quantitative performance ranking methods include: Sharpe Ratio, Treynor Index, Jensen Alpha, Security Market Line (SML) Theory and Capital Asset Pricing Model (CAPM). Furthermore, researchers may also use qualitative methods to conduct a performance comparison such as case studies, phenomenological studies (Lee and Stevenson, 2005; Lin, 2011; Ro and Ziobrowski, 2011; Shisana, 2016). This study will take on a qualitative approach using a case-study design where semi-structured interviews will be conducted and analysed. However, it is necessary to mention quantitative metrics such dividend yield, capital growth and total return in this qualitative study, which are basic metrics any investor would use to assess a REIT's performance (Newell, 2008).

2.8. Chapter Summary

This chapter reviewed literature related to the background, investment and performance of REITs in general. Relevant legislation, taxation and corporate governance affecting REITs in SA were then discussed.

The types, structures and performance drivers of REITs were explored and a review of both international and SA property markets was carried out with respect to diversified and specialised industrial REITs performance. Research analysis methods were discussed and the relationship between how risk and return of REIT portfolios are minimised and maximized, respectively, was also addressed.

Chapter 3: Research Methodology

3.1 Introduction

This chapter addresses the research method details. The objective is to explain and justify how the findings in Chapter 4 were reached, thus improving the reliability of the research. An overview of the research method is presented followed by the explanation and justification of the qualitative case study design as the overarching methodology, unit of analysis, sampling techniques, data collection method and lastly the thematic data analysis method which provides results for Chapter 4.

3.2 Methodology Overview

This section addresses the overview of the research process as a whole. Figure 3.1 outlines the research framework of this study in order of occurrence. It gives a graphical illustration of how this chapter is arranged.

Figure 3.1 lays out the details of the research process followed by this study. The process logic is linear, however, the implementation of the research was iterative in the sense that knowledge acquired during the research process was used to amend features of the research design.

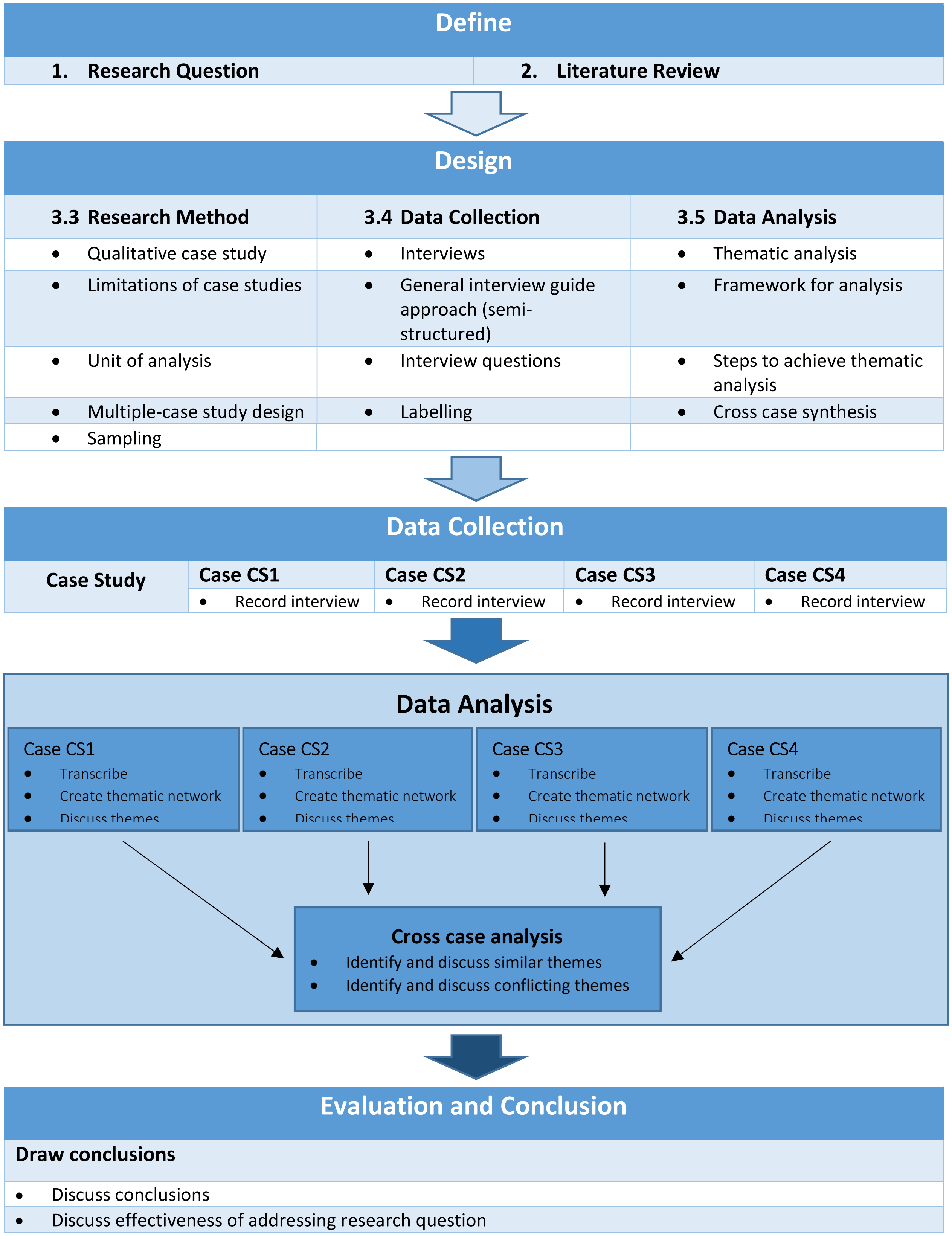

Figure 3.1 – Research Process Outline

3.3 Research Method

This section defines and justifies the overarching research method. It recognises the qualitative case study method as the most appropriate to address the research question and supports the use of the case study analysis by describing the limitations, unit of analysis, single and multiple case study design and the sampling strategy.

3.3.1 Qualitative Case Study

The case study method is an intensive investigation of a single or multiple units in the real world with an aim of, ultimately, generalising the phenomena across a larger set of units (Gerring, 2003). The cases are tools used to understand the phenomenon in more depth explaining why it happened, how it happened and what the result was. This method is applied, especially, when the boundaries between the phenomenon and context is not clearly set out (Yin, 2009).

Quantitative analyses seeks to investigate how frequent an event has occurred in order for the outcome to be numerically measured and interpreted and other qualitative methods aim to define a process's efficiency in generating an outcome (Yin, 2009). This study seeks to investigate and compare the performance between specialised industrial and diversified REITs in SA and because there are multiple factors of interest than just data points, case study analysis is more appropriate than a quantitative method (Yin, 2009). A case study design is best fitting because the plan is to address other factors which will be captured during the interview discussions.

The research aims to address the "how" and "why" questions surrounding the performance comparison of the REITs and the case study design is normally used under such conditions, when the research questions are descriptive, explanatory or exploratory (Yin, 2009; Sunday, 2016). The semi-structured interviews allow for a detailed data collection session with key industry players (mostly senior management) from the targeted sample of SA REITs as they have more information than the publicly availed data (Boshoff, 2013b).

Due to the iterative and progressive factors of case study analysis, this is going to give rise to a broad spectrum of sub-topics surrounding the anchor topic which will be addressed by the respondents and ultimately be interpreted to result in logical and sensible information to contribute to the body of knowledge or even build a theory (Yin, 2009). Even though qualitative methods tend to overlap, the case study method is appropriate for the following reasons: it answers the "how" and "why" questions, the researcher has little or no control over the events and the focus is on a contemporary phenomenon within a real-life context (Yin, 2009).

3.3.2 Limitations of Case Studies

Case study methodology might have a number of advantages but it also has multiple shortfalls. It is argued that it suffers from lack of rigour and excess of bias (Amaratunga and Baldry, 2001). The use of opinions or subjective judgements at the data collection stage renders the arguments invalid as the data is not tested in any way but is said to be valid for contribution to the body of knowledge or theory. The opinions do not carry significant weight because they are exposed to bias. Compared to other methodologies, case studies are considered exploratory, therefore they do not qualify to be used when making generalisations and this made it unpopular to a certain extent within the research environment (Yin, 2009).

However, Yin (1994) argued that for any research study, including one using case study analysis, to be valid, it should pass the following design tests: construct validity, internal validity, external validity and reliability. The design tests are to ensure that the research conforms to good academic practice and relevant to the market and practice environment. Table 3.1 shows research design tests and at which stage they are applied.

Table 3.1 – Research Design Tests adapted from Yin (1994)

Tests	Case Study Tactic	Phase of research in which tactics occur
Construct Validity	Use of multiple sources of evidence	Data Collection
	Establish chain of evidence	Data Collection
	Have key informants review draft case study report	Composition
Internal Validity	Do theme matching	Data analysis
	Do explanation building	Data analysis
	Do time services analysis	Data analysis
External Validity	Use replication logic in multiple case studies	Research design
Reliability	Use case study protocol	Data Collection
	Develop case study database	Data Collection

Construct validity is the use of multiple sources of evidence in the data collection phase, such as documents and interview recordings, to avoid researcher bias (Flick, 1992; Perakyla, 1997). According to

Bromley (1986), internal validity of the data, at the analysis stage, can be influenced by researcher bias. Becker (2010) concurs that if a researcher has an emotional interest in the subject, his/her opinion loses its objectivity and the data analysis results cannot be considered reliable. Construct validity also ensures that the research question is addressed by the analysis and interpretation. However, this study only used one method of data collection, being interviews with senior management or personnel who have broad knowledge on the company they are working for and the SA property market as a whole, for a more robust research process, which is described in section 3.3.4 under multiple case study design.

Internal validity seeks to ensure coherence of findings in the data analysis phase which is achieved by cross-checking the results (Yin, 1994). This validity test normally applies to explanatory case studies therefore it is not a concern for the study at hand.

External validity establishes the ability of the study to be generalised (Yin, 1994). Case study results can only be generalised to theoretical propositions (analytical generalisation) but not to populations or universes (statistical generalisation) therefore the case study design cannot be used to infer large population findings from a sample but rather to detect and understand themes and relationships that are important for building theory (Amaratunga and Baldry, 2001). It was argued that case studies deal with unique scenarios therefore it is not possible to elaborate detailed and direct data comparison (dos Santos, 1999). This study wishes to generalise its results in SA using the sample data collected therefore to ensure accuracy and overcome the external validity issue, critical sampling on section 3.3.5 was applied.

Reliability ensures that operations that make up the research can be repeated and still yield the same results (Yin, 1994). It also shows the significance of research design and methodology. The operations have to be well documented, replicable and yield the same results in order to be valid. This study ensures reliability through the detail in this chapter, addressing any issues of concern within the research methodology and providing relevant data documentation as part of the appendices.

Yin (1994) believes the validity of the research is highly associated with its limitations and how much it portrays in reality. These tests, and how this study addresses them, are well reported in this chapter. The measures have been implemented in the study and relevant documentation attached where applicable. The validity tests above depend highly on the unit of analysis used for the research.

3.3.3 Unit of Analysis

Determining the “case” or unit of analysis in a case study method is the first step in research design (Yin, 1994). It is important to determine the correct case as it is also what the study seeks to examine. The unit of analysis will be informed by the research question therefore it is easier to refer to the research question in order to confirm the unit of analysis or case that is being studied. Determining the unit of analysis will help distinguish information about the subject of the case study (phenomenon) from information external to the case (context) (Yin, 1994).

The study's research question reads "Do specialised (industrial) REITs outperform diversified REITs in South Africa?" The subject of the question is "REITs in South Africa." The subject already highlights what the focus is on, which is Real Estate Investment Trusts performance in SA therefore REITs performance will be the unit of analysis.

To ensure consistency and a broad representation of each REIT, the interview respondents were all senior management or held positions of a high decision making level within the company. The aim is for the respondents to speak on behalf of the REIT they are representing versus as an individual entity.

3.3.4 Multiple Case Study Design

Case studies can be done through single or multiple case analysis. Single case studies have key disadvantages which are generalisability and several information processing bias and they are normally used for unique scenarios (Eisenhardt, 1989). Generalisation from a single case study is frail and can result in bias. To guard against general bias, multiple case studies are used and besides enhancing external validity, they add confidence to the findings (Meyer, 2001). Furthermore, multiple cases allow for a detailed investigation in each case which will also act as a foundation for cross examination between the cases and a comprehensive conclusion can be reached (Silverman, 2013).

Yin (2009) believes that single case studies are appropriate for rare, special and extreme situations and these are normally found in the medical industry where experiments are conducted. However, for robustness and confidence in the findings, multiple case studies are more appropriate in order to detect all concepts in the data collected due to its iterative nature. Additionally, with confidence in the findings, the results become more reliable (Baxter and Jack, 2008; Yin, 2009).

The underlying goal of this study is to investigate the reality of the REIT industry on the performance between the specialised industrial and diversified REITs in SA and to achieve this, multiple case study analysis is appropriate in order to compare and contrast each case which will allow the researcher to highlight common schools of thought or themes. Using one case would be a weak approach as that would question the generalisability and validity of the findings (Meyer, 2001). There are a number of REITs in SA which calls for a multiple versus a single case study in order to achieve robust findings.

In order to augment construct validity as mentioned in section 3.3.2, senior management or key decision making personnel were interviewed to represent the REIT they work for. The approach adopted for this study is considered appropriate in order to satisfy all the research design tests outlined on Table 3.1, for reliable findings.

3.3.5 Sampling

Researchers have been criticised for not explaining their sampling strategy well enough and as a result this makes the interpretation of the findings difficult and unreliable (Kitson *et al.*, 1982). Qualitative sampling is a collection of information-rich data or cases for an in depth study (Patton, 1990). The process entails collecting data from which theories related to the study at hand can be extrapolated (Glaser, 1978). Under the case study method, the data to be collected or cases are determined by the unit of analysis.

The sample used plays a very important role in this study as the aim is to generalise about the REIT industry from the sample findings. However, there are limitations to the number of cases that can be collected and analysed due to limited time, resources and accessibility. From a total of 26 REITs only four (4) are specialised.

According to the 60% threshold, out of the four, only two (2) are industrial specialised REITs (Invest South Africa, 2018). Other REITs that make part of the sample were included because their portfolios have significant industrial property portion in their split by number of properties. The sample should be a true reflection of the population because the more the sample represents the population, the more generalisable the findings will be (Marshall, 1996).

Case study sampling is different from quantitative or statistical sampling. Quantitative sampling is more about representativeness through randomly selecting units to be studied in order to determine a normalised conclusion (Eisenhardt, 1989; Johnston *et al.*, 1999; Yin, 2009). Whereas, case study sampling involves theoretical sampling where the goal is to select cases that are likely to replicate or emphasize the theory being investigated given the limitations of a case study research, in order to fill theoretical categories (Eisenhardt, 1989). Each case should be selected carefully so that it can either yield similar findings (literal replication) or yield contrasting results but for anticipatable reasons (theoretical replication) (Yin, 2009). Qualitative sampling seeks detailed cases and selects the cases purposefully rather than randomly as with quantitative (Crabtree and Miller, 1992).

3.3.5.1 Definition and justification for sampling technique used

The sampling technique adapted in this study is known as purposive sampling. Purposive sampling is a form of data collection where information-rich cases are selected for an in depth investigation (Patton, 1990). Information rich cases are defined as cases where one can learn about issues that are relevant to the study at hand (Patton, 1990). Glaser (1978) mentioned that theoretical sampling and selective (or purposive) sampling are different and not similar as Schatzman and Strauss (1973) argued. Glaser defines selective sampling as “the calculated decision to sample a specific locale according to a preconceived but reasonable initial set of dimensions (such as time, space, identity or power) which are worked out in advance for a study” (Glaser, 1978: 37). Therefore, it is entirely up to the researcher which cases are selected to form part of the sample under purposive sampling and there are multiple techniques that can be used for as purposive sampling (Patton, 1990). The technique acts as a guide to purposively sampled cases, enhancing external validity. Table 3.2 outlines and defines some of the different purposive sampling techniques that can be used.

Table 3.2 – Purposive sampling techniques adapted from Patton (1990) and Flick (2008)

Sampling technique: Extreme case sampling
Explanation: The outliers or special units in the sample are selected as cases in order to study the phenomenon under investigation. This is to show the prominent effects of the phenomenon.
Typical case sampling
This technique is the opposite of extreme case sampling. Cases selected here are the most normal of the population. Success and failure are typical for the average or majority of the cases.
Maximum variation sampling
Also known as heterogeneous sampling which aims to get a wide range or differentiation of the cases in the sample to highlight common themes. These cases are few and different from each other.
Critical case sampling
Selected cases here have detailed experiences and can develop a logical generalisation about the phenomenon. For example, an expert opinion in the field.
Convenient case sampling
Cases selected here are the easiest to access under given conditions. This technique is only chosen if there is no any other appropriate technique as it is not an appropriate way to represent the population.
Total population sampling
Cases here are selected when the population has attributes that make it small enough to conduct a qualitative analysis on the whole population.

The selection of the sample is done in order to be able to generalise the findings across the REIT industry in SA. In order to accomplish this, critical case sampling is applied. Cases or REITs that are considered the major key players in the REIT market were selected due to the industrial split, size and influence in the entire market. Some of the cases selected are one of the biggest diversified REITs with a significant industrial component in their portfolios while some are industrial property specialist REITs with a split threshold of 60% industrial or more in the SA market (Invest South Africa, 2018). These cases were also selected because they can be used to establish the generalisation boundaries and the time, resources and accessibility limitations restricted the sample to only these four (4) cases.

It is critical to also mention the geographical restriction experienced in this research. The researcher selected cases or REITs with offices in Cape Town as these were the most accessible. This technique is known as convenience sampling and it was used together with other techniques (Patton, 1990). Fortunately, the researcher never had to discard a case because it had no person to represent it in Cape Town, all cases that were initially selected have offices in Cape Town.

This ultimately resulted in four (4) REITs that were selected and willing to participate in the research study. These cases included diversified REITs with properties in office, retail, residential and industrial sectors, as well as specialised REITs in industrial sector. Some of these cases have elements of international exposure in their portfolio. The sample is fitting because even though there are 26 REITs, this sample of four makes up 42% of the industry by market capitalisation (Johannesburg Stock Exchange, 2017).

The criteria used to select the sample, which is described in this section, was applied accordingly throughout the study to ensure construct validity.

3.3.5.2 Maintaining sampling rigour

In order for qualitative data analysis to be informative and apply construct validity, the purposive sampling should meet a few requirements to be able to maintain the rigour it requires (Guba and Lincoln, 1985). The requirements are outlined in table 3.3, along with how this study addresses it.

Table 3.3 – Overall research and sampling strategy guidelines adapted from Guba and Lincoln (1985)

Criteria	Definition	Assumptions	Strategies/practices to satisfy criteria
Credibility	Authentic representations of experience.	Multiple realities. Causes not distinguishable from effects. Empathetic researcher. Researcher as instrument. Emphasis on the research endeavour.	Purposeful sampling. Disciplined subjectivity/bracketing. Prolonged engagement. Persistent observation. Triangulation. Peer debriefing. Negative case analysis. Referential adequacy. Member checking.
Transferability	Fit within contexts outside the study situation.	Time and context-bound experiences. Not responsibility of 'sending' researcher. Provision of information for 'receiving' researcher.	Purposeful sampling. Thick description.
Dependability	Minimisation of idiosyncrasies in interpretation. Variability tracked to identifiable sources.	Researcher as instrument. Consistency in interpretation (same phenomena always matched with the same constructs). Multiple realities. Idiosyncrasy of behaviour and context.	Low inference descriptors, mechanically recorded data. Multiple researchers. Participant researchers. Peer examination. Triangulation, inquiry audit.
Confirmability	Extent to which biases, motivations, interests or perspectives of the inquirer influence interpretations.	Biases, motivations, interests or perspectives of the inquirer can influence interpretation. Focus on investigator and interpretations.	Audit trail products. Thick description of the audit process. Autobiography. Journal/notebook.

The criteria outlined in table 3.3 summarises the criteria used by multiple qualitative researchers (Sandelowski, 1986; Burns, 1989; Krefting, 1991) which makes it important to be reviewed as part of this study. Credibility may be defined as the way human experience is described such that those with the experience easily relate and those without it easily understand (Guba and Lincoln, 1985). Credibility on this study is addressed by purposeful sampling in order to get information rich cases from key industry players through face to face interviews. Senior management from the selected REITs were interviewed because they are more likely to know more about the company and the SA property market.

Transferability refers to the degree to which the findings of one study can be applied or fit within the context of another study (Baxter and Eyles, 1997). This is also known as generalisability or external validity. This study addresses transferability through the use of information rich multiple case studies. The multiple case study findings can be generalised across a larger population. Multiple case studies also help guard against bias and adds confidence to the findings of the study (Meyer, 2001).

Dependability can be defined as consistency where the same research constructs can be matched with the same phenomenon over a certain period of space and time (Baxter and Eyles, 1997). One may argue that dependability is credibility but Guba and Lincoln (1985) disagree, arguing that credibility refers to the right representation of experiences while dependability talks to the researcher-as-instrument and the consistency in interpretation over time. To address dependability, the researcher-supervisor relationship functions as auditee-auditor research relationship which focuses on decisions made on things like respondent selection, methods used and data interpretation techniques over the research period.

Confirmability or objectivity may be defined as the degree to which the findings are determined by the respondents and conditions of the data collection method, and not necessarily by the researcher, bias or perspectives (Guba and Lincoln, 1985). Confirmability is part of the audit process which ensures objectivity in research process and it is addressed, in this study, by the ethical sampling strategy used. The respondents each signed an informed consent form (refer to appendix 1) prior to the interview which informed them of the process being undertaken and there was no relationship between the researcher and any of the respondents.

The sampling was done according to the framework outlined in this section and this resulted in the experts chosen in each specific REIT. The next stage for the research design is the data collection method which establishes how the data and what data is gathered from the samples.

3.4 Data Collection Method

This section focuses on the data collection method applied in this research. Firstly, the use of interviews as a means of collecting data is justified then the type of interviews that were used is specified and explained. The interview questions used are presented and the respondent labelling in order to anonymise the respondents and the sources are explained. The choice of the data collection method is subject to constraints in time, financial resources and access to information.

3.4.1 Interviews

Interviews are one of the most commonly used methods of data collection in qualitative research due to the detailed information the interviewer can potentially get from the respondent and the familiarity with the method (Gill *et al.*, 2008). This method allows for significant amounts of data to be collected which compliments the case study analysis applied that requires information rich sources.

The qualitative nature of this performance comparison research requires a significant amount of data to be analysed. The aim was to collect detailed insights from REITs' senior management and interviews were the most appropriate data collection method for respondents to express themselves easily and for interviewers to clarify their questions or ask further questions.

Four interviews were conducted where all the respondents were part of senior management. These were carried out on a convenience basis which, to some extent, restricted the researcher in the length and timing of the interviews. Therefore, the main goal of the interview was to highlight the key points required by the research.

The issue of trust between the interviewer and respondent is of pivotal importance when carrying out interviews (Meyer, 2001). Trust was addressed in two ways in this study. Firstly, in most cases, the researcher called the respondents to briefly explain what the research is about, then sent out an informed consent letter explaining the key features of the project in more detail coupled with the interview questions that were to be asked. The informed consent letter had to be signed and returned to the researcher. In the letter, support from the University of Cape Town's Ethics in Research Committee and the research supervisor were communicated and the intended use and storage of the data collected. In order to establish trust, the researcher's preunderstanding of the context and phenomenon was actively used. The challenge faced was striking a balance between asking open-ended questions and appearing too knowledgeable.

3.4.2 General Interview Guide Approach (Semi-Structured)

Research interviews may be grouped into three main categories, namely: structured, semi-structured and unstructured (Gill *et al.*, 2008). The researcher's knowledge on the topic or phenomenon being researched and the type of information required are the main determinants of which interview type will be used.

Structured interviews involve asking the respondent predetermined questions with little or no variation and with no room for follow-up questions on answers that require further elaboration (Gill *et al.*, 2008). Despite the ease in coding and administering these type of interviews and the detection of any question clarification required, structured interviews only allow for limited respondent responses therefore it would be inappropriate since this study requires interpretative depth due to the small sample used.

Unstructured interviews do not involve any preconceived theories or questions and they are performed without following any structure or framework (Gill *et al.*, 2008). These can take up to several hours because there is no guidance due to the lack of predetermined questions. Unstructured interviews are normally used where not too detailed information is required on the topic. The approach allows for flexibility but due to the inconsistent questioning, it may be difficult to code the data and as a result proves to be unreliable (Gill *et al.*, 2008). Reliability is critical for this research therefore this interview type would be inappropriate.

Semi-structured interviews involve several key questions that act as a guide to the area that needs to be investigated and allows the interviewer or respondent to further explain a question or response (Gill *et al.*, 2008). The flexibility of this approach, relative to structured interviews, allows for a further investigation or elaboration of information that was not previously thought of by the participants. Semi-structured interviews might also have an inconsistency limitation but the key question guide ensures the same general direction while also ensuring the depth required by the study.

This research follows the semi-structured interview guide approach due to the exploratory nature of the study. The semi-structured approach allows the interviewer to probe further questions when necessary, during the interview, for a deeper understanding. Since there is no qualitative approach to performance comparison of REITs in SA that has been done, the structured approach is inappropriate. The key interview guide questions were informed by the literature review in Chapter 2.

3.4.3 Interview Questions

Table 3.3 lists the semi-structured interview questions used for the sample in this research. Each question is followed by the researcher's justification for the question together with the source(s) from which the question is drawn from the literature review in Chapter 2. The questions act as the interview guideline as per the semi-structured interview approach and all the interviews were tape-recorded to ensure accuracy and information richness.

Table 3.4 – Interview Questions

Question:
1. What types of REITs are offered in SA and how do you decide on a specific type?
Reason and source of question:
To compare and contrast types of SA REITs **(South African Real Estate Investment Trust (SAREIT) Association, 2018b)**.
Question:
2. Does a REIT structure affect the performance of the REIT?
Reason and source of question:
To establish types of structures that REITs (in SA and other countries) use and why they use that kind of structure (Beals and Singh, 2002).
Question:
3. What are the key performance drivers of REITs?
Reason and source of question:
To determine what factors affect the REITs performance in general (Eichholtz *et al.*, 1995; Lee and Stevenson, 2005; Benefield *et al*., 2009; Lin, 2011; Ro and Ziobrowski, 2011).
Question:
4. How would you define a specialised REIT compared to a diversified REIT?
Reason and source of question:
To establish the difference between specialise and diversified REITs (Geltner and Kluger, 1998; Lin, 2011).
Question:
5. How does a REIT qualify to be specialised in SA?
Reason and source of question:
To determine the SA market split threshold for specialised REITs (Ambrose and Linneman, 2001; Benefield *et al*.**,** 2009).
Question:
6. Do property type specialist REITs outperform diversified REITs in SA?
Reason and source of question:
To compare specialised and diversified REITs' performance in SA (Eichholtz *et al.,* 1995).
Question:
7. Why do some REITs choose to specialise in a property type or geographic location?

Reason and source of question:
To establish the pull factors of specialisation in general (Geltner *et al.,* 2001).
Question:
8. How is the Industrial Property Sector performing relative to other sectors in SA and the world?
Reason and source of question:
To investigate the industrial sector's performance relative to other sectors currently in SA and the world (Cushman & Wakefield, 2017).
Question:
9. What are the industrial property sector performance drivers in SA?
Reason and source of question:
To find out what drives the industrial property sector in SA (Rich and John, 2012).
Question:
10. To what extent does the e-commerce industry affect the industrial property sector in SA?
Reason and source of question:
To establish how much impact the e-commerce industry has on the industrial property sector in SA (Hinton, 2015; Colliers International, 2016; Smith, 2017).
Question:
11. How does the REIT's gearing level affect its performance?
Reason and source of question:
To establish the gearing implications on the REITs performance (Riddiough *et al.,* 2005; Lin, 2011; Ro and Ziobrowski, 2011).
Question:
12. How does the economic status of a country affect the sectoral performance of property?
Reason and source of question:
To investigate how the economic status (recession or recovery for example) affects each property sector (Lin, 2011).
Question:
13. May you briefly explain the company's diversification techniques used, if any?
Reason and source of question:
To establish the type of diversification techniques available and how they work (Lee and Stevenson, 2005).
Question:
14. What factors affect the risk and return of a REIT's investment and how is risk minimised and return maximised?
Reason and source of question:

To determine the factors that have an impact on risk and return (Morri and Lee, 2009).
Question:
15. How would you describe the relationship between the REIT equity market and Stock market?
Reason and source of question:
To investigate the possible relationship between the REIT equity market and stock market (Liu *et al.,* 1990).

3.4.4 Respondent Labelling

In order to protect the respondent's identities from the interviews, the respondent labelling needs to be anonymised (Clark, 2006). This forms part of the ethical requirements in order to protect business interests of the respondents and it was communicated in the informed consent letter, so that respondents felt comfortable when divulging information during the interview.

Each case label from the sample has the prefix 'R' which represents the word 'Respondent.' The letter is then followed by a number representing the case from 1 to 4 and, thereafter, a letter 'a' or 'b' representing the first or second respondent for a specific case.

For example, R1b in figure 3.2 would be defined as follows:

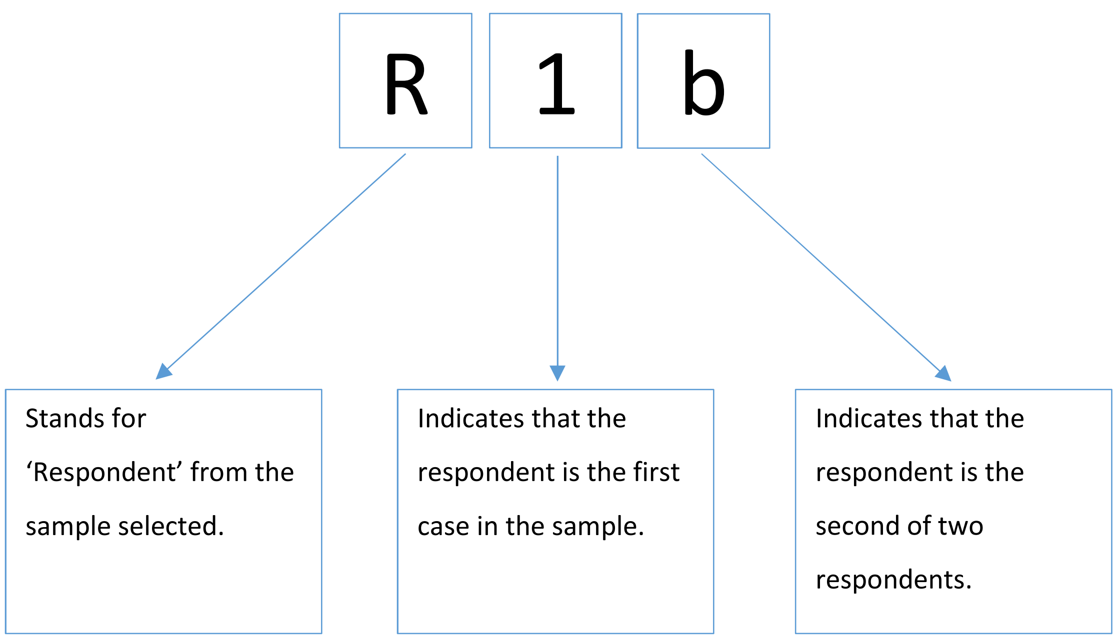

Figure 3.2 – Respondent labelling format

The respondents are listed in table 3.5 in their formats and their respective positions. Table 3.5 aims to emphasise research validity by revealing the level of knowledge that can be associated with the information that is provided by the research respondents.

Table 3.5 – Table of respondents

Respondent Label	Position
R1a	Group Finance Chartered Accountant at first REIT.
R1b	Group Finance Executive at first REIT.
R2a	National Industrial Asset Manager at second REIT.
R3a	Western Cape Regional Head at third REIT.
R4a	Group Financial Manager at fourth REIT.

3.5 Data Analysis Method

After the interview data collection process was completed and transcribed (refer to interview transcriptions on appendix 2), the data was then organised in such a way that the concepts and ideas were clear in order for the researcher to be able to analyse and highlight common themes in the cases. Thematic analysis was used as the method of analysis. The method selection is justified below and a step by step explanation of it follows. Both the coding and cross-case analysis were performed using software called NVIVO and analysis is conducted in Chapter 4.

3.5.1 Thematic Analysis

Thematic analysis is a method used in data analysis to identify, analyse and report themes in the collected data sample (Boyatzis, 1998). Furthermore, it allows for data set organisation, description and interprets various aspects of the research topic. Yin (2009) argues that the iterative process is important for thematic analysis because the confidence in the findings is increased and the proposition is addressed. However, it ultimately depends on how the researcher interprets the findings to reach a conclusion.

In order for this research to achieve its aim of establishing whether specialised industrial REITs outperform non-specialised REITs in SA, the use of thematic analysis plays a critical role to discover themes in the cases and, as a result, enable an easier cross-case analysis to take place. The data collected needs to be compiled interpreted, analysed and compiled into a meaningful summary as most of the interviews were lengthy with different conversational styles. The common themes within the cases will give an accurate general perception of the key industry players' view on the performance comparison between specialised and diversified REITs in SA.

3.5.2 Framework for Analysis

Thematic analysis may also be viewed as a data analysis method that organises data into a layered network of themes (Boyatzis, 1998; Attride-Stirling, 2001). Furthermore, the network reflects the structure and illustration of the different data themes and their interconnectivity, in qualitative research. Thematic networks involve a web-like network which is used as an organisational and representational tool, and is also includes procedures that are used to analyse and interpret the data.

The thematic network system categorises the different themes into three main classes, namely: the basic, organising and global themes (Attride-Stirling, 2001). The aim of thematic networks is not to discover the beginning or end of an argument, it simply breaks up text to find significant rationale in the data. Basic themes are considered to be the lowest order of network and they give a sense of direction towards the organising theme. Basic themes alone, not in context of other basic themes, do not mean anything but they contribute to the middle order or organising theme build. The organising themes are basic themes clustered together in an abstract form, which highlight the similarities between the basic themes and also contribute to building the ultimate global theme. The global theme is the principal concept that is formed by grouping the organising themes and represents the phenomenon being researched. Figure 3.3 shows an abstract illustration of a thematic network.

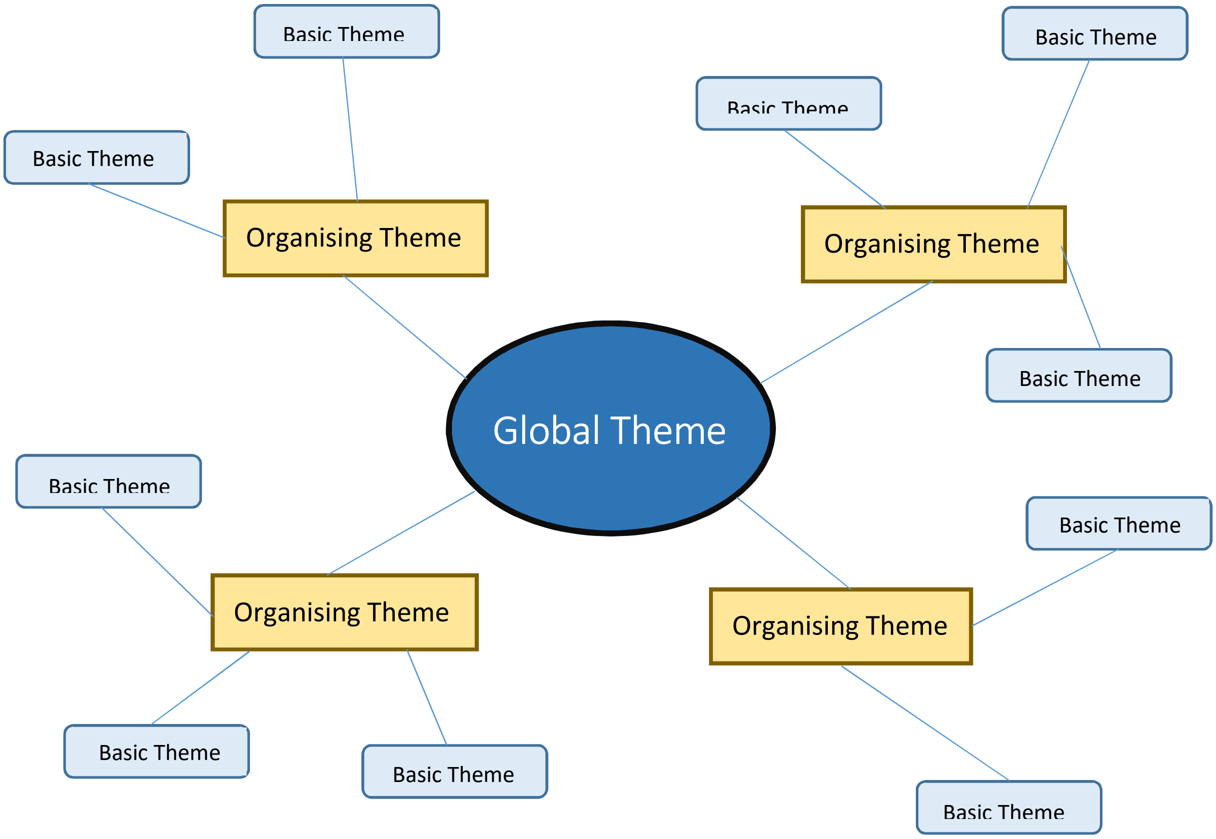

Figure 3.3 – Thematic Network adapted from Attride-Stirling (2001)

The general idea of figure 3.3 involves starting with the basic themes and working towards the core global theme through the organising theme (Attride-Stirling, 2001). The network does not necessarily follow any hierarchy but rather breaks up the data to help make sense of it, and reflects fluidity and interconnectivity. Yin (2009) supports Attride-Stirling (2001) in that the fundamentals of case study research involve iteration and this means reorganising, reanalysis and reinterpretation of the data therefore the hierarchical approach would be inappropriate.

There may be multiple global themes depending on the data complexity and analytic aims of the research (Attride-Stirling, 2001). However, these will be fewer than the organising and basic themes but because the core of a thematic network is the global theme, an analysis can have more than one thematic network. It is entirely up to the researcher how the network is interpreted as it is just a tool and not the analysis itself.

3.5.3 Steps to Achieve Thematic Analysis

The thematic analysis has been identified as the most appropriate method of analysis for this research and Attride-Stirling (2001)'s guideline steps was followed. These are just guidelines and not rules, therefore, flexibility relevant to the research questions can be applied in order to best analyse the data (Patton, 1990). Furthermore, analysis is not a linear process where you have to move from one step to the next, it is more recursive or iterative (Anzul *et al.*, 2003; Yin, 2009). The researcher can move back and forth, as needed, throughout the steps. Other similar structures, forms and steps of analytic techniques can be found in other studies such as Corbin and Strauss (1990), Guest *et al.* (2011) and Jones *et al.* (2011).

The guidelines process is made up of six steps which may be split up in two phases. The first three steps are considered the first phase where the thematic network is constructed or the data is broken down by the researcher. The last three steps are the second phase where the network is used to extract key concepts of each theme or the data is explored. Each case is run through these steps for analysis. Figure 3.4 outlines the steps in their phases.

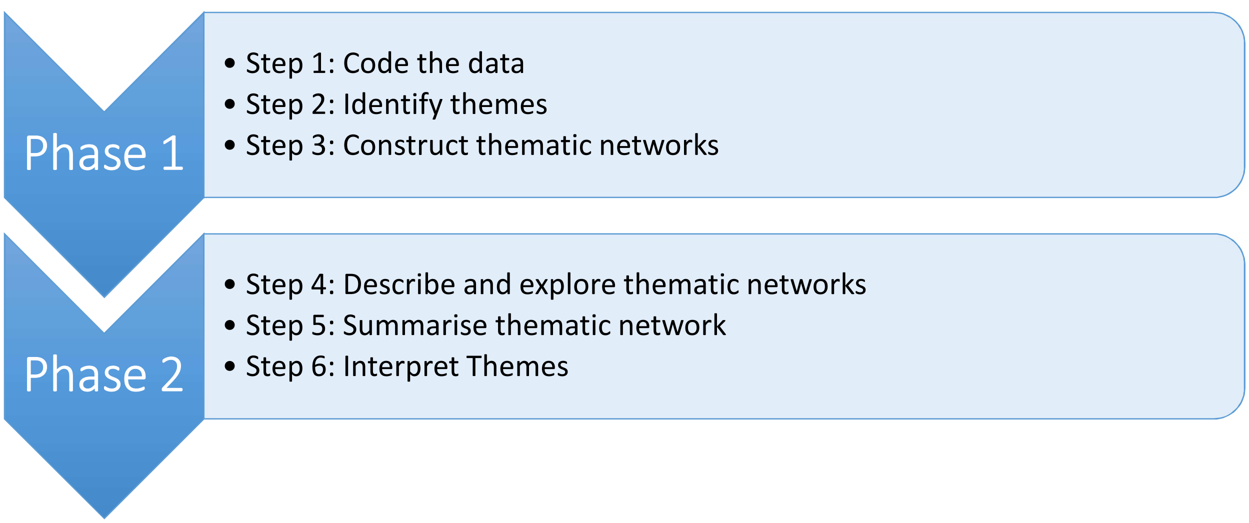

Figure 3.4 – Thematic network guideline adapted from Attride-Stirling (2001)

Step 1: Code the data

The first step in thematic network analysis is to breakdown the data and this can be done by separating the data into meaningful text segments through a coding framework (Boyatzis, 1998; Attride-Stirling, 2001). It sorts the raw data into common principles that will be known as basic themes discussed in 3.5.2.

Coding the data is done to ensure that the data is more manageable and interpretable. The researcher first develops the coding framework which can be done in several ways but involves reading the data, developing codes that highlight recurring common issues then attaching those codes to their respective topics and sentences in the data that will be explored (Corbin and Strauss, 1990; Attride-Stirling, 2001).

After developing the coding framework, the researcher will then dissect the data using the coding framework. This is done through applying the codes to the raw data in order to dissect it into text segments such as words, quotations, sentences, diagrams or any other resource used for analysis (Attride-Stirling, 2001). The codes should be more of a description or label of what the raw data addresses. In order to easily code, this research used information from the literature review and interviews mostly.

For an easier process of analysis, the audio recorded interviews had to be converted into text before the coding could be done. The audio interviews were recorded using a recording device then transcribed into text and labelled as per section 3.4.4. Only then could the codes be applied to a written output of data which would clearly reflect the commonalities observed as basic themes. Transcribed interviews are attached as appendix 2.

The coding process should be performed with great rigour and attention to detail (Attride-Stirling, 2001). From codes, they are placed into groups then themes are formed. The codes should have clear set boundaries or definitions to ensure that they are not interchangeable and they should have a limited scope to avoid coding every single sentence in the transcribed raw data. Guest *et al.* (2011) argue that it is important for the researcher to know the data so that interpretations are not supported by assumptions, but rather solid evidence.

Step 2: Identify themes

After coding and collating the data the researcher will have a list of codes that have been identified in that data set and this step will sort all the codes into potential or abstract themes and collating the identified all coded information within the abstract themes (Attride-Stirling, 2001; Braun and Clarke, 2006). Different codes will be analysed and considered how they might complement each other to contribute to a potential overarching theme. The data is fine-tuned further to ensure the themes are broad enough to incorporate multiple sources of data and avoid repetitive themes. The data will be reduced to manageable significant themes that summarise the data. Broader topics start to be visible from this step.

At the end of this step, the researcher should have visible candidate themes, sub-themes and text extracts that have been coded in relation to them (Braun and Clarke, 2006). Similar to the coding step, the data is treated the same way, with rigour and attention to detail to ensure reliability (Attride-Stirling, 2001). No data is abandoned at this step because all the data extracts are still to be looked at in detail to determine whether some themes need to be merged, refined, separated or discarded on the next step (Braun and Clarke, 2006).

Step 3: Construct thematic networks

The themes identified in step 2 will be arranged in step 3 into coherent groupings to form the thematic network as illustrated on figure 3.3. Each grouping will result in a global theme, formed by organising themes and subordinate basic themes (Attride-Stirling, 2001). The basic themes are selected and re-named from the themes that were derived grouped from the raw data.

Organisational themes may have been already identified in step 2 but they are then identified as the broader theme and labelled as such in step 3. Organisational themes are essentially made of clustered basic themes (Attride-Stirling, 2001). The same way basic themes formed organisational themes, global themes are made of organisational themes and this is the core concept of the study. If there were multiple groupings then that will result in multiple global themes. The whole structure will result in a non-hierarchical web-like visual illustration in figure 3.3. The network is formed by working from the peripheral basic themes to the global theme, thus unifying themes and concepts derived at lower levels.

The network is then refined and verified to ensure that text segments relate to the basic themes, all the themes (global, organisational, and basic) reflect the data and the data supports the themes. This verifies that the network is complete and ready for the next step. This was achieved using the NVivo computational tool.

Coding, grouping and constructing using NVivo

The coding and grouping of the raw data was done through a computer software tool called NVivo developed by QSR International. It is computer aided qualitative data analysis software (CAQDAS) used by researchers to organise data into manageable and meaningful themes for interpretation (Welsh, 2002). The data resources are added to the software where tools are used to arrange the data into a thematic network which will be interpreted by the researcher.

The transcribed interviews or data was coded using NVivo and basic, organisational and a global themes were identified. Tools were used to organise the data in order to identify advanced interpretations within the themes. NVivo is merely a tool the researcher uses to produce a thematic network and the process is not automatically done by the software.

The software was used to generate the thematic network labelled figure 4.2. The network helped the researcher interpret the data grouped into themes and also help reach informed conclusions from the findings that resulted from the thematic network.

Step 4: Describe and explore thematic networks

Once the networks have been established, the contents of each one of them is then described with support from the text segments and as the description is being constructed, each of the networks is explored in order to highlight emerging trends (Attride-Stirling, 2001; Braun and Clarke, 2006). For this step to be possible, the researcher reads the original text again, now in terms of basic, organisational and global themes and interprets the networks. The rich network descriptions of each theme are presented in Chapter 4. For an easier approach, Attride-Stirling (2001) suggests the networks are to be read in a sequential manner, such as clockwise.

Step 5: Summarise thematic network

After defining and exploring the networks, a summary of the themes is provided (Attride-Stirling, 2001; Braun and Clarke, 2006). To make the interpretation more convincing, the main themes that emerged in the description process in step 4, are succinctly summarised in order to make them explicit. The summary is illustrated in table 3.6 which represents a global theme together with its organising and basic themes. The same table was used for cross-case analysis.

Step 6: Interpret themes

Deductions from network summaries are brought together and they are used to explore the themes in each case (Attride-Stirling, 2001). The aim in this step is to address the research question using the arguments found in the interpretations that resulted from the analysis findings.

3.5.4 Cross-Case Analysis

Cross-case analysis is used to highlight the similarities and differences within the themes amongst the case studies with regards to specialised and diversified REITs in SA. The cross-case analysis was undertaken to produce the summary table in step 5 of the thematic network guide. The ideas for each case, are listed and grouped into themes and similar or contrasting ideas were highlighted by the researcher, using the background knowledge of each case. The similarities were colour-coded, with different shades indicating the strength of the similarity or contrast and each table represent a single global theme.

Ideas that were strongly similar were coded in green and the most robust findings are informed by these. Slightly similar ideas were coded in orange and the findings were informed using the researcher's discretion and judgement. Contrasting ideas were coded in red and the findings were discussed considering the differences in the ideas. However, two cases may have similar ideas and the third case argues differently or the idea is weak compared to the similarity of the other two. In this case, another shade of colour is added to the idea box to specify which idea is the double colour coded one opposing or weakly similar to. Table 3.6 shows an example of the cross-case analysis colour scheme.

Table 3.6 – Cross-case analysis colour scheme

Global Theme						
	Organising Theme 1	**Organising Theme 2**			**Organising Theme 3**	**Organising Theme 4**
		Basic Theme 1	**Basic Theme 2**	**Basic Theme 3**		
Case 1	Idea 1	Idea 8	Idea 15	Idea 23	Idea 28	Idea 36
	Idea 2	Idea 9	Idea 16	Idea 24	Idea 29	Idea 37
			Idea 17			
Case 2	Idea 3	Idea 10	Idea 18	Idea 25	Idea 30	Idea 38
	Idea 4	Idea 11	Idea 19		Idea 31	Idea 39
		Idea12				
Case 3	Idea 5	Idea 13	Idea 20	Idea 26	Idea 32	Idea 40
	Idea 6	Idea 14	Idea 21	Idea 27	Idea 33	
	Idea 7		Idea 22		Idea 34	
	Ideas 1, 3 and 5 are strongly similar concepts.	Ideas 8, 10 and 13 are strongly similar concepts. Ideas 9 and 14 are strongly similar concepts. Idea 11 opposes strongly similar ideas 9 and 14.	Ideas 15 and 18 are strongly similar concepts. Idea 20 opposes strongly similar ideas 15 and 18. Ideas 16, 19 and 21 are slightly similar concepts.	Ideas 23, 25 and 26 are slightly similar concepts.	Ideas 28 and 32 are strongly similar concepts. Idea 30 opposes strongly similar ideas 28 and 32. Ideas 29 and 31 are slightly similar concepts. Idea 33 opposes slightly similar ideas 29 and 31.	Ideas 38 and 40 are strongly similar concepts. Idea 36 is slightly similar to ideas 38 and 40.

The reliability of these findings highly depends on the strength of the similarities between the ideas while the contrasting ideas are interpreted within the context of the cases. Each colour code relation between cases was elaborated at the bottom of each column or theme, specifically explaining which ideas are related or opposing each other. This procedure highlighted the most significant ideas that resulted in primary conclusions.

3.5.5 Chapter Summary

This chapter addressed the research methodology applied to this study. The unit of analysis is specified as the Real Estate Investment Trust performance and the multiple case study analysis design was described and justified as the selected over-arching research method. The purposive and convenient sampling approach was explained and justified.

The data collection method was the semi-structured interview where the interview questions were used to guide the interview and the respondents were labelled to anonymise them so that their identities and business interests could be protected. A thematic data analysis approach was selected, explained and justified in detail in addition to outlining a step-by-step procedure of its application. Lastly, a cross-case analysis was applied in order to highlight the significant ideas that will result in solid conclusions.

Chapter 4: Findings and Data Analysis

4.1 Introduction

This chapter presents the findings collected from the interview data in the respective case studies. The Finance Group Chartered Accountant (R1a) and the Finance Group Executive (R1b) were interviewed together for Case 1 while the National Industrial Asset Manager (R2a) was interviewed for Case 2. The Western Cape Regional Head (R3a) was interviewed for Case 3 and the Financial Group Manager (R4a) was interviewed for Case 4. All the interviews were done on a face-to-face basis resulting in four interviews with five respondents.

The findings discuss the cases' views of the SA REIT market performance, focusing on specialised industrial and diversified REITs. Furthermore, the discussion addresses other factors such as the performance drivers, the e-commerce effect on the industrial property sector and the risk and return associated with REIT investments. The respondents share their opinions on how the economy of a country affects the performance of REITs and also discuss international markets for a comparison with the SA REIT market.

A cross-case analysis was conducted to discuss themes, similarities and differences among the selected case.

The thought process of this chapter is outlined below on Figure 4.1:

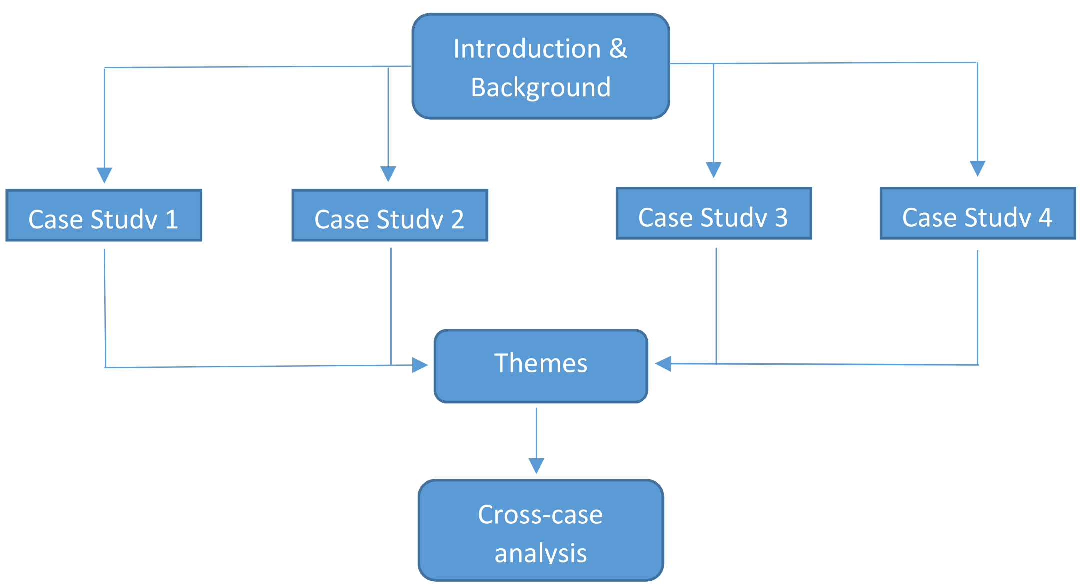

Figure 4.1 – Chapter 4 outline

4.2 Case Study 1 (CS1)

4.2.1 Overview

CS1 is a listed property fund on the Johannesburg Stock Exchange (JSE) which listed on the 24th June 2014. The fund provides its investors with exposure to international property markets such as the United Kingdom and South Africa.

CS1's portfolio consists of 52 properties with a market capitalisation of R8.64 billion. The fund has a portfolio mix of mostly industrial and a small portion of office. Their investment strategy includes developing new buildings for long lease blue chip tenants, acquiring properties and renovating existing buildings on their portfolio.

Two respondents were interviewed together, under CS1, to provide information on the property fund, industrial specialised and non-specialised REIT performance and the SA property market as a whole. R1a represents the Finance Group Chartered Accountant and R1b represents the Finance Group Executive.

4.2.2 South African REITs

Types of REITs, Governance and Performance

Both R1a and R1b specify that there are two types of REITs that are allowed in SA, namely Company REIT and Trust REIT. R1b mentions that their REIT is a Company REIT governed by the SA Companies Act which is in line with the SAREIT Association and SA Companies Act (Republic of South Africa, 1973; SAREIT Association, 2018b).

R1b adds that REITs do not choose a type and they were born out of the previous legislation.

> "*REITs were born out of previous legislation or Property Unit Trusts or Property Loan Stocks and I think if you were property unit trust you had to convert to a Trust REIT so there is no choice.*" – R1b

R1b mentions that most SA REITs are company REITs and the Trust REITs were just for the transition from the old legislation that had different property investment vehicles, namely; Property Loan Stocks (PLS) and Property Unit Trusts (PUT). R1a explained that the Companies Act was formed to protect the shareholders, stakeholders and govern the rules around the formation of the company as well as the directors' responsibilities, not necessarily to regulate how the business would operate. The respondent (R1a) added that there are other legislation supplementary to the Companies Act that addresses the operations of companies such as the Income Act and the King IV Report on Corporate Governance

(Republic of South Africa, 1962; PwC, 2016). R1a explained that there might be two types of REITs but the mechanisms are identical and that ultimately does not affect performance. The only difference is the administration when forming the different REITs.

In relation to international markets, R1b mentioned that the United States of America (US) property market is far much evolved than the SA property market and the legislation has not developed in SA the same way it has in the US.

Performance metrics

R1a explained that the study needs to have standard performance metric(s) that will be used to measure performance among the sample REITs under an efficient market condition, filtering out market volatility, in order to get an accurate reflection of the fundamentals of a business. R1b considers this very important because the SA property market has been very volatile in the past 12 months therefore, it would not yield an accurate reflection of the REIT performance. R1a adds that it might be vital to establish the differences between the developing SA and developed US REIT market when comparing performance because the US "started REITs in the 1960s and we started 50 years later." The respondents implied that performance studies are normally done through a quantitative approach.

Financial metrics

Both R1a and R1b suggested financial metrics that can be used such as net asset value (NAV), market capitalisation, contractual income, net profit, share price, liquidity, debt expiry profile, distribution per share, capital growth, total growth and financial risk management (interest rate risk and exchange rate risk) from their February 2018 audited financials. These metrics are in line with several similar research studies which had a quantitative approach (Lin and Yung, 2004; Benefield *et al.*, 2009; Lin, 2011; Jalil and Ali, 2015).

Property fundamentals

The respondents also agreed that, for such a qualitative study, there are property fundamentals that could be used to measure performance such as portfolio value, lease expiry by revenue, tenant profile by revenue and geographical location. R1a adds that that the strength of the management and the quality of buildings in the portfolio could also form part of the qualitative metrics. R1b concludes by adding the number of years of operation and better cost of capital. These are in line with what Jalil and Ali (2015) and Lin and Yung (2004) argued.

Structure

R1a explained that normally REITs operate in a combination of structures which include the traditional structure and paired-share structure as mentioned by Beals and Singh (2002). The respondent (R1a) elaborated by explaining that REITs also take on the paired-share approach. This involves agreeing to a joint venture (JV) agreement with another party, in order to diversify the investment portfolio risk. R1a added that other reasons behind the JV collaboration include sharing of knowledge and experience between the investors.

Stock and REIT market relationship

R1a explains that because the REIT equity market is segmented from the stock market, the REIT equity market is less volatile than the stock market and they are positively related. The respondent added that the REIT market is predictable due to the long term lease agreements which is in line with what Liu *et al.* (1990) and Liu and Mei (1992) argued.

4.2.3 REIT Performance

Drivers

Financial and Property fundamentals

R1a explains that their performance drivers are made up of financial drivers and property fundamentals. These include portfolio value, lease expiry by revenue, tenant profile by revenue, geographical location, NAV growth and market capitalisation, contractual income, net profit, distribution per share, share price, liquidity, debt expiry profile and financial risk management (exchange rate risk & interest rate risk) which are in line with the following studies, Eichholtz *et al.* (1995); Lee and Stevenson (2005); Benefield *et al.* (2009); Lin (2011); Ro and Ziobrowski (2011).

Sustainability (Green Buildings)

The respondents mentioned developing green rated buildings soon which should have a positive impact on the property returns in in the long run. They share the same sentiments with Ellison and Sayce (2007).

Investment Strategy

R1a and R1b agree that, as part of their investment strategy, the investment committee assess the type of property or potential development by looking at the prospective financial performance and property fundamentals. Depending on the nature or sector of the asset, the criteria might change slightly with each deal. With an industrial property development, labour and location are vital. R1a emphasises that labour will remain important until robots take over in SA as they have in China.

Diversification

R1b express that because they are a specialist REIT, they only diversify in terms of geographic location, not by sector.

> *"We have noticed South Africa faces an immense amount of emergent market risk, political uncertainty therefore we have decided to diversify into highly developed markets."* – R1b

This is in line with Eichholtz *et al.* (1995) who argue that diversification can either be by sector or by geographic location.

Reasons for Specialisation

R1b explains that REITs have different reasons to specialise and one of them is because the management understands the sector more than others which is in line with Geltner *et al.* (2001). The respondent gave an example with the industrial sector by saying, "…[I]f you look at what has been happening in the world in terms of supply chain management, in terms of e-commerce, where the focus is shifting, the world is shifting away from traditional retail and people will always need somewhere to store things." There should be enough evidence clearly indicating outperformance in the future.

R1a and R1b agree that REITs specialise in a geographic location because of several reasons such as understanding the area's tax legislation, English being the primary language and the area being developed.

Specialised vs Diversified

R1b explained that specialisation is when a REIT is focused on a specific asset class. It seems that the specialisation title is subjective and there is no official split threshold in order to qualify the REIT as specialised or not.

> *"By focusing on a specific asset class you want to get better at understanding that asset class fully. To manage it, you become a bit of a master of that asset class."* – R1b

R1a explained another perspective of diversification whereby the investor diversifies his/her portfolio by investing in a mixture of specialised REITs instead of investing in REITs that have diversified portfolios already. The respondent (R1a) added that there should be a qualitative performance metric used in order to standardise the different REITs and be able to accurately measure outperformance.

Theoretically speaking, specialised services outperform the diversified (or "Jack of all trades" as referred to by R1a), most of the time - if not always. However, R1a concludes by saying diversified REITs have outperformed the specialised REITs, depending on the timeframe and this could be due to different reasons such as a brilliant team of executives. This conclusion is in line with Benefield *et al.* (2009); Ro and Ziobrowski (2011).

SA vs International Property Market

R1b highlights that the US REIT market is far much evolved than the SA REIT market and there are far more specialised REITs in the US compared to SA. For example, these include self-storage, hospital, educational and industrial REITs. This is supported by Leković and Stanišić (2017). The respondent (R1b) continues to emphasise that the SA legislation is new. R1a agrees by adding that the SA REIT market is 50 years behind compared to the US REIT market and the US research could be used to establish where the SA market is lagging. At the same time, that might be difficult because that will be comparing two different jurisdictions where there is exposure to political risk, currency risk and others which change with different countries.

Industrial Sector Performance

R1b believes the industrial sector has been doing well because of the change in the retail space. The brick and mortar stores are becoming less attractive. Shops are closing down on high streets in the UK.

> "*Shopping was done in store and people are now moving towards online shopping people are moving towards convenience so there's definitely been a shift in the landscape to facilitate all those online sales and you need more warehouses*." – R1b

R1a agrees by saying that the chain of production to consumption has cut out the brick and mortar stores. Therefore, from the factory they go to the national distribution centre then the regional distribution centre, skips the brick and mortar retail store going straight to the end-consumer.

Industrial Sector Performance Drivers

R1b mentioned that the distribution centres need to be situated close to most end-users in order to minimise the travel or delivery time. The warehouse also needs to be efficiently built, with high ceilings to allow racking and it should also be a smart warehouse to allow software use to optimise delivery time and efficiency.

E-commerce

R1a believes that the e-commerce industry is prevalent in SA but not to an extent where it could change the model or nature of business. SA shopping centres still have anchor tenants which sell inelastic goods that people go to the shopping centre to get, no matter how the economy is performing. According to R1a, grocery shopping in the UK is done mostly online because the business model is different with respect to more trust and reliance. This is consistent with the views of the Colliers International (2017) report which states that REITs in the US ensure same-day or next day delivery with the distribution centres located close to the densely populated areas. R1b agrees with R1a, adding that internet penetration and cost of data are also one of the main key issues why online shopping or e-commerce has not affected the nature of business in SA. It will take time as it is still in its infancy stage. R1b and R1a conclude, respectively, by stating that:

> *"In the UK there's an interesting stat that says last year 19% of all retail sales were done online and they project that by 2021 or 2022 it will be almost half."* – R1b

> *"Shopping centres are servicing a lot of the really high-ends and you go there as a recreational thing rather than to get your groceries or whatever they are."* – R1a

Gearing

R1a explained that gearing will only affect the financial performance of the properties, which is necessary to mention considering that this is a qualitative study, otherwise it would not affect the underlying asset base. The respondent defined gearing as debt funding used for investment which can magnify the returns in either direction, depending on that cost of debt. It ultimately depends on the investor's risk appetite because gearing is risky and the investor needs to be rewarded with a higher return (compared to an ungeared return) for the risk taken. This is supported by Lin (2011) and Ro and Ziobrowski (2011), which argues that gearing affects REITs' performance significantly.

Economic Status

R1b believes the economic status of a country in which the REIT is registered affects its performance. The respondent (R1b) explained that a high inflationary economy or one with a stagnant economic growth affects the consumer's purchasing power negatively and the retail sector is normally the first to experience the effect. Under a recessionary economy, the number or rent defaulters increases and the sector suffers. The BREXIT talks also had a negative impact on the office sector in the UK where there was a question on where the next European Union headquarters would be. The opposite is similarly true, in that a well performing economy normally results in well performing sectors. Eichholtz *et al.* (1995) share the same view that the population dynamics, economy and city features are some of the key points that affects the performance of REITs differently in their respective locations.

R1a concurs adding that each economy has its own dynamics which are not similar to other countries. For example, the fact you can demand a 10% yield on a property in SA does not mean you can demand the same in the UK, because the underlying economics is different.

"Our inflation rate is different, our interest rates are different, our GDP forecast is different, our unemployment is different, our unproductive capital therefore is different… our relative bargaining power is very different, our ability to raise debt as a country is different, our balance of payments is different, we've got current account deficit issues in SA so there's a number of factors which will drive the economic status of a country and that will invariably have a knock-on effect on property." – R1a

Risk and Return

R1a explains that investors mostly diversify their investments to eliminate any other risk besides market risk, because market risk cannot be diversified away. However, more return normally comes with more risk for the investors. The respondent (R1a) explains that there are internal and external risks that they experience as a REIT in SA and there are ways they manage the different types of risks. R1a referred the researcher to the company's 2018 Integrated Report which clearly outlines and explains them. External risks include macroeconomic outlook which involves risks in the opportunities for the REIT from interest rate movement, forecasted GDP and the macroeconomic climate in general. The risk is managed by an ongoing assessment of the financial stability of the market. The political and regulatory outlook is another external risk which may affect access to capital (through debt funding) due to political instability. The REIT maintains a conservative 25-35% LTV (loan-to-value) and monitors the market closely for any opportunities from corporate sponsors and other investors. Availability and cost of finance is a vital risk that the company also faces which involves reduced availability of finance that result in the cost of finance increasing. The company has a hedging policy of hedging at least 80% of its interest rate exposure and currently it is over 100% on term balances. Tenant default and weak occupier demand is another external risk which is managed by maintaining A-grade blue chip tenants and also regularly engaging with tenants to assess their financial status and their likelihood to default. Foreign exchange fluctuations can have a direct impact on the NAV and distribution growth of the company and to mitigate this risk the company monitors exchange rate exposures in real time and actively hedges against foreign currency exposures. Increase in utility (water and electricity) costs is one of the external risks faced by CS1 and it is investigating the use of renewable energy sources and energy saving technology. CS1 also have a drafted plan to provide water to all tenants in the Western Cape when needs be.

Internal risks experienced by the REIT include capital structure and finance strategy which involves failure to assess the liquidity requirements of the company in order to pay all obligations as they become due and an increased use of leverage which might end up increasing the cost of debt to an unfavourable rate.

This risk is managed by maintaining a healthy balance sheet with properties that have strong fundamentals providing a sustainable cash flow to the portfolio. Failure to execute the company's investment strategy could have a negative impact on its financial performance and to avoid this, the investment committee ensures an effective execution of the strategy. The company also faces risks of not achieving transformation targets which may impact the REIT's ability to compete on development bids with specific BEE criteria. The social and ethics committee monitors transformation in the company and focuses on initiatives that could improve transformation. Adequate human resourcing is another internal source that the company faces and the executive management constantly monitors the capacity of the available staff and monitors staff requirements as the business grows. Lastly, the company faces the risk of not complying with law and regulations of the country and may result in fines, reputational harm or potential loss of REIT status. Staff hired are qualified and experienced to ensure compliance with the necessary laws and regulations. These risk and return relationship factors are in line with Morri and Lee (2009)'s argument who agree on similar elements that affect the risk and return of funds.

4.3 Case Study 2 (CS2)

4.3.1 Overview

CS2 is a listed property fund on the Johannesburg Stock Exchange (JSE) which listed on the 28th October 2013. The fund provides its investors with exposure to international property markets such as the Poland, Australia, United Kingdom, Morocco, Nigeria, Kenya, Zambia Mozambique, Mauritius and South Africa.

CS2's portfolio consists of 327 properties in SA with a market capitalisation of R85.6 billion. The fund has a portfolio mix of office, industrial and retail. Their investment strategy includes developing new buildings for long lease blue chip tenants for secured growth in rentals, acquiring properties and renovating existing buildings on their portfolio in well located nodes both in SA and internationally.

One respondent was interviewed under CS2, to provide information on the property fund, industrial specialised and non-specialised REIT performance and the SA property market as a whole. R2a represents the National Industrial Asset Manager.

4.3.2 South African REITs

Types of REITs and Governance

R2a views a REIT as a property fund that resembles a Property Loan Stock (PLS) which is a form of a Proprietary Limited company. This is in contrast to Ramjee (2017)'s viewpoint who believes that PLSs and Property Unit Trusts (PUTs) make up the old legislation prior to the introduction of REITs in SA. In 2013, after the REIT system was introduced, most PLSs and PUTs adopted the REIT regulatory framework set out by the Johannesburg Stock Exchange (SAREIT, 2018b). However R2a highlights that REITs, compared to other property funds, qualify for the tax dispensation where they do not have to pay Capital Gains Tax (CGT) unlike non-REITs.

Structure

R2a explains that the different structures they operate on are better explained by the different types of leases (because they are a diversified fund) they have with their tenants. For example, in a retail environment, there are turnover clauses and terminal clauses. A terminal clause could allow a smaller tenant to cancel their lease due to an anchor tenant leaving the shopping mall they both operate in because the smaller tenant depends on the anchor tenants for foot traffic. There could also be a covenant between the tenant and landlord where the tenant relies a lot on the performance and marketing of the landlord. Therefore the performance of the REIT based on the way the company structure is set up depends on both the tenant and the landlord according to R2a.

The respondent (R2a) explained that, primarily they employ the traditional structure setup where they get into a triple net lease agreement with their tenant and also highlighted that the relationship is governed by the common law before their lease. This is in line with Beals and Singh (2002) who explained that there are three most commonly used structures namely Traditional, Paired-share and Paperclip structures. The triple net lease agreement ensures that:

> *"…the tenant is responsible for everything, pays rental upfront, maintains the asset as if it was their own."* – R2a

Stock and REIT market relationship

R2a believes that the REIT industry performance rather tracks the bond market. The respondent adds on that bonds are the least risky financial instruments.

> *"REITs track the bond market relatively well or has in the past."* – R2a

R2a mentions that this might be different since the downgrading of SA's credit status by the rating agencies but the REIT market is less volatile than the stock market. This is affirmed by the literature Gyourko and Keim (1992) who agree that REIT and stock returns are positively correlated.

4.3.3 REIT Performance

Drivers

Financial Drivers

R2a mentions that REITs are underpinned by the net asset value (NAV) and there is brick and mortar behind it unlike any other share on the Johannesburg Stock Exchange.

Sustainability (Green Buildings) and Efficiencies

R2a believes that the performance drivers stem from efficiencies. Minimising costs, utilities and losses helps the company perform better. Examples include the greening of buildings, grey water and solar panels on roofs to generate electricity. R2a explains that some light fittings, for example, use a lot of electricity and alternatives are energy saver lights which give the same or better light output. It is such measures that make a building more efficient. Levies, rates, power demand charge, cost of occupancy and market demand of the building are some of the factors that drive the performance of the property, considering how the factors are managed. Property maintenance in terms of things like roofing need to be constantly checked for any leakages and to prevent any future problems. Gardening and landscaping costs are can also be minimised by changing to succulent landscape with less water usage, in order to enhance the performance of that property. R2a's viewpoint regarding green buildings and its effect on performance ultimately is in line with Ellison and Sayce (2007).

Investment Strategy

R2a explains that the company has a different investment strategy for each sector and the properties or investment opportunities are categorised. For example, the investment team has secondary assets or non-core that normally do not have a long life expectancy. They are eventually sold after creating value or profit from them, in order to channel back the funds into the core investments for renovations, development or acquisition. They consider trends in both the SA and international markets and search for investment opportunities they can capitalise on. The company recently sold an office block in Australia and looking to invest in student accommodation because that is the current property trend.

Diversification

The respondent (R2a) implied that the company diversifies both by location and property type. They have office, industrial and retail properties, and they are looking to invest in student accommodation in Australia. The investment team is also searching for other opportunities in Europe.

> *"As a diversified fund, we don't only look at this, we look – I would say not globally is a bit wide but – into Europe and into Australia and to see where is our money best spent. We are selling in Australia where we sold out of the office holding we had."* – R2a

This is affirmed by Hartzell *et al.* (1986) who argue that diversification can be done by property sector or by geographic location.

Reasons for Specialisation

R2a explains that specialised REITs are regarded to have better value offering compared to diversified REITs especially in the US. The other reason is that they understand the sector and the geographic location very well and they are confident about the investment decisions they make.

> *"Location is important because of road infrastructure, access to major highways…"* – R2a

Accessibility is vital especially for industrial properties, and modern infrastructure in order to ensure efficiency in the operations of the buildings. For example, modern attenuation where storm water is released on a delayed basis which ultimately helps the whole system around the precinct to run efficiently.

> *"So from a design point of view, new is better when you look at industrial property."* – R2a

SA has become a distribution hub for Southern Africa, therefore industrial properties seem like an attractive investment at the moment. This is the same reason why there are industrial specialised REITs being developed, in order to take advantage of this opportunity. It all depends on the investment strategy of the company which can include sector and asset selection, single or multi-tenanted parks and the financial performance with regards to the potential investment. This is affirmed by the literature Geltner *et al.* (2001) who argue that one of the reasons why REITs specialise in a geographic location is that management knows the area very well.

However, the respondent (R2a) believes that it is better to diversify your investment or spread your risk as an investor.

Specialised vs Diversified

R2a views a specialised REIT as a company that has investment focus on a single sector primarily, giving an example of industrial specialised REITs in SA. The company has student accommodation and hotel which R2a considers a specialised sector, explaining that they diversify as a group but they have specialised listings within the group. The respondent believes there is an official split threshold that qualifies the company a specialised REIT in SA which can be retrieved from the Financial Sector Conduct Authority (FSCA), former Financial Services Board (FSB), of SA. R2a says one could tell by looking at the financial annual report to see if it has a specialised focus. The respondent (R2a) does not know whether specialised outperforms diversified REITs.

SA vs International Property Market

R2a explained that they went to Poland to draw inspiration from the industrial properties there and they found the opposite of what they expected. CS2 expected very large industrial properties with very high stacking heights (more than 13m) and they found 40 000 m^2 buildings with standard heights of 10m. CS2 then decided to construct bigger industrial properties with higher heights of more than 13m to accommodation high-reach trucks. The respondent (R2a) mentions that CS2 try look for opportunities everywhere, and they are currently looking to sell their office holding and consider student accommodation in Australia in order to get the best returns on their capital.

Industrial Sector Performance

R2a explains that the industrial sector performance in SA compared to the world depends on how the industrial buildings were designed. CS2 benchmarked with Poland for their exceptional industrial performance and well educated workforce. For instance they decided to build large volume (more than

40 000m^2) warehouses with high stacking heights because it will be used efficiently, whereas in Poland they built nothing more than that because once,

> *"…you go above that height, you need to bring in inline sprinklers, your fire requirements got up dramatically."* – R2a

The respondent (R2a) implies that the industrial sector is doing well both in SA and other parts of the world (developed countries) in general and more industrial specialised REITs might list on the JSE in the next few years.

Industrial Sector Performance Drivers

R2a believes that one of the drivers for not only the SA but SADC (Southern African Development Community) industrial sector is major logistics developments such as the Cape Town Harbour container terminal upgrade which is said to be an upgrade worth R4.8 billion. The upgrade is said to increase the number of cranes and capacity by approximately 40%. The Maydon Wharf in Durban is also being upgraded where one of the main material handling piers are being deepened. There are more developments, one in Richards Bay which is part of the R350 billion Transnet CAPEX said to be spent over 10 years. The respondent (R2a) emphasised that these developments will definitely have a positive effect on the supply of warehousing and logistics properties.

> *"…that will definitely have a major influence in warehousing logistics, industrial sector in SA. As this infrastructure is developed further, you'll have the increased capacity. It doesn't just work for SA but also for the rest of SADC."* – R2a

Warehousing and logistics properties are best located within close proximities to airports and harbours for easier and cheaper transportation to the end users. Rich and John (2012) and Smith (2017) share similar views.

E-commerce

R2a explains that e-commerce has not significantly affected the retail sector in SA because people still do their shopping physically at the mall but there is however the click and collect option which is popular in SA in order to skip queues. This is where a customer buys something online and collects it from the store. Another form is trying out the product physically at the store, to see if you are satisfied with the size and quality for example, then go back home to order it online. These are mostly delivered by the stores. The respondent also explains that e-commerce is more about the software because it needs to be able to communicate with warehouse management systems so that the product is picked accurately and effectively for a faster dispatch to the end-user.

R2a suggests that, by the time SA is ready to move on to the next step towards growing the e-commerce industry the government should stop allowing the zoning for shopping malls altogether like in Paris, France. This in line with the literature that talks to e-commerce taking over the retail industry (NAREIT, 2018b). This will give e-commerce the push it deserves in order to grow efficiently. The respondent (R2a) believes SA has reached its saturation point and shopping mall zoning should be restricted to allow for e-commerce but most importantly reduce the pressure on resources such as road infrastructure and storm water sewer utilities. Every time the development bulks up from say 20 000 m^2 to 40 000m^2 the utilities also have to be adjusted accordingly. Even though it might be a great source of income for the municipality through assessment rates, it also applies pressure to the environment.

Gearing

R2a explains that the gearing level is limited to 40% which is a limitation set by the company and normally the margin only works on the LTV of about 30 – 35%. The respondent (R2a) concludes by saying that cost of debt should not be more than the return.

> "Anything above the cost of debt starts playing up against your returns." – R2a

R2a adds on to say that an investor needs to find what works for the company, regarding the terms and conditions of the debt funding in order for it to affect the performance positively. This is similar to Lin (2011)'s viewpoint, that gearing has a significant impact on performance.

Economic Status

R2a agrees that the economic status of a country affects the performance of REITs. The respondent (R2a) explains that it starts at the manufacturing level. If the manufacturers move out of SA, unemployment increases, markets are lost in SA because it becomes cheaper to import. This is followed by a reduction in demand, electricity and other resources which translates to an increase in vacancy levels in the property industry due to that economic environment status. As vacancies rise, functionally obsolete properties are going to feel the effect first. They are then demolished in order to find new use for the land. The respondent (R2a) gave an example of the meat packing district in New York, US where the old retail properties were obsolete (functional) and they were demolished to build new ones with a different use to match the current demand.

Another example is the old industrial properties with a coverage of 80% on an erf. R2a explains that these eventually lose demand because currently what is in demand is warehousing property with a coverage of 60% to enable circulation space for delivery vehicles. This ultimately depends on the demand at a point in time and how the property sector is performing. The literature Eichholtz *et al.* (1995) and Lin (2011), have the similar views which explain that the economic status of a country, the population dynamics, political aspects and other factors affect the overall performance of REITs.

Risk and Return

R2a outlines the following as the main factors that affect the risk and return of a REIT's investment. Liquidity, funding available, tenant covenants and legislation. These can determine how high your return is depending on the level of risk associated with the investment. Morri and Lee (2009) share a similar perspective with regards to factors that affect the risk and return of property funds which ultimately has an impact on the REIT's overall performance.

4.4 Case Study 3 (CS3)

4.4.1 Overview

CS3 is one of the largest listed property funds on the JSE, having listed in 1987. It attained its REIT status on the 1st of June 2013 and it diversifies its investment across the office, retail and industrial sectors. It also diversifies by geographic location having properties in Australia, United Kingdom, Poland and South Africa.

The portfolio consists of 454 directly owned properties in SA with a market capitalisation of R79.3 billion. The company seeks to unlock value by development, acquisitions and renovations of properties, while delivering sustainable income distributions and capital appreciation supported by effective financial structures.

One respondent was interviewed, under CS3 to provide information on the property fund, industrial specialised and non-specialised REIT performance and the SA property market as a whole. R3a represents the Western Cape Regional Head.

4.4.2 South African REITs

Types of REITs and Governance

R3a is not aware of any other types of REITs besides diversified and specialised REITs. The respondents defines diversified REITs as a listed company that invests in different types of sectors while specialised REITs focus on one sector. However, the respondent believes CS3 is a company REIT:

> *"…because it is a listed limited company, so I'd imagine that's a company REIT."* – R3a

This, however, is in line with SEC (2011) and Leković and Stanišić (2017) who explain that there are several ways to categorise types of REITs.

Structure

R3a is not aware of any structures used by REITs but believes that it is beneficial, performance wise, for a real estate company to list on the JSE as a REIT compared to just a property fund because REITs enjoy the tax dispensation advantage. According to the SA legislation, REITs are exempt from tax and they are instructed to pay out more than 75% of their income. The respondent (R3a) explains that the expenses are deducted from their income and they pay out 98% of that income which is fully taxable in the hands of the shareholders. Whereas in a non-REIT property fund, the companies pay tax before distributing the dividends. The tax dispensation is according to Section 25BB of the Income Tax Act, REITs Taxation (Republic of South Africa, 1962).

Stock and REIT market relationship

R3a believes that there is a relationship between the REIT share prices and the bond rates. When the long bond rates go up, share prices go down. The respondent mentions that the company has no control over that because it can be influenced by politics. For example the president of SA, may fire the finance minister and the property market has nothing to do with that but will feel the instability effect. The interest rate rises and as a result, it negatively affects the property market as funding becomes more expensive which will essentially drop property demand. Liu and Mei (1992) affirm the bond market and REIT equity market relationship.

4.4.3 REIT Performance

Drivers

Financial

R3a considers total return (dividend yield and capital growth), the size of the fund and the sectors the fund is invested in as the key performance drivers. The respondent explains that that investors normally want to know the return they will receive on their invested capital and also adds that bigger sized funds have more chances of survival than smaller funds. These factors are similar to factors mentioned in the following literature: Eichholtz (1995), Lee and Stevenson (2005), Benefield *et al.* (2009) and Ro and Ziobrowski (2011). For example;

> *"I guess, the size, the bigger it is, the potential is that if you have a hiccup in a building, it's not going to make as much of a dent in it as if it's a smaller fund and one of your buildings goes vacant and you get no income from it, then they'll have a huge effect on your performance…"* – R3a

Political

R3a implies that politics are also a performance driver. For example, when the SA President fires the finance minister or what the US President says, that political move indirectly affects the property market and SA long bond rates might go up which will then result in share prices decreasing or vice versa. Colliers International (2016) support this statement stating that political moves have an impact on the property industry, be it a significant or an insignificant impact. These are forms of market risk in developing countries that the companies or funds cannot do anything about.

Sustainability (Green Buildings)

R3a mentions that proper due diligence is taken with their property developments and management. The green building principles are applied in order to preserve the environment and save water and electricity for a sustainable project. This is increasingly becoming a significant performance driver (Ellison and Sayce, 2007).

Investment Strategy

R3a explains their investment strategy depends on a lot of factors but the most important is the total expected return from the investment. Other factors that are considered include;

> *"…Ultimately, it comes down to what does it cost, how much it's going to cost if it hasn't got a tenant, how much it's going to cost to fix it up, what rentals are you likely to get, and what return are you going to make? Have you got a tenant for it? Haven't you got a tenant for it?"* – R3a

Diversification

R3a explains that risk plays a significant role. It is better to spread out the investment risk geographically or by investing in different property sectors.

> *"In an economy such as ours which is so volatile, you never know what's going to happen next, so it's maybe better to be diversified, although if you get it right and you're specialised, you can score big time."* – R3a

The respondent explains that they have an investment criteria which specifies how much of each sector (office, retail and industrial) they should be invested in – sectoral split - and two years ago they bought a fund which was overweight in retail and they were underweight in retail in order to balance their diversification.

Industrial might be the best sector (return wise) to invest in right now but there are a lot of factors which need to be considered when investing. For example, the industrial sector might give a higher return overall but it can be more difficult to acquire at that high return. Whereas with retail, it might yield a slightly lower return than industrial but their large tenants in national and regional shopping centres seem like safer tenants to go for compared to industrial tenants who tend to have financial problems and are not as spread out geographically.

Hartzell *et al.* (1986) and Eichholtz (1995) agree that diversification minimises risk and also that there different ways to diversify a portfolio.

Reasons for Specialisation

R3a explains that the growth of internet shopping is one of the factors that lead companies into specialising in a sector such as industrial for example. This is based on the fact that retail is being replaced by the growing e-commerce industry. Other factors include, timing where the investors believe that it is the best time to invest in a particular sector or location, or they see potential for that specific sector or location in the near future. A specific sector could be outperforming other sectors in a certain area or it could be that management know that specific sector and area very well and they would like to capitalise on that. It could be as simple as some people do not like to travel therefore they would rather specialise in the area they live. These reasons are similar to specialisation reasons given by Colliers International (2016) and Smith (2017).

Specialised vs Diversified

CS3 consider themselves a diversified REIT because they invest in office, retail and industrial. They are diversified both by property sector and geographically. A specialised REIT is one that focuses on a single sector. The respondent (R3a) explained that diversification does not guarantee outperformance of the specialised REIT because it depends on the economic market condition and how that specific sector is performing at that point in time. The respondent gives an example explaining that, if a specialised fund is focused on the retail sector and the market is performing poorly, it is going to suffer heavily whereas if it was a diversified fund with its risk spread out in different sectors, it would not have a great impact on the performance of its portfolio. It is ultimately all about risk. The respondent concludes by saying that it is better to be diversified and not specialised.

Industrial Sector Performance

R3a mentions that the industrial sector is doing really well at the moment compared to office and retail, which are sectors that CS3 has invested in. Some areas are better than the others however the rentals in Cape Town have been increasing. CS3 has approximately 50 buildings in Cape Town where the vacancy level is negligible. Even though industrial is doing better than office, this is an overall perspective. There are places where offices are doing better than industrial at the moment, for example in Claremont, Cape Town. It ultimately depends on the time and location at that given point in time.

Industrial Sector Performance Drivers

R3a mentions that the performance drivers of REITs have a lot to do with what is happening outside the actual buildings themselves. The drivers include the geographic location, the economic status and type of industrial property 'booming.' The drivers are factors that cause the growth in capital. The respondent (R3a) explained that rental reversion plays a role in the performance of the REIT. For example, if a 10 year industrial property lease comes to an end and it was escalated every year for 10 years, there is a chance that there would be some form of market rental reversion rolling back the rental level to match market rent. Lease escalation rates are normally between 7% and 9%, therefore considering the possibility of rental reversion, there is no way a REIT can perform more than the escalation rate. The respondent continued to state that the currency strength and the country's trade balance also have an impact. Smith (2017) shares the same views that the performance of industrial properties is driven by the factors mentioned above.

E-commerce

R3a explains that SA is a long way behind in terms of e-commerce taking over the retail sector as whole. This is in line with NAREIT (2018b) that states that the e-commerce industry is replacing the brick and mortar retail industry. However there is a significant progress towards e-commerce, as the number of people owning cell phones with internet is growing rapidly. The respondent mentioned that trust and delivery of the products and services will be one of the factors to slow the growth progress. A reliable and sophisticated delivery system is required for same day delivery like what is being done in developed countries.

R3a believes there are too many shopping centres in SA at the moment and the government could restrict shopping centre zoning in order to support the e-commerce industry growth. However it ultimately depends on the retailers;

> *"…but at the end of the day, it's all driven by the retailers, so as long as the retailers want to go and be shopped in traditionally, you're still going to have shopping centres."* – R3a

There is an element of wanting to feel or fit the clothes, in the case of a product, before buying it therefore shopping centres might turn into showrooms according to R3a.

Gearing

R3a explains that there is a limitation to the gearing level of REITs and this is found in the company's memorandum of articles or regulation. The respondent (R3a) adds that if the cost of gearing is higher than the return (negative leverage), then it is not advisable to gear but if the return is higher, then it is safe to gear. This is consistent with Lin (2011) who state that gearing does affect the performance of a REIT.

Economic Status

R3a explains that the economic status affects the performance of REITs depending on the sector(s) that the REIT is invested in at that particular point in time. If the retail market is down, this will definitely affect a retail specialised REIT a lot more compared to a diversified REIT that has spread out its investments in office, retail and industrial sectors. If the retail market is performing well then the specialised REIT will probably outperform the diversified REIT if the other two sectors bring its performance down. In conclusion the respondent (R3a) stated that it depends which sector the REIT is investing in and what is happening to that sector economically at that point. Colliers International (2016) affirm that the economic status of a country affects the performance of REITs.

Risk and Return

R3a explains that the reason why the company diversifies its portfolio is to spread its risk. The respondent (R3a) adds on to say that the biggest risk is one that the investors do not have control over such as currency risk and interest rate risk. Otherwise the solution to the diversifiable risk is due diligence.

> *Where is it? How much does it cost a square meter, or what are the rentals going to be? What's happening in the vicinity? Have you got tenants lined up for it? Is the building in good condition, bad condition? What is your assessment of it in terms of fire…"* – R3a

Ensuring that the properties are built according to green buildings principles minimising water and electricity usage ultimately affects the performance of the REIT. These are similar factors considered when assessing the risk return ratio for a prospective investment which are in line with Brown (1991), Cho (1997) and Ellison and Sayce (2007).

4.5 Case Study 4 (CS4)

4.5.1 Overview

CS4 is a specialised REIT that listed on the Johannesburg Stock Exchange on the 16th November 2015. It exposes its shareholders to both the United Kingdom market and the SA property market.

Its portfolio is made up of 50 properties with a market capitalisation of R3.8 billion. The fund is specialised focusing on self-storage units which is a form of industrial property on a light scale. The REIT follows a 5 year growth plan cycle and they intend to enhance performance and grow the shareholders capital by extracting organic growth, leveraging their tenant management software, pursuing acquisitions and managing financial risk.

One respondent was interviewed, under CS4, to provide information on the property fund, industrial specialised and non-specialised REIT performance and the SA property market as a whole. R4a represents the Group Financial Manager.

4.5.2 South African REITs

Types of REITs, Governance and Performance

R4a explained that a REIT is called a Real Estate Investment Trust but it is simply a property company that is listed on the Johannesburg Stock Exchange. There are two types of property companies in SA and it is either you are a REIT or you are not a REIT, according to the respondent (R4a). To be a REIT you need to fulfil the listing requirements which include a portfolio of R300 million or more and 75% of the company income should come from property rentals. This is affirmed by information on the SAREIT Association (2018c) official website. There are five sectors in SA that these property companies could invest in namely, office, retail, industrial, self-storage and hospitality. However more developed countries such as the US have more specialised REITs like electricity REITs.

The respondent (R4a) believes that REITs come from the old property legislation which was made up of Property Unit Trusts (PUT) and Property Loan Stocks (PLS) and these have fallen away. They do not exist anymore and keeping real estate in a trust is a very old structure of investment.

Structure

R4a explains that the structure's effect on performance depends on a lot of factors. The structure alone will not guarantee good performance because there are other factors such as location, the properties themselves and the development or construction process has to also be executed properly. With all the other factors done well then how the REIT is structured could then have some weight when assessing the performance of the company. A REIT can be structured differently; it can manage property that it owns and it can also negotiate joint venture terms and conditions which is similar to what Beals and Singh (2002) argued. It ultimately depends on what is required at that point in time to drive the revenue.

> *"The way you structure your company is very dependent on how you want returns… or how much capital you have because you might be capital-drained and you want to buy a bigger asset … the only way you can buy the bigger asset is by entering into a structure…"* – R4a

Stock and REIT market relationship

R4a believes there is a relationship between the REIT and stock market and this is visible when considering the effect interest rates have on property as well as inflation. The more the interest rate rises the less the investor confidence and the same applies to inflation. As inflation rises, shareholder capital loses value in real terms which is in line with what Mueller and Pauley (1995) mentioned.

4.5.3 REIT Performance

Drivers

Financial drivers

R4a explains that there are several drivers that may affect the performance of a REIT. These include the sector that the REIT is invested in, rental growth, net asset value growth, gearing level and ratios, dividend growth and revenue growth. These factors are in line with those mentioned by Eichholtz *et al.* (1995) and Benefield *et al.* (2009).

Investment Strategy

Diversification

R4a explains that because they are a specialised REIT, the only diversification they did was geographically within South Africa as well as the United Kingdom. The respondent explains that the UK is a different market from SA and it is highly competitive. However there are investment opportunities there.

Reasons for Specialisation

R4a believes it depends on what is happening in that market at a particular point in time. For example, a fund could want to set up a small mall in a rural township because the costs will be low and they see growth potential in that area. Another reason is that management would like to specialise in a certain sector because that is all they know and understand and they believe that they do it very well. These reasons are similar to those stated by Colliers International (2016).

Specialised vs Diversified

R4a explains that being specialised is a choice and there is no official required split that qualifies companies as specialised in a particular sector. The respondent (R4a) does not know if specialised REITs outperform diversified REITs but believes it depends on the sector and how it is performing at the point in time. For example, the office sector could be the best performing currently but six years later it might be the most unattractive sector for investors. As a result, their office general vacancy level increases because there is no demand. The respondent (R4a) adds that the same applies to the industrial sector. It is doing well right now but things might change in the coming years. Therefore, it depends on the sector and what is happening at the point in time. Xing and Anderson (2003) state that outperformance is not a standard perception and it depends on several factors as mentioned.

Industrial Sector Performance

R4a explained that the industrial sector is and has been the best performing sector globally for the past three to four years due to the growing e-commerce industry. Big e-commerce companies are demanding large industrial property space near towns and the end user. The respondent (R4a) also adds that retail units are becoming smaller and investors are demanding modern bigger industrial properties. They are looking at being easily accessible near harbours, airports and train stations in order to enable fast delivery times to the end user.

E-commerce

R4a believes e-commerce is still at its infancy stage in SA but it is definitely growing and changing how the retail market works which is confirmed by Colliers International (2017). It is cheaper to rent a website and go pay R50 per square meter for an industrial property to store your products and run the store online than pay between R100 and a R1000 per square meter for retail space.

R4a explained that one of the factors required for SA's e-commerce industry to grow even bigger is access to cheap data, faster delivery (same day or next day delivery) and trust between the buyers and online sellers. The respondent adds that there are not a lot of safe places in SA therefore people end up going to the mall for a walk or to past time and end up doing their shopping their which makes it difficult for the e-commerce industry to grow at a faster rate.

Gearing

R4a explains that a healthy gearing level is 20% and an unhealthy level is 40%, therefore the company's gearing level should be within that range. Debt can be expensive or cheap relative to your return.

> *"If you have cheap debt, that's great. If you have expensive debt, then it's not great: then, you become owned by the bank and you become constrained on what you can do and what you can't do."* – R4a

The respondent implies that gearing does affect the REITs performance and this is confirmed by Lin (2011).

Economic Status

R4a believes that the economic status of a country does affect the REIT's performance and summarises it by saying:

> *"The country's doing well, the property's doing well, that's what happens."* – R4a

The opposite is equally true. When the economy is not doing well, there is a very high chance that it will also affect the property market negatively.

This relationship between the economic status and the property market is also acknowledged by Eichholtz *et al.* (1995).

Risk and Return

R4a explains that there are several factors that affect the risk and return of REITs. These include, location of the property, the sector, inflation rate, interest rate, currency risk and e-commerce. Morri and Lee (2009) share the same view, implying that these factors affect the risk and return ratio of REITs and they ultimately affect the performance of the fund. The respondent (R4a) adds that interest rate risk is minimised by hedging the REIT's (CS4) investments and from a management's perspective, analysts try predict the future consumer behaviour and take measures to protect the investments such as discounts and promotions to attract customers and create demand for their product and services. Costs are then minimised by monitoring and ensuring that, without compromising on quality, the cheapest option is taken.

4.6 Cross-Case Analysis

This section is aimed at discussing the findings from each case, evaluating them in relation to each other and the literature in Chapter 2. The global themes, organising themes and the basic themes are illustrated in Figure 4.2:

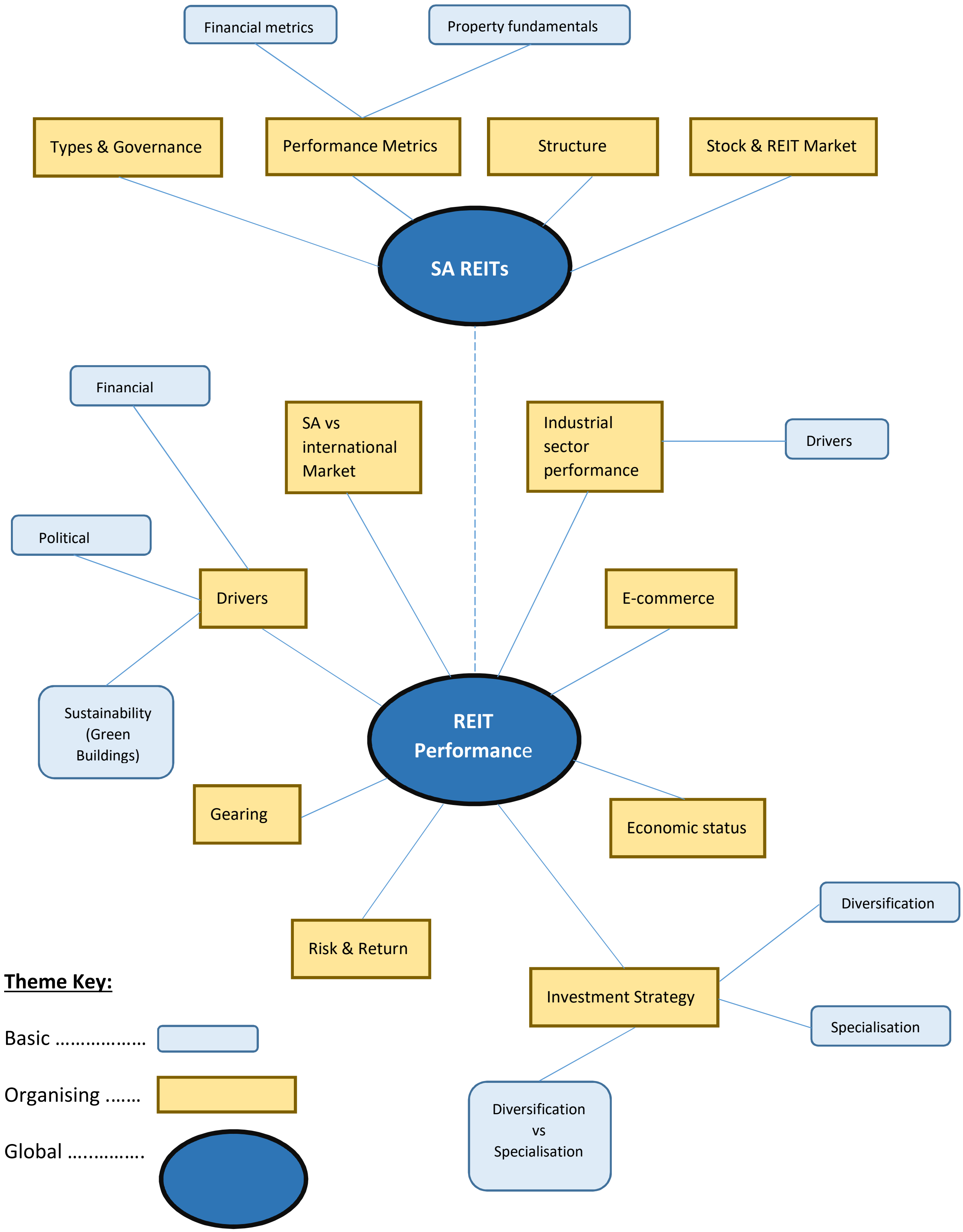

Figure 4.2 – Finding themes and sub-themes

There are two global themes established, namely South African REITs and REIT Performance. SA REITs addresses topics around REITs background, governance, types of REITs, common REIT structure and their overall performance. The other global theme, REIT performance, speaks to issues that affect REIT performance in detail. Factors like performance drivers, investment strategies, gearing and how the economic status of a country affects the property market, specifically the diversified and specialised industrial REITs.

The first global theme, SA REITs, addresses the background of REITs, how they were introduced in SA and the property investment vehicles such as Property Loan Stocks (PLSs) and Property Unit Trusts (PUTs) that were used prior to the introduction of REITs in 2013. These were governed differently compared to Company REITs and Trust REITs which are regulated by the Companies Act and Collective Investment Schemes Control Act respectively. An investigation was done to find out whether the different acts or regulations affect the performance of the REITs. Different funds operate under different structures and these were assessed in order to understand the role they play in influencing performance. An overview of REIT performance and performance metrics was done to understand how the assessment will be undertaken. Lastly, a check was conducted to determine if there is any relationship between the stock market and the REIT market to understand if the stock market also influences the behaviour of the REIT market.

The second global theme, REIT performance, assessed the performance of REITs in more detail. The respondents raised financial, political and green building status as performance drivers and their impacts were explained in depth. Gearing and the economic status of the country were also investigated to conclude to what extent they affect the REIT performance. The industrial sector performance in SA was discussed along with the performance drivers according to the respondents and the e-commerce industry surfaced multiple times as it is playing a huge role in the industrial sector's performance at the moment. The property funds' various investment strategies were outlined by the respondents in order to find if they influenced the respondent's opinions. Different forms of diversification (property sector and geographic location) were explained by the different respondents and the REITs' reasons to specialise. A performance comparison of specialised REITs and diversified REITs was discussed with every respondent justifying their conclusions. Risk and return factors were also considered to play a critical role in the performance of REITs in general and the manner in which each REIT minimises its risk and maximises its return. Substantial reference was made to the international property markets such as the US and the UK because there is relatively little literature on REITs in SA compared to developed countries.

Some concepts did not apply to all respondents because some of the companies they work for are specialised and some are diversified. For example, a specialised REIT would not have diversification strategies except diversification by geographic location.

4.6.1 South African REITs

Types of REITs, Governance and Performance

CS2, CS3 and CS4 (except CS1) are not aware of the official company and trust types of REITs as per the information on the SAREIT website (SAREIT Association, 2018b). R1b explained that, although most are company REITs, there are two official types of REITs namely the company REIT and the trust REIT in SA, governed by the Company Act and the Collective Investment Schemes Control Act respectively (Republic of South Africa, 1973; 2002). CS2 believes a REIT is a property fund in the form of a Proprietary Limited company, while CS3 is only aware of specialised and diversified types of company REITs and CS4 views a REIT as a property company listed on the JSE with no types. This, however, is in line with SEC (2011) and Leković and Stanišić (2017) who explain that there are several ways to categorise types of REITs. CS1 and CS4 agree that REITs were born out of the old legislation, PLSs and PUTs, prior to 2013. R1a explains that there might be two types of REITs but the mechanisms are identical and they do not affect performance. The only difference is the administration process when setting up the different REITs. The other cases (CS2, CS3 and CS4) imply that the REITs are similar and the different forms do not affect performance.

Performance metrics

CS1 is the only case that raised concerns about the performance metric(s) to be applied, filtering out market volatility in order or get an accurate reflection of the market performance. This is in line with the following literature: Benefield *et al.* (2009) and Lin (2011). The respondents (R1a and R1b) added that performance assessment methods are normally quantitative. R1b mentions that it is necessary to consider market volatility when assessing performance because the past 12 months in the SA property market have been volatile.

Quantitative

R1a suggested financial metrics that can be used such as net asset value (NAV), market capitalisation, contractual income, net profit, share price, liquidity, debt expiry profile, distribution per share, capital growth, total growth and financial risk management (interest rate risk and exchange rate risk) from their February 2018 audited financials. These metrics are in line with several similar research studies that had a quantitative approach, which are Lin and Yung (2004); Benefield *et al.* (2009); Lin (2011) and Jalil and Ali (2015).

Qualitative

The CS1 respondents also agreed that, for such a qualitative study, there are property fundamentals that could be used to measure performance such as portfolio value, lease expiry by revenue, tenant profile by revenue and geographical location. R1a adds that that the strength of the management and the quality of buildings in the portfolio could also form part of the qualitative metrics. R1b concludes by adding the number of years of operation and lower cost of capital. These are consistent with Lin and Yung (2004) and Jalil and Ali (2015).

Structure

All cases agree that the structure of a REIT does affect its performance. The most common structure setups are the traditional and paired-share structures which is affirmed by Beals and Singh (2002). Under the traditional structure, the landlord leases out the property to the tenant who then treats the property like their own, for example on a triple net lease, while under paired-share the landlord enters into a joint venture with another company for different reasons. These reasons include diversification of the portfolio, and sharing of knowledge and experience amongst investors. R2a mentioned that their different structures are better explained by their different leases (with various terms and conditions) with their tenants, therefore the performance of the REIT based on the company structure depends on both the landlord and the tenant. CS4 adds that, even though the structure affects performance, the structure alone does not guarantee good performance from the company. CS3 is not aware of structures but agrees that structure does affect the performance ultimately. An example given, is that REITs are exempted from paying tax according to Section 25BB of the Income Tax Act (REITs Taxation) and are instructed to pay out 75% of their income as dividends, while unlisted property funds pay tax before distributing dividends (Republic of South Africa, 1962).

Stock and REIT market relationship

All cases agree that, that the equity and bond market explain the REIT market performance to a certain extent. R1b believes that due to the long lease agreements, the REIT market performance is predictable and less volatile than the equity market which is consistent with Liu *et al.* (1990) and Liu and Mei (1992). R1a adds that the REIT equity market is segmented from the stock market which explains their positive relationship. Although it might be different now due to SA's credit risk status downgrade by the rating agencies, R2a believes that the REIT market tracks the bond market and the REIT market is less volatile than the stock market. This is affirmed by Gyourko and Keim (1992) who agree that REIT and stock returns are positively correlated. CS3 and CS4 mention that any political instability causes the interest rate and inflation to rise which negatively affects the property market. The cost of funding rises which drops demand for property. Rising inflation results in a decrease in purchasing power which is affirmed by Mueller and Pauley (1995).

4.6.2 REIT Performance

Drivers

Financial and Property fundamentals

CS1, CS2 and CS4 agree that the net asset value (NAV) is one of the key financial drivers and the R1a adds that property fundamentals are also important performance drivers. The property fundamental drivers include portfolio value, lease expiry by revenue, tenant profile by revenue and geographical location while financial drivers include NAV growth and market capitalisation, contractual income, net profit, distribution per share, share price, liquidity, debt expiry profile and financial risk management (exchange rate risk and interest rate risk). In addition to the above CS4 added the following: the sector that the REIT is invested in, rental growth, gearing level and ratios, dividend growth and revenue growth. CS3 did not mention the NAV but mentioned total return (dividend yield and capital growth), the size of the fund and the sectors the fund is invested in as the key performance drivers. All these financial drivers are affirmed by Eichholtz *et al.* (1995); Lee and Stevenson (2005); Benefield *et al.* (2009); Lin (2011); Ro and Ziobrowski (2011).

Political

CS3 is the only case that mentioned political activity as one of the key performance drivers of REITs in SA. For example, considering the highly volatile SA business environment, the current president's speech or actions can affect the REIT market and its performance. R3a mentioned that the president firing the finance minister could result in the long bond rates rising which would cause the share prices to drop. This is supported by Colliers International (2016) who explained that political moves have an impact on the property industry.

Sustainability (Green Buildings) and Efficiencies

Other than CS4, who did not have a response regarding sustainability as a REIT performance driver, there was a strong similarity among responses by CS1, CS2 and CS3. They all agreed that green buildings would have a significant positive impact on the portfolio performance in the long run. Properties would be operated efficiently, saving on resources such as water and electricity through different ways such as usage of grey water, solar panels to generate electricity and energy saver light fittings.

CS2 believes that performance drivers also stem from efficiencies. Minimising utilities and costs or losses helps the REIT perform better. R2a added that levies, rates, power demand charge, cost of occupancy, market demand of the building and overall property maintenance costs are some of the factors that drive the performance of the property. CS2's viewpoints regarding green buildings and its effect on performance is in line with Ellison and Sayce (2007).

Investment Strategy

All cases, except CS4, commented on their respective investment strategies that are followed. CS1 explained that they have an investment committee that assesses a potential investment opportunity according to what they consider performance drivers, financial performance and property fundamentals. CS1 and CS2 agree that depending on the sector, the criteria might differ slightly for each opportunity. For example, for industrial properties, labour and location carry more weight until robots take over in SA as has occurred in China. CS2 categorise their investment opportunities into secondary (non-core) and primary (core) with the latter being long term investments. They consider international opportunities and trends too, and they recently sold an office block in order to buy a student accommodation property. CS3, explain that their investment strategy depends on a lot of factors but most importantly the expected return on investment.

Diversification

All cases agree that diversification, as part of their investment strategy, is necessary, specifically to minimise risk and maximise return. CS1 and CS4 explain that because they are specialised REITs, they only diversify by geographic location. CS2 explain that they diversify both by property sector and by geographic location. Their portfolios include office, retail and industrial, and they are looking at acquiring a student accommodation block in Australia or Europe. R3a adds that the industrial sector might be the best performing right now but there are other factors that need to be considered when assessing an investment opportunity. For example, retail might yield a slightly lower return than industrial but their large tenants in national and regional shopping centres seem like safer tenants compared to industrial tenants who tend to have financial problems and are not as spread out geographically. This is consistent with Hartzell *et al.* (1986) and Eichholtz *et al.* (1995) who agree that diversification minimises risk and also that there different ways to diversify a portfolio.

Reasons for Specialisation

All cases agree that one of the key reasons why REITs specialise in a certain geographic area is that the management know and understand the area very well. Other reasons cited by CS1 include, understanding the area's tax legislation and English being the primary language used in a given area. CS2 explained that the belief is that specialised REITs have a better value offering compared to diversified REITs. R3a mentioned that SA is Southern Africa's distribution hub which has increased demand for industrial properties and this explains the focus on industrial properties by multiple firms. R3a believed that e-commerce growth plays an important role in why REITs are specialising in industrial properties. CS3 and CS4 mention timing as another reason for specialisation, that it is currently the best time to invest in the industrial sector and REITs are looking to taking advantage. These reasons are consistent with the following literature: Geltner *et al.* (2001); Colliers International (2016); Smith (2017).

Specialised vs Diversified

All cases have the same definition of a specialised REIT and a diversified REIT. A specialised REIT focuses on a single specific sector while a diversified REIT invests in more than one sector. All except CS3, who believes the information can be retrieved from Financial Services Board (FSB) of South Africa, believe that there is no official split threshold that qualifies a REIT as specialised.

CS1 and CS3 explain that they believe diversified REITs outperform the specialised REITs but it depends on multiple factors such as the analysis time of reference, investment risk involved, the efficiency of the executive team and the sector being referred to which is affirmed by Xing and Anderson (2003); Benefield *et al.* (2009); Lin (2011); Ro and Ziobrowski (2011). CS2 and CS4 state that they do not know which type outperforms the other.

SA vs International Property Market

Only CS1 and CS2 addressed SA and international property market differences. They mentioned that the US REIT market is 50 years ahead of the SA REIT market therefore they have different legislation, more specialised REIT types and more similar research. These differences can be used when benchmarking from developed countries. However, it might not be easy because of factors like a different level of political risk and currency risk.

Industrial Sector Performance

All cases strongly agree that the industrial sector is performing very well both in SA and the rest of the world mainly due to the rising e-commerce industry. CS1 explained that the brick and mortar retail stores are becoming less attractive and the demand for industrial properties is increasing. CS2 adds that more specialised industrial REITs might list on the JSE in the next few years. CS3 adds that industrial property rentals are increasing in Cape Town and their portfolio vacancy level is negligible. However, there are places like Claremont, Cape Town where office is doing better than industrial, therefore the location plays a vital role. CS4 mentioned that big industrial players such as Take-a-lot, are demanding modern 'big boxes' near airports, harbours and train stations in order to ensure the delivery is fast to the end user.

Industrial Sector Performance Drivers

All cases strongly agree that key drivers are the economy and being in close proximity of airports and harbours for a cheaper travel or delivery time. R1b adds that the warehouse needs to be efficiently built, with high ceilings and automated picking and packing software to optimise delivery time and efficiency. CS2 believes major logistics developments also serve as a performance driver. For example the Cape Town Harbour Container Terminal upgrade worth R4.8 billion will result in an increased supply of industrial properties in the surrounding nodes. R3a explained that rental reversion and the currency strength have an impact on the performance of REITs. For example, if a 10 year industrial property lease comes to an end and it was escalated every year for 10 years, there's a chance that there would be some form of market rental reversion rolling back the rental level to match market rent. Lease escalation rates are normally between 7% and 9%, therefore considering the possibility of rental reversion, there is no way a REIT can perform more than the escalation rate.

E-commerce

All cases strongly agree that, even though the e-commerce industry is growing rapidly, it has not significantly changed the SA business model where people depend highly on online shopping. They explain that people still physically go to the mall to do their shopping. The cases mention that trust between buyers and online sellers, reliance, delivery time and cost of internet access are the key problems which restrict the e-commerce industry growth in SA. CS2 added that the software programme that enables communication with the warehouse management systems is also important for a faster and more efficient dispatch. R2a also mentioned that the restriction of shopping centre zoning could also help the growth of the e-commerce industry like in Paris, France. However, the e-commerce industry is definitely replacing the brick and mortar retail sector which is affirmed by NAREIT (2018b) and Colliers International (2017).

Gearing

All cases strongly agree that gearing can either impact the performance of REITs positively or negatively, depending on the cost of debt compared to the expected return. For a positive gearing effect, the cost of debt should be less than the return. They mention that a healthy gearing level is between 20% and 40%. CS2 added that the cost of debt should not be more than the return which is referred to as negative leverage.

Economic Status

All cases strongly agree that the economic status of the country where the REIT is registered does affect its performance. When the country is doing well, there is a high chance the property sector is doing well and the opposite is true. R1b explained that a high inflationary economy for example affects the investors' purchasing power negatively and the retail sector normally experiences it first. CS2 explained that it starts at the manufacturing level. If the manufacturers move out of SA, unemployment increases, markets are lost in SA because it becomes cheaper to import. This is followed by a reduction in demand, electricity and other resources which translates to an increase in vacancy levels in the property industry due to the economic climate. Eichholtz *et al.* (1995) and Colliers International (2016) share the same view that the population dynamics, economy and city features are some of the key points that affects the performance of REITs differently in their respective locations.

Risk and Return

All cases agree that risk does affect return and there are different types of risk. Diversifiable risk and non-diversifiable risk. Diversification is one of the key ways that help spread or manage risk. R1a mentions they categorised their risk into internal and external risk, and each form of risk is managed differently. External risk includes macroeconomic outlook which is managed by a continuous assessment of the financial stability of the economy. The political outlook may affect access to capital, therefore the company maintains a conservative LTV of 25% to 35%. Tenant default is another external risk that is minimised by selecting A-grade blue-chip tenants only and increase in utility costs which is managed by an ongoing investigation of renewable energy sources. Internal risk includes not complying with law and regulations and to manage the risk, they certify that the staff hired is qualified and experienced to ensure compliance. The other risk is failure to assess liquidity requirements of CS1 in order to pay obligations, which is managed by maintaining a healthy balance sheet. CS3 adds that developing green certified buildings helps with minimising water and electricity usage. Morri and Lee (2009) affirm that factors such as location of the property, the sector, inflation rate, interest rate, currency risk and e-commerce affect the performance of the REIT as mentioned my CS4.

Table 4.1 summarises key information surrounding the sampled SA REITs, including the relationship between the REIT and stock market. Table 4.2 summarises key information on REIT performance, drivers, investment strategies, and risk and return.

Table 4.1 – SA REITs Cross-case analysis

SA REITs			
	Types	**Structure**	**Stock and REIT market**
CS1	Company and Trust REITs governed by Company Act and Collective Investment Schemes Control Act, respectively.	Structure affects performance. Most common structures are traditional and paired-share.	Equity and bond market explain REIT market performance. REIT equity market segmented from stock market which explains positive relationship.
CS2	Not aware of any official type but knows REIT is a Proprietary Limited Company.	Structure affects performance. Structure better explained by lease agreement conditions.	Equity and bond market explain REIT market performance. REIT market less volatile than stock market.
CS3	Not aware of any official type but knows a specialised and diversified company REIT.	Structure affects performance. REIT tax dispensation.	Equity and bond market explain REIT market performance. Political instability negatively impacts property market.
CS4	Not aware of any official type but REIT is a property company listed on JSE.	Structure affects performance but not structure alone.	Equity and bond market explain REIT market performance. Political instability negatively impacts property market.

Table 4.2 – REIT Performance Cross-case analysis

	REIT Performance									
	Drivers		Investment Strategy			Industrial Sector Performance and Drivers	E-commerce	Gearing	Economic Status	Risk and Return
	Financial and Property Fundamentals	Sustainability (Green Building)	Diversification	Specialisation	Diversified vs Specialised					
CS1	Both financial and property fundamentals.	Green building have a positive impact on performance in the long run.	Specialised REIT but diversifies by geographic location to minimise risk and maximise return.	Management understand area, tax legislation and language very well.	Diversified REITs outperform Specialised REITs depending on multiple factors.	Industrial sector performing well predominantly driven by e-commerce.	Growing rapidly but has not significantly changed SA business model.	Can affect performance of REITs positively or negatively depending on cost of debt and expected return.	Economic status affects the performance of REITs.	Internal risk and external risk managed differently to maximise return.
CS2	NAV and property fundamentals.	Green buildings enhance efficiencies and also has a positive impact on performance.	Diversified REIT, by property type and by geographic location to minimise risk and maximise return.	Belief is that specialised REITs have a better value offering compared to diversified REITs.	Indifferent because it depends on several factors.	Industrial sector performing well predominantly driven by e-commerce.	Growing rapidly but has not significantly changed SA business model. Multiple factors help e-commerce growth.	Can affect performance of REITs positively or negatively depending on cost of debt and expected return.	Economic status affects the performance of REITs and the change starts from the manufacturing or secondary sector.	Risk: Liquidity, funding available, tenant covenants and legislation affect return.
CS3	NAV not mentioned but highlighted total return, the size of the fund and the sectors the fund is invested in.	Green buildings have a significant positive impact on the portfolio performance in the long run.	Diversified REIT, by property type and by geographic location to minimise risk and maximise return. Multiple ways to diversify.	SA is southern Africa's distribution hub which has increased demand for industrial properties due to e-commerce.	Diversified REITs outperform Specialised REITs depending on multiple factors.	Industrial sector performing well and Cape Town rental are increasing and vacancies negligible.	Growing rapidly but has not significantly changed SA business model.	Can affect performance of REITs positively or negatively depending on cost of debt and expected return.	Population dynamics, economy and city features affect	Developing green buildings minimises utility costs and maximise return.
CS4	Highlighted NAV and other financial drivers.	No mention of green building.	Specialised REIT but diversifies by geographic location to minimise risk and maximise return.	Best timing to invest in industrial properties.	Indifferent because it depends on several factors.	Big industrial companies (tenants) demanding 'big boxes' near transport orientated nodes to ensure fast delivery customers.	Growing rapidly but has not significantly changed SA business model.	Can affect performance of REITs positively or negatively depending on cost of debt and expected return.	When the economy is doing well, the property industry is doing well and the opposite is true.	Source of risk include: location of the property, sector, inflation rate, interest rate and currency risk which affect return.

4.7 Chapter Summary

This chapter highlighted the themes found in the empirical data gained from the semi-structured interviews conducted between the four cases, in relation to the literature in Chapter 2. A cross-case analysis was then conducted in order to highlight the similarities and differences amongst the four cases and compares the data found within each of the themes. It was found that two cases (CS1 and CS3) believe that diversified REITs outperform specialised REITs and the other two cases (CS2 and CS4) do not know, but added that it depends on multiple factors at that particular point in time, linked to the company investment strategy, economic status of the country and the company structure.

Chapter 5: Conclusion

5.1 Introduction

The purpose of the study was to conduct a performance comparison between specialised industrial REITs and diversified REITs in SA. Themes were identified from the conducted interviews and compared to the literature in Chapter 2 to identify any similarities or differences between the collected data and literature. A cross-case analysis was conducted in order to compare the data amongst the four cases with regards to SA REITs and their performance.

The problem statement as presented in Chapter 1 is:

> *There is limited data regarding a performance comparison of specialised (industrial) and non-specialised REITs in South Africa.*

The research question as presented in Chapter 1 is:

> *Do specialised (industrial) REITs outperform diversified REITs in South Africa?*

The research proposition to be supported or refuted is presented in Chapter 1 as:

> *Specialised Industrial REITs outperform non-Specialised REITs in South Africa.*

This chapter will revisit the research objectives which will be reviewed against the findings, before the research proposition is supported or refuted and future research recommendations are outlined.

5.2 Achievement of Research Objectives

The research objectives were achieved as follows:

Objective (i), the comparison of the performance of a specialised industrial REIT to a non-specialised REIT was achieved through a critical analysis of both the literature and the findings. The consensus from the literature review and the findings was that outperformance depends on several factors, which include the political climate, e-commerce, risk and return variables, but most importantly, the economic status or market condition of a country. REITs yield different results in a rising economy compared to results in a declining economy. Benefield *et al.* (2009) and Lin (2011) argued that property type diversified REITs outperform specialised REITs when the markets are doing well while diversified REITs are outperformed by the specialised REITs when markets are not as favourable. Although half of the sample believes that diversified REITs outperform specialised industrial REITs and the other half is indifferent, the findings reveal that there are other factors which outperformance is dependent on. These include the analysis time of reference, investment risk involved, the efficiency of the executive team and the property sector being referred to.

Objective (ii), the identification of stock and income performance drivers of a specialised industrial REIT and a non-specialised REIT was achieved through a critical analysis of both the literature review and the findings. The performance drivers can be categorised into internal and external drivers. The internal drivers include the operational structure of the REIT, financial drivers, property fundamentals, investment strategy and green buildings within the portfolio, while external drivers include the political climate, the stock and bond market performance, e-commerce industry and the economic status of the country. These drivers will apply to some REITs depending on whether the REIT is a specialist REIT or a diversified REIT and the sectors it invests in.

Objective (iii), the identification of drivers for REITs to specialise in the industrial sector was achieved through an analysis of the findings. The findings show that the brick and mortar retail stores are becoming less attractive as the e-commerce industry grows and the market demands more industrial properties. Capital intensive major logistics developments in major cities around airports and harbours result in an increase in industrial property supply to service the developments and also for the e-commerce companies to ensure faster and cheaper deliveries to the end users. Besides the belief that specialised REITs have a better value offering than diversified REITs, SA is considered to be Southern Africa's distribution hub therefore it is the best timing to invest in industrial properties as the demand for them is growing. Findings indicate that management may specialise in the industrial property type because of the current international investment trends and performance as well as knowing a certain geographical area or property sector very well. The economic performance of a country plays a major role, because there is a positive relationship between the economic performance of a country and its property market performance.

Objective (iv), the investigation of the impact of a specialised REIT's structure on its performance was achieved by critically analysing both the literature and findings. The REIT's operational structure has a significant impact on the performance of the company. The different structures are better explained by the different leases (terms and conditions) with the tenants, therefore the performance of the REIT, based on the company structure, is dependent on both the landlord (REIT) and the tenant. Other forms of structures include joint ventures with other REITs for reasons such as diversification of the portfolio, and sharing of knowledge and experience amongst investors.

Objective (v), determining the effect that the growing e-commerce industry has on specialised industrial property sector was achieved by analysing both the literature and findings. Retail property demand is decreasing and the industrial property demand is rising due to the growing e-commerce industry. Clients require more storage space in 'smart' industrial warehouses for the online stores, near major transport orientated nodes, airports or habours for cheaper and faster delivery to the end-user. As other factors like trust between buyers and online sellers, reliance and cost of internet access become better, the more e-commerce will grow and the more industrial space will be demanded.

5.3 Findings of the Research Question

The research study aimed to address the following question:

Do specialised (industrial) REITs outperform diversified REITs in South Africa?

A popular belief is that specialised REITs have a better value offering than non-specialised REITs generally but according to the literature and findings this is not always guaranteed, both internationally and in SA. It might apply to other disciplines but it is dependent on several factors in the property industry. These factors include e-commerce influence, the REIT investment strategy, company structure, economic and political status of the country. The time of reference is an underlying factor for all the other factors.

The brick and mortar retail properties are becoming less attractive for investors and industrial space demand is increasing due to the e-commerce industry. Developed countries (for example, France) have gone to the extent of restricting shopping centre zoning as people do not physically go to the shopping centres anymore. E-commerce giants are demanding large warehouse space close to airports and harbours for a cheaper and faster delivery to the end-consumers. SA acts as a distribution hub for Southern Africa and there are major logistics developments that are currently ongoing in SA which will result in the industrial space supply increasing. As a result, the industrial sector is performing well at the moment.

Different REITs have different investment strategies. The investment committees assess their opportunities according to their criteria which differs per REIT and per sector. The industrial sector mostly consider the expected return, location and availability of labour until the use of robots is preferred like in

China. Industrial Properties are normally located on the outskirts of the city near transport orientated nodes. The industrial space might be in demand currently and strategies definitely contribute to the REIT performance but the industrial sector does not guarantee outperformance because the properties need to be in the right area. For example, the findings showed that office space yields a better return than the industrial space in Claremont, Cape Town.

The key structure setups were derived from literature and they were based on international markets but applied in SA. These structures are the traditional and the paired-share structures. The findings revealed that REITs' structures are very flexible and they are ultimately reflected on the terms and conditions of the lease agreements between the landlord (REIT) and tenant which resembles the traditional structure. The paired-share structure involves a joint-venture between the REITs or another company, for multiple reasons that favour all parties. Even though the structure do affect performance, structure alone does not guarantee outperformance.

The economic and political status of the country is highly likely the most important factor because it affects all the others. The findings imply that if the political climate is stable and the economy is growing, then there is a high chance the property industry is growing. The opposite is equally true; if the country is experiencing political instability and the economy is not performing well, there is a high chance that the property industry is not performing well.

Outperformance depends on several factors with the time of reference as an underlying factor. Ultimately, investors consider outperformance to be financial, therefore it has to make financial sense in order to be able to assess under or over performance among the REITs.

5.4 Support or Refute the Proposition

The research aimed to address the following proposition:

Specialised industrial REITs outperform non-specialised REITs in South Africa.

SA's credit rating has been downgraded by the rating agencies and its political climate has been unstable recently which has negatively affected its economic performance and its currency. However, the industrial sector has been performing well, primarily due to the e-commerce industry growth. Investment analysts consider outperformance to make financial sense.

Due to the findings, the proposition is refuted based on the grounds that the industrial sector might be performing well at the moment, but that does not necessarily mean that the specialised industrial REITs financially outperform the diversified REITs. Furthermore, half of the sample was certain that the diversified firms outperform the specialised industrial REITs and the other half was indifferent.

5.5 Conclusions

There might be multiple metrics that can be used to assess outperformance, however, realistically what matters to investment analysts are those factors that ultimately have a financial impact on the REITs, directly or indirectly. The multiple factors should make financial sense and influence the overall financial performance of REITs.

Each property sector in every region has its own property cycle clock (Figure 5.1) and the industrial space in SA is one of the best performing sectors due to the e-commerce influence. The industrial sector currently is in its rising period where rentals are rising, vacancies are dropping and the general demand for industrial space is increasing. This rising phase might go on for a few more years because the key driver for this sector, e-commerce, is still in its infancy stage and it has not changed the SA business model yet but it is definitely growing.

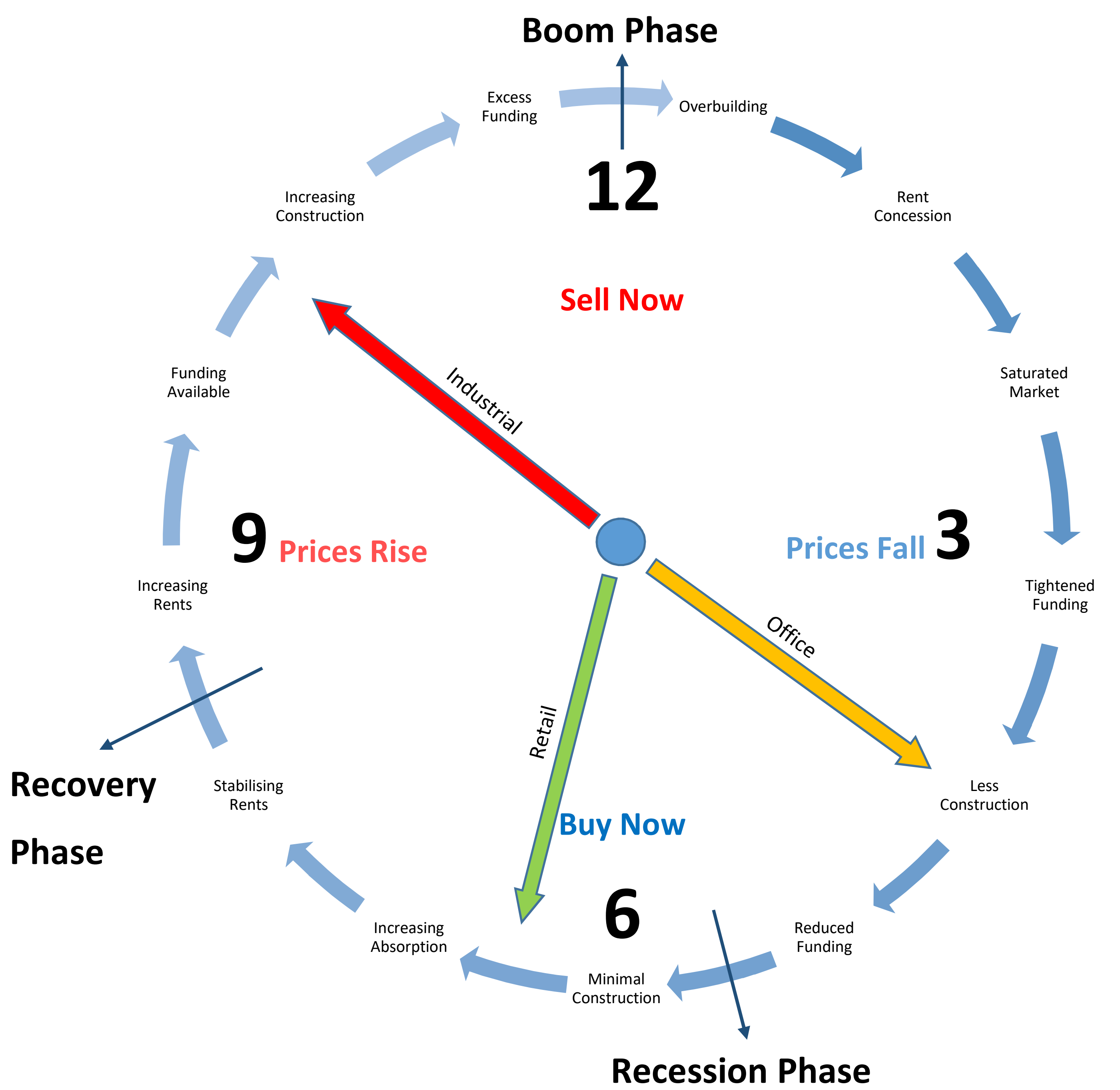

Figure 5.1 – Property Clock adapted from Viruly Consulting (2018)

The industrial sector is definitely performing well in SA but this does not necessarily mean that specialised industrial REITs financially outperform diversified REITs. However, the sector is growing and the JSE might see more new specialised industrial REITs, or any other property type specialist REIT, list especially because there are, not many in SA currently. The brick and mortar retail sector is being replaced by the industrial sector through e-commerce and the office sector is still experiencing the effect if oversupply (Urban Real Estate Research Unit (URERU), 2018).

In conclusion, performance assessment for investment analysts always has to make financial sense and this has to be reflective in the study even for a qualitative research.

5.6 Limitations and Further Research

One of the shortcomings of the study on the performance comparison between specialised and non-specialised REITs is limited performance information. Boshoff (2012) argues that information deficiency can have a direct impact on the company's performance. REITs were only introduced on the 1st of April 2013 in SA, which leaves only just over 5 years' worth of data for analysis. Further research could be conducted regarding the performance of REITs prior to the REIT status and after, to give property professionals and investors a better understanding of how the REIT status affects performance. With a longer time period of analysis, more information can possibly be found regarding performance of REITs in a SA market.

Out of a total of twenty-six (26) REITs, four (4) are specialised REITs and out of the four according to the 60% split threshold applied in this study, only two (2) are industrial specialised REITs. Furthermore, only REITs with offices in Cape Town were sampled because they were the most accessible to the researcher. These formed part of the limitations for the study because there was not a large REIT population to sample from. This creates an opportunity for a performance comparison among REITs in different sectors (office, retail and residential) and cities.

The qualitative component of the report relies on semi-structured interviews for data collection and these are subject to bias. There is an opportunity for a quantitative research on the performance comparison of REITs in a SA market using methods such as Sharpe Ratio, Treynor Index, Jensen Alpha as these are the most commonly used methods when assessing performance in a quantitative study.

The economic status affects performance significantly and just as the property clock, it is known to have several stages in its own economic cycle. These include peak, contraction, trough and expansion phases. There is an opportunity to assess REIT performance in each of these phases in SA. Empirical research such as Lin (2013) from the UK argues that REITs yield different results during each phase, therefore the same concept could be investigated in the SA market.

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List of Appendices

Appendix 1 - Consent Forms

Case Study 1 (CS1)

CONSENT FORM

UNIVERSITY OF CAPE TOWN

CONSENT TO PARTICIPATE IN A RESEARCH STUDY

Research Topic: A Performance Comparison of Specialised (Industrial) and Non-specialised Real Estate Investment Trusts in South Africa

Dear potential participant,

You are invited to participate in a research study conducted by Ntseno Peter Makatsane, master's student at the University of Cape Town. The research study is supervised by Saul Nurick from the Department of Construction Economics and Management of the University of Cape Town. The results of the research study shall be presented to the Department of Construction Economics and Management in fulfilment of the requirements of the degree in Masters of Science in Property Studies.

Should you have any queries or concerns regarding the research, please feel free to contact me, Ntseno Makatsane at pn.makats@gmail.com or mktnts003@myuct.ac.za. The research supervisor, Saul Nurick, can be contacted at sd.nurick@uct.ac.za.

Purpose of the research Study

The purpose of this research study is to establish whether specialised industrial REITs outperform non-specialised REITs in South Africa.

This is anticipated to be achieved by:

i. Determine the performance of specialised (industrial) and non-specialised REITs.
ii. Determine effect the growing e-commerce industry has on specialised industrial property sector.
iii. Investigate drivers for REITs to specialise in the industrial sector.
iv. Investigate what drives the stock and income performance of a specialised (industrial) REIT and a non-specialised REIT.
v. Investigate whether the economic status of a country has an effect of REITs performance.

Procedure

Your participation in this research study is completely voluntary. Should you volunteer to participate in the research study, I will communicate in order to agree on a time that would be suitable for a semi-structured face-to-face or telephone interview. Various questions shall be asked, and the participants' responses will be used as data which will then be analysed thereafter to reach an informed conclusion.

Potential benefits to participants

Should you request, the research findings will be shared with you.

Confidentiality

Every effort shall be made in order to ensure that the subjects are anonymous and the safeguard of any information provided. Confidentiality of all information shall be maintained. The information obtained from the interview process shall be used for this research study only. The raw data obtain from the interview shall only be revealed to individuals directly associated to the supervision and marking of this research study.

Participation and Withdrawal

You may elect to withdraw from this study at any time. You may also elect to refuse to answer any question that you do not wish to answer.

Rights of research participants

You may elect to withdraw your consent at any time and discontinue participation without any penalty. This study has been reviewed and granted ethics clearance through the University of Cape Town Research Ethics Board.

Signature of Research Participant/Legal Representative

I have read the information above and my questions have been answered to my satisfaction. I hereby agree to participate in this research study and been given a copy of this form.

Name of Participant (Please Print)

Company of Participant

Signature of Participant

Case Study 2 (CS2)

CONSENT FORM

UNIVERSITY OF CAPE TOWN

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Potential benefits to participants

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Name of Participant (Please Print)

Company of Participant

....

Signature of Participant

Case Study 3 (CS3)

CONSENT FORM

UNIVERSITY OF CAPE TOWN

CONSENT TO PARTICIPATE IN A RESEARCH STUDY

Research Topic: A Performance Comparison of Specialised (Industrial) and Non-specialised Real Estate Investment Trusts in South Africa

Dear potential participant,

You are invited to participate in a research study conducted by Ntseno Peter Makatsane, master's student at the University of Cape Town. The research study is supervised by Saul Nurick from the Department of Construction Economics and Management of the University of Cape Town. The results of the research study shall be presented to the Department of Construction Economics and Management in fulfilment of the requirements of the degree in Masters of Science in Property Studies.

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Potential benefits to participants

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[redacted]

....

Name of Participant (Please Print)

[redacted]

....

Company of Participant

[redacted]

....

Signature of Participant

Case Study 4 (CS4)

CONSENT FORM

UNIVERSITY OF CAPE TOWN

CONSENT TO PARTICIPATE IN A RESEARCH STUDY

Research Topic: A Performance Comparison of Specialised (Industrial) and Non-specialised Real Estate Investment Trusts in South Africa

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Name of Participant (Please Print)

....

Company of Participant

....

Signature of Participant

Appendix 2 – Transcriptions

Case Study 1 (CS1)

CS1 Interview

There are 3 Speakers:

Researcher
R1a - Respondent 1
R1b - Respondent 2;

Held on the 2nd of July, 2018 at the CS1 Property Fund Offices in Cape Town.

R1a - You need to decide what that performance metric is going to be. You need to decide what's the right basis on which to assess performance and that maybe may be a combination of factors, so if you just look at the market you going to be subjected to market volatility which may not reflect the underlying fundamentals of a business. Assuming markets are efficient then it's probably a good measure, but there is a lot of research that suggests the market is not. Markets are not efficient in accurately assessing the fundamentals of a business. Then you have a problem there because it depends at point in time you look at the performance. I don't know what other REITs you using…

Researcher - I think that's a very interesting point you making which is one of the points I read for my literature review. Similar studies that were done in the UK were saying that really depends on the economic status of up that nation at that point in time. The nation is going a recession or recovery stage, it will be yield different results each and every time.

R1a - I think how you assess performance is one of the critical questions you are going to have to answer in your research because of how fundamental it is. If you look at number of a property REITs in the last 12 months, most of them have done very poorly from a market perspective because there has been a lot of realignment and adjustments back to what market participants considers to be more of a fundamental view of a business rather than a speculative inflated view of a business. There's a few that would have an issue if you use market performance because they are going to say, if you had to use a certain REIT that was influenced by some market downturn at the beginning of the year, you are going to have a problem. Say the REIT's share price dropped 60% that is not really reflecting market performance.

R1b - I think what Chris is talking to is are you aware of what has been happening in the SA REIT space? The Resilient Group of companies (Fortress, Resilient, and NEPI) but Nepi hasn't really taken much of a hit but it was a group of companies at the beginning of the year that took an incredibly big knock and they comprise of about 40% of the listed property market. I don't know at which point in time are you looking at doing your research but there will be some funny share price behaviour from the beginning of the year to now. So it is very important if you're going to use share price to take that into account. Both Chris and I studied at UCT and what we were taught was highly theoretical, we studied Finance, and we realised when we got to CS1 we realised that a lot of what we learned isn't exactly how it works in the real world. There are tons of performance metrics you may be able to study but what people look at most is when it comes to analysing REITs is Distribution per share. If you look at the SA REIT guide, there's the best practice for determining distributable earnings and distribution per share. REITs distribute almost a 100% of their profits but there is a guidance to say that you have to distribute more than 75% and most REITs distribute more than that. There is a formula to help you get to what your distributable earnings is and what analysts assess REITs on is most often distribution per share. Things like LTV, yield and share price are important but the most important that analysts look at is distribution per share.

R1a - Which may or may not be a good metric but that is the metric that is used because typically what an investor would look at when they're trying to invest is, say, I expect a desired level of return depending on the risk profile of that equity investment and then I'll say I expect that in two components; I expect that in a the cash component which I'm going to receive every year and I also expect it in a capital growth component. So effectively, the two components is what they're looking at to get their total return which is the decision that they need to make. For instance, they say I want 15% and I'm going to see 7% it distribution growth and therefore I want to see 8% return through capital appreciation. So typically, an investor will think of a REIT in that way, that's why the distribution per share is so important to an investor because it is one of the critical components in assessing their return. That's very different to other equities and other sectors. It is specific to the REIT sector because the REITs have a mandate to distribute at least 75% and what you will find is that distributable earnings is quite similar to the cash generated from the operations of a business. So bear in mind that the distributable earnings is one of the closest proxies you going to find to the underlying free cash that a business generates which they then distribute to the equity holders. That's why it is an important metric for a REIT and it might not be that important for another industry. Also specifically for Non-REITs like property stocks, they may not be that concerned about distributable earnings although it is one of the main metrics, it may not be the main metric they consider. But for a REIT, because of the nature of the structure, it means a distribution growth is the most important factor for an analyst perspective, in analysing whether a share is worth investing in. So they are focusing closely on it distribution per share and whether that gives them the required return that they are expecting.

R1b - The reason why I brought our presentation is that we have presented NAV growth per share. We show NAV growth, portfolio growth, growth in share price and growth in distribution. Those are the key metrics we look at. I think that is a good place for you to go in considering which one is important and a good place to start.

Researcher - Probably you didn't pick this up but the research is more of a qualitative research than a quantitative one. Initially I wanted to go quantitative but I was advised otherwise by my supervisor. Not that he is against it but because he's more skilled in the qualitative approach.

R1a - Then you are going to have a much more difficult task because qualitatively, I could probably argue on most counters on why they might be better than another counter. So on a qualitative basis you could have a hundred arguments like the strength of a director in the board but in all of that at the end of day, has got to translate into results. If your qualitative aspects are strong, how you are going to assess the relative strength and say this CEO is a lot more experienced than this other CEO potentially and therefore he's able to... I mean you are going to be clutching at straws. So you going to really struggle with that I think.

R1b - What type of qualitative factors were you thinking you are going to be looking at?

Researcher - Well, I haven't gotten to that part yet. I was going to analyse the interviews thereafter and see what common themes are there.

R1a - Well let's work through it and let's see. But at the end of the day you are going to put together a rubric of qualitative factors; I think it is going to be a flawed at some level.

Researcher - I understand.

R1a - You are going to have to try put a limitation on your research to say, I appreciate this may be flawed in some sense but there is no better way of me identifying this for the current purpose. Then explain why there was no better way.

Researcher - Thank you for the point, I will definitely note it down.

R1b - What about quality of underlying assets?

R1a - Could be, quality of the assets... But you see it's a different market so you can say that the quality of the assets is important but for one property stock they might have a brilliant portfolio of assets which are very low yielding assets whereas another portfolio might not have as great asset but the yield is far superior on a relative basis. People might be more attracted to that. That might drive up performance. But that's your task.

Researcher - Thanks man. Should we get right into it?

R1b & R1a - Let's go for it.

R1a - You'll see that there's a few overlaps here, let's see where we get to in response to that.

Q1: What types of REITs are offered in SA and how do you decide on a specific type?

Researcher - Question one, what types of REITs are offered in SA and how do you decide on a specific type?

R1b & R1a - what do you mean?

Researcher - So I read on the SAREITs website…

R1b - Company REITs and Trust REITs?

Researcher - Yes and that's basically it. Of the two, how would you decide which one to go with?

R1b - So you don't decide. REITs were born out of previous legislation or Property Unit Trusts or Property Loan Stocks and I think if you were property unit trust you had to convert to a Trust REIT so there is no choice.

R1a - I would just check that because I don't know if that's an important question for your thesis if you talking about what types as in a company and a trust REIT. Presumably if you want, you could potentially try and convert by, I don't know the specifics on converting, but I don't think that's a relevant point in your analysis around performance. I think the actual structure, whether it's a company or trust, the mechanisms identical on both sides. It is just an administrative thing in terms of the formation of an entity is performed.

Researcher - So the legislation or rules and laws…

R1a - ...are identical for both!

Researcher - Really?

R1b - Yes they are.

R1a - So you wouldn't know by looking at this list, which was a trust REIT and which one is a company REIT. I don't know if there are any Trust REITs because most of them are Company REITs.

R1b - Most of them are Company REITs. It was just for the initial transition from the old PUTs and PLSs to the new REIT legislation that those were introduced but I think most of them are Companies.

Researcher - It's that I don't have my facts straight but I think it was it was on the same site that they said that Company REITs are governed by the Companies Act and the Trusts by something totally different. Don't you think that would affect the performance ultimately?

R1a - Well you got to ask the question, when it comes to companies being governed by the Companies Act, the purpose and the Companies Act was not necessary to affect how a business would operate but to govern the rules around the formation of a company and the requirements that directors have. Actually the Companies Act was drafted with intention of protecting shareholders, protecting other stakeholders which trust legislation might not have. But I would seriously question whether they would change anything because both without to subscribe to other legislation that be overarching our JSE listing requirements. It would invariably hold you to a higher standard than the Companies Act and you could add King IV and a number of other pieces of legislation, the Income Tax Act. When you put it all together, I think it is a higher burden of proof than the Companies Act is when it comes to the actual fundamentals of the business. So that would be my thought around that.

Q2: Does a REIT structure affect the performance of a REIT?

Researcher - And the second question, does the REIT structure affect the performance of the REIT?

R1b - Were you talking about the tax consequences?

R1a - Are you talking about the first question, the following one or are you talking about…

Researcher - The second question.

R1a - I know, I mean structure as a Company or Trust REIT or a REIT structure as in how a REIT is different from a non-REIT.

Researcher - Ok just that there's is a mixed up of facts here with international and…

R1a - Yeah but we want to have a conversation here, tell us your thoughts around what motivated the question and we try and answer it.

Researcher - So I read some literature where they said that there's a traditional structure, well basically three types, traditional structure, paired-share and paper clip. I don't know if you guys are familiar with them.

R1a - Can you give me some details around what they look like?

Researcher - They said that under a traditional setup the REIT owns the property which is then leased out to the obviously the lessee which then manages the properties. Then the paired-share, the REIT is in a joint venture, I'm assuming another company and then in that setup the company basically operates as a separate entity from the REIT. Then the paperclip the only difference there is that the shares are traded differently.

R1a - I think in practice REITs are a combination of those. So you have traditional, where you own the underlying property and you rented out to a tenant and that generates rental income and distribute your income after settling whatever financial obligations you have. I think that's almost all REITs have that traditional element to it, I think all do. Almost all also have the second element which was called paired-share, a joint venture type relationship. Because of the nature of it, if you buying one asset, any asset in this space is going to typically require quite a big capital investment. You can't buy an asset without putting the capital investment and also it's going to take on quite a bit of risk because the joint ventures (JV) are normally structured. Well you could enter the JV for a completed building but you normally do it where there is a risk relating to a development and you trying to mitigate the risk. In the same way that if you mining for gold, you be quite silly to say well I'm going put all my resources into this one spot that I mining for and if I hit gold then beautiful but if I don't or then I'm bankrupt, I need to be liquidated. So effectively, it's a way of diversifying risk and sharing that risk it with another party so that if it doesn't work out or if doesn't work as intended the consequences aren't devastating for the entity. Whereas it's the same thing as far as the mine, you might buy a share in a mining enterprise and buy a stake so that if it doesn't work out will you know that one in a hundred in this area it might work so best not put all your eggs into that one basket, you diversify some of your risk. The JVs intention, I think, is to diversify risk while also while also having a situation where you creating a relationship with another entity so able to collaborate and share knowledge, experience and knowhow in a specific pursuit.

R1b - The third one I don't know what exactly you mean by instrument of traded differently. But definitely if I think about CS1 we are a combination of the first two. We've done JVs and we have properties we've let out to tenants but I can't comment on the third.

R1a - Where is the literature from?

Researcher - It is from the US.

R1a - That could be why it's not…

Researcher - ...relevant to this market?

R1a - It is relevant in the sense that we are a combination of that, but not relevant in the sense that people would not normally identify themselves as one or the other.

R1b - Also the US REIT market is far more evolved than South African (SA) REIT market and rand and the their legislation is far more advanced than ours. I mean they have private and public REITs in the US. They have lots of different types of REITs. Specialised REITs are massive in the US, you have self-storage REITs, you have hospital REITs, you have educational REITs, and you have industrial REITs. Whereas in SA, specialisation hasn't evolved yet to that point because our legislation is new.

R1a - We also 50 years behind. I mean they started REITs in the 1960s and we started 50 years later. So if we have this discussion in 2060, maybe then we will be at a point where the US is… So that might be an important disconsideration when you are thinking about your topic looks specifically at South Africa and identifying some of the differences when doing a comparative analysis based on your findings from the interview questions might be a useful part. Say, where is South Africa lagging based on my research of the US, what I can see you have done, and based on my interviews that I've conducted in relation to South African REITs.

Q3: What are the key performance drivers of REITs?

Researcher - Question number three, what are the key performance drivers of REITs?

R1b - I think we have touched on it.

R1a - Take this hand booklet with you. There is property fundamentals bit and then there's a financial performance and so if I presume if it's in property performance then those are our key performance drivers and if you look at other REITs you going to see that it is very similar. So there are very few REITs that deviate from these key performance drivers because most analysts uses the basis on which they value these entities.

Researcher - Thanks.

Q4: how would you define specialised REIT compared to a diversified REIT?

R1b - How would you define a specialised REIT compared to a diversified REIT? Specialised is focused on a specific asset class. For example, in the SA market there aren't many specialised REITs and what we found is that majority of them have a retail division, a residential division, an office division and some of them focus purely on commercial and that will be office, a little bit of warehouse, and some retail and CS1 came to market as the first pure-play logistics counter and 98% of our portfolio is industrial. So I think that's telling someone that it is specialised. I don't know if you're looking for a number?

Researcher - I think the next question will address that. Is there a certain threshold officially, that would...

R1a & R1b - No.

R1a - You can read other counters who have like three different asset classes that might say they are specialised so specialised is a term that you coin yourself if you can be consider your assets to be specialised. You might also consider the assets itself to be specialised because of the functionality of the asset or whatever is in that asset that means that it's unique and in a sense and there's only a few of those available in the country, regardless what it actually is.

R1b - And last year what we saw which is actually interesting was when a player came to market on the AltX, so they weren't listed on the main board, but they called themselves the Specialised Western Cape Fund. So they specialised on a specific region of the country. The only one I've seen.

R1a - Which is one of your questions.

Researcher - Yes the geographical specialisation.

Q5: How does a REIT qualify to be specialised in SA?

R1a - Let's get down to it, so five, how does a REIT qualify to be specialised in SA? There is no criteria. You decide on whether you specialised and then investors have to assess whether you are lying or not.

Q6: Do property type specialist REITs outperform diversified REITs in SA?

Researcher - And then number six, Do property type specialist REITs outperform diversified REITs in SA? These questions might seem obvious but they are just to get your opinions.

R1b - I would like to but I don't think that there are many specialised REITs in SA. If you look at CS1, we are probably the only specialised REIT.

R1a - (pointing at Business Day newspaper) This says there are 20 specialised REITS in SA.

R1b - What is specialisation? They have commercial under residential.

R1a - I don't know. So maybe you need to think about that. They have a split here between diversified, industrial… Have a look here they break up REITs into categories. Stor-age, is called specialty REIT.

R1b - I'm sure Stor-age is specialised.

R1a - So maybe go through this. I wouldn't say Resilient is a retail REIT because there is a bit of Industrial and it's got office. So they put industrial and office same category, which is a bit flawed. It's a very different business model, I mean it's very different in its nature and its surprising that Accelerate isn't in an office category because this office is owned by Accelerate and it's an office block. So this is very strange that they are in the retail category, I don't know what they classify as retail but I don't think this is retail.

R1b - If you think about it qualitatively, what specialisation does is it brings you a certain degree of focus. It does focus your attention and it does make you a lot more picky with what you can buy and what you can hold in your portfolio. By focusing on a specific asset class you want to get better at understanding that asset class fully. To manage it, you become a bit of a master of that asset class.

Researcher - I think we are also addressing one of the questions which is... I don't if it's the benefits of… anyway, we'll get there.

R1b - So I mean if I can say that's what I think it does. And I've seen in our circumstance for example we have a very specific mandate: Type of asset that we buy, type of asset that we like and we get things thrown at us with every week. We get presented with 15 opportunities every week and it's very easy for us to go this is what we buy this is well we do and this is what we know so 12 of those don't even meet our criteria, let's look at the three. That's how we've managed to really just...

R1a - I think you could tackle this question, let's say I had this question in my finance exam, I would go from a very different angle. I would say, a well typically diversification in a finance setting means that you able... so you've got to understand some finance concepts for you to establish whether this is true or not. Because in a traditional sense we would say diversification is something an investor can do, so the company shouldn't really be diversifying. Let's say you wanted to have a mix of office, industrial and retail as an investor, what you wouldn't want is 20 different diversified REITs that have a combination of all of those because then you take the investing decision away and say basically you can't really invest in what you want, here is just the options of diversifying. So typically diversification is something the investor should be able to do and is able to do to eliminate any risk that's not market related. A market related risk which is the beta of that stock you can't diversify away but you can diversify all the business related risks and it might be specific to that sector. A diversified REIT as a first step is always going to be less preferable because that investor can diversify on his own. They can go and diversify if they want to and a specialist REIT will always be your gut feel will be towards something that's specialised. Having said, that if you get to look at diversified REITs, I mean it depends on what time frame you use but they have typically outperformed what this would consider specialised REITs for other reasons and not specifically for the reasons of the asset. Maybe because they got a brilliant set of brilliant executives or the business is well managed or well run or…

R1b - ...it's been around longer, their cost of capital is better.

R1a - ...yes, they have a bigger bargaining power. There are other factors that drive out performance other than specialisation. The reason for a diversified REIT direct out performing a specialised REIT might be completely unrelated to the actual specialisation. Does it make sense? It might be other factors involved in that business which might drive out performance. It's very difficult to get a subject or control so you're going to have to use a control in the company and say this is the subject I'm using. Had it been diversified or had it been specialised, which way would have been better, would it had outperformed the other as specialised or diversified. You wouldn't be able to tell that because you can't any one company and split. Let me try and see any two pairs, let me compare Redefine and Growthpoint. Oh by then I can't do that. I got to use specialised and try find two combinations with the exact same, all other factors held constant. You can't get that. You know you going to make assumptions with whatever stocks you choose. You need to decide when I consider or when I talk about out performance what am I what am I actually looking for? What do I consider to be out performance and then maybe that would be the basis on which you can think about where the specialised REITs outperform diversified REITs. The whole REIT markets in SA is tiny, I have a small piece of paper (newspaper) here that I can show you the REITs. So in the UK you have a lot more and it in the US you have tons more so maybe this is not the best... the problem is you going to have to infer some stuff from other jurisdictions or infer information from outside of the REIT space for you to come up with a benchmark for outperformance. That then becomes difficult because you open up to a ton of other questions. As soon as you look out of SA you can't compare, because you got other aspects involves like you political aspects and currency aspects which differ across the board. It all depends on what you consider out performance to be and your traditional sense would be that specialists in any field should outperformed diversified because, I mean use it in a simple context, a specialist surgeon in a specific field should outperform somebody who's diversified and is a jack of five different trades. They couldn't be a master in one specific field so then I'm able to demand prices that a specialist surgeon would be able to. Theoretically speaking it would make sense for specialised anybody who specialised has a certain set of skills which no one else has, should be able to demand a higher price for things but that's not necessarily what you see because there is other factors involved.

Q7: Why do some REITs choose to specialise in a property type or geographic location?

R1b - Why do some REITs choose to specialise in a property type or geographic location? I think firstly it's understanding an asset class, That's probably the most important thing and taking it back to CS1 when I joined which was 3 years ago now, I met with the CEO and ask him why Warehouses. It was terribly unsexy at that point in time. He said if you look at what has been happening in the world in terms of supply chain management, in terms of e-commerce, where the focus is shifting, the world is shifting away from traditional retail and people will always need somewhere to store things and that was he believed in. We may not have all believed in it at that time but we've slowly were convinced of it but he believed in a certain asset class and that's what he wanted to execute, he's vision. That's just an example. But why do you want to choose to specialise in a property type, I think it is understanding the asset class, believing that it will outperform, or there must be enough significant evidence that there will be some outperformance in the future. So geographic location, we are a South African based REIT and as any South African business does we faced emerging market risk. For example when we chose to diversify, some of our emerging markets risk we chose developed markets. So the UK was a developed market we understood the tax legislation, they speak English which is the same as ours and those are some of the things you look towards when you think about diversifying. The UK for example is an incredibly developed market, it has a lot of opportunities in logistics so you look for those sort of things. If you know what your asset class is you look for a market that your asset class is performing well or you think will be performing well in the future.

Researcher - Alright. Chris anything on that?

R1a - Can you clarify something on this question, so you asked why do some REITs choose to specialise in a property type or geographic location. Do you mean in either of the two?

Researcher - Yes.

R1a - I think that the geography bit is a relatively simple one and that's just basically understanding of the market. It's very difficult to walk in to a market you don't understand and then to try and command and demand high prices on things and be able to buy assets at a good price. It's just very difficult if you don't know the market at all. You could put yourself in the same situation here on a very simple scale, if I had to drop you in Gaborone and say buy a house, you just wouldn't know the market. You just wouldn't know where is even up-and-coming, where's a good idea, are there other risks, I don't know how land reformation is looking there. I just wouldn't be able to buy. It would be very risky to throw my money there. But equally we could say well put your money in California, drop you there and say buy something. It would be very difficult too because you don't know the makeup of the territory, that geographical location is not well known to you then how you going to make an informed decision about an asset that you need to in order to generate a good return. You can rely on property fundamentals to do that and say what's the return I'm going to get from this asset but a lot of it is looking through in saying how's this region going to evolve over time. Can I see what the evolution is going to look like so that based on that I can make an informed decision? I was talking to a guy yesterday, who said he bought a house in Greenpoint 40 years ago. At that point in time it was basically a dump there, it was just next to the harbour and nobody wanted to buy in Greenpoint. He bought it because he was working as a marine electrician on the ships and he bought the house for something like ten thousand rand right on Main Road. But no one wanted it. He didn't envisage that it's going to be a wonderful area to be in and 40 years down the line. You get that there's got to be some thought like is this area can evolve in a way that's going to demand or people are just going to move away from it? Are they're going to move to another area? You are now not looking on a 40 year time frame, you looking at a 5 to 10 years when you making decisions like that. How is this areas going to evolve and its demand for these types assets are going to be higher now in 5 years' time than they are right now or is it going to diminish over time? If is going to diminish then you have to rethink your strategy. We have an investment committee to make a decision about whether to buy an asset or not so evidence is put forward to propose the acquisition and in that is a number of factors that the board consider in making decision about where to buy property. Obviously location is one of the critical aspects of it. It's the first aspect to think about but there are other factors like availability of labour because of the nature of the assets. Depending on what asset class we thinking about, the factors differ. For us in a warehouse space labour is important until such time when robots take over which they have in China and other areas. For us labour is an important Factor because warehouse demands a significant number of people to operate.

R1b - We put out a SENS so if you look at the SENS… When you talking about a Geographic location you referring to a country or a region right?

Researcher - Yes.

R1b - When we bought our first Warehouse in June 2016 In the UK, we put out a long detailed SENS which explained the rationale of why we expanded into the UK and it listed about 6 or 7 factors as to why we went there. Evolution of the market, diversifying away from emerging market risk, transparency, availability of high-quality assets.

R1a - Go to share data, then the company, then news and it has all the SENS announcements. Look there too for every acquisition and it will explain why we invested in that property, and what fundamentals of that property drew us into it and made it a good acquisition in our view. So you can look at both factors by just looking and reading in our SENS announcements because they are quite lengthy.

Q8: How is the Industrial Property sector performing relative to other sectors in SA and the world?

Researcher - Alright and how's the industrial property sector performing relative to other sectors in SA and the world?

R1b - Qualitatively, it's been going well because of the change in the retail space. So if you read all these articles, "Is retail dead?" "The retail Apocalypse" the landscape has definitely been changing. People are moving away from brick and mortar stores. In the UK on the High Street you see massive stores which are closing. New look, House of Fraser, Mark and spencer, they are all closing stores. Because 20 to 30 years ago people wanted big stores, that's how shopping was done on the High Street. Shopping was done in store and people are now moving towards online shopping people are moving towards convenience so there's definitely been a shift in the landscape to facilitate all those online sales and you need more warehouses. Furthermore even the traditional brick and mortar retailers they need to have a more efficient supply chain. So where houses are becoming increasingly important. Your Warehouse needs to be situated in the correct place to minimise travel time. Your warehouse needs to be efficiently built, high ceilings so you can do racking. It needs to be a smart Warehouse so you can use software to optimise delivery. So how is it doing? I think given the change in landscape of retailing Industrial is definitely being doing well.

R1a - Certainly more attractive than your traditional retail REITs where you operate as a shop in a mall. But you have to understand that adding "...and the world" in that question you opened up many cans of worms. But also as an example I saw this (showing CS1 audited financial statements booklet) and it's titled "the changing face of production and consumption." In the past you have international and domestic manufacturing happening if its international then it gets transported into South Africa let's say and your traditional sense would go from a national distribution centre which is one of you really big boxes somewhere in the middle of nowhere where land is very cheap to a regional DC which is more closer to where you have to fulfill that order then you have your brick and mortar store which is your shopping mall or High Street and then to your end consumer. Whereas, what was seeing more and more of is you got manufacturing transported to a national DC. That hasn't changed. You got your regionals, but from your regionals you don't necessarily have that the brick and mortar. You've got your last mile performance centres which go straight to truck and the e-commerce platform is introducing this aspect of it which is certainly more prevalent in other developed markets. In South Africa as an emerging market, we've seen more of that but not to the point that is changing the business model yet in that space. It isn't fundamentally changing the shape and nature of the business. What's also important to realise is that how shopping malls function in South Africa's is very different from how shopping centres function overseas. Shopping malls in South Africa generally have an anchor tenant which supplies goods which are very inelastic. So your Pick n Pay's, your Checkers which means that regardless of how the economy as a whole is operating, people still need to go to shopping centre because they still need to buy groceries. The online possibilities with Pick n Pay and other retailers are there but there certainly isn't a buy in that you get elsewhere. So I still don't use Pick n Pay online to buy my grocery whereas is in the UK I was living there for 2 years and I only ordered groceries online, I never went to the shop to buy groceries. There is a different business model and it's because there are other factors in that model. I suppose there's more trust, more Reliance, it's more dependable. The efficiency means that I can demand in the UK that you arrive at 5:55 on a certain day and I have no question about when you going to be there. There are other factors in in those markets which mean that people have a lot more trust in that and also they don't want to go to the store to buy groceries whereas here people are very happy to do it. It caters to a different market.

Q10: To what extent does the e-commerce industry affect the industrial property sector in SA?

R1b - I think you answering the next question too. All those things that Chris just said talks to why maybe e-commerce hasn't made such a dent in SA yet but the other part is internet penetration and the cost of data. I mean to do online shopping in South Africa you still have to pay 50 rand delivery fee and the majority of people can't exactly afford a 50 rand delivery fee but that's because our distribution networks aren't evolved enough where we could do it for free. So there are all those other elements which impact or which may hinder the impact of e-commerce in South Africa but it's definitely growing, it will just take a while for it to catch up. In the UK there's an interesting stat that says last year 19% of all retail sales were done online and they project that by 2021 or 2022 it will be almost half. Like Chris said with REITs, we are 50 years behind, with internet penetration we are probably 20 years behind and we will eventually catch up. It's just a lot slower it's still in its infancy.

R1a - That's why I think the question is how is the industrial property sector performing and, I think performing better but also market positioning is important here because the fundamental question is the developed markets' model going to be replicated here at some point in the future? If it's going to be replicated here at some point in the future then market positioning is very important because buying into a retail REIT or office REIT, doesn't seem like the best option if it what's going to happen is you name it away from shopping centres and their shopping centres are really going to service the very high end, what you see a lot of the UK. When you do see them, shopping centres are servicing a lot of the really high-ends and you go there as a recreational thing rather than to get your groceries or whatever they are. It's a very different model. The fundamental question is that model there, going to be replicated here? I think in most cases you would probably conclude that yes, in some shape or form it's going to. It's going to be hindered by other factors. It is not going to necessarily play out exactly the same way but certainly it's moving in that direction. So we sort of put questions 8, 9 and 10 together.

Q11: How does the REITs gearing level affect its performance?

R1b - So we are at 11.

Researcher - Yes, so how does that REITs gearing level affect performance?

R1a - Okay, what do you know about gearing?

Researcher - I know that on average in SA, REITs gearing levels should be between 20 and 40%.

R1a - Something like that. What does that even mean?

Researcher - In layman terms I just look at it as debt level in a way.

R1a - Okay, fair enough. So when you say 20 to 40% what you're basically saying is a certain percentage of the assets is financed through debt as opposed to equity. So your capital structure is a combination of debt and equity which together give you your total cash capital you've got to invest in your asset base. Now how does the REITs gearing level affect its performance? Again so if performance is a qualitative factor then it may not affect your performance in the sense that you still have the unclaimed underlying asset so your asset base is not affected by the gearing. You can invest in whatever that you want to invest it. Gearing is determined by how you get the cash to go and invest in. Does that make sense? So if you determine performance based on the underlying fundamentals of the property, then the answer is gearing won't affect it at all. If you determine performance to be a financial metric like a distribution growth or distribution per share, then we can talk about how the gearing levels affect it. You need to do some research around this but there's a very common calculation for the degree of financial leverage which you can just go to research quite easily. It just looked at the level of finance costs as a percentage of your earnings that you generating before those finance costs. So it looks and how… because remember your finance cost... let's say my earnings are growing at say 5% for the underlying property but my finance cost aren’t going to be changing, effectively like a fixed cost. So you able to gear yourself up or down depending on or how the underlying performance of the property is doing. So a simple way might be… I’m just trying to get an analogy that might make sense to you if I had to explain the degree of financial leverage. Let me explain some other things first. Typically, we looking at 20 - 40%, I think it's probably fair that you look in that range but across the property sector you going to see a wide range. I mean some of them are towards 50% or higher than. Which means half of their capital structure is debt funded and what that says then is if the underlying asset is performing really well you are able to gear or elevate or magnify or enhance your return on the underlying asset by using debt, if the cost of that debt is cheaper than the equity that you using. Debt can be expensive and debt can be cheap and if you able to finance it through expensive debt it can actually work against you. But if you're able to finance it through cheaper debt then it can actually work for you. So you got to understand that there is a cost associated with debt and that cost can either leverage your returns up or down depending on what that finance cost is but it's worth.. I’m just trying to think if you look at an analogy on a graph.

Draws graph (refer to diagram at end of interview) and works out a hypothetical example on boardroom whiteboard.

R1a - So let's say you buy a property at a hundred million, let's just use very simple numbers here, at 10% yield and you obviously going to generate at 10% return from the underlying rental income from that property. Does that make sense? Your cost of debt let's say is 9% so that's your acquisition yield and your LTV, your loan to value, that’s the percentage of your loan over the total cost of the property, let’s say is 50% and remember you said during normally between 20 and 40%. That's on a sustainable basis, that overtime. It doesn't typically start off that way but you could choose where to keep your gearing level at but that's over time sort of when your LTV matures as the property appreciates. So in year 1 your rent income is going to be 10 million. Your finance costs on that effectively saying a hundred million over 2 (LTV), 50 million at 9% is 4.5 million. So 5 and a half million effectively it is your distributable earnings. In year 2 how it works in South Africa is we normally have lease escalations and those lease escalations because we have the high inflationary environment which means you need to compensate the owner and the fact that on a real basis, you know there is nominal and real costs, on a real basis the underlying cost structure… if they didn’t generate an escalation, on a real basis they’d be out of pocket. So to compensate them for the effects of inflation on a nominal basis let's say you're going to get an escalation of 8%. So in year 2 you have 10.8 million, finance costs remain the same, which means you have 6.3 million in year 2. Now let’s look at it and say if we hadn’t geared what would have happened. So if we hadn’t geared it we’d have rent income still of 10 million, finance cost would have been 0. So you can say then that this looks like a worse situation but it's not. Why? Because you put in half the cash in here. So what’s your return in year 1, your cash on cash return? It’s 5.5 million over 50 million which is 11%. What would you have generated without gearing? 10%. So you generated another 1% by gearing the asset in year 1. In year 2 you’ve now got 6.3 million over 50 million which is 12.6%. So not only does gearing help you and year 1… it doesn’t always have to help you in year 1. If your yield is only 8% then it's going to hurt you and Year One because you’re going to be paying out 9%. It's going to hurt you in year one but as soon as the escalations occur it’s going to help you. Gearing can either help you or hurt you depending on the cost of that gearing, how much it cost you relative to what you're using that money for. If you tell me it's going to cost you 9% to borrow that money but you going to get 8% return I'm going to tell you that you're being silly by doing that because you going to be paying 1% to get that money. Why not just invest at all? But if you tell me the following year you are going to generate anything more than 9% then I'll tell you now that makes sense financially whereas before it wasn’t a good decision. So in the first year on an unlevered or ungeared basis the return is 10% then on a geared basis the return is 11%. In the second year the finance cost is still 9% but the rental has escalated to 10.8% on an ungeared basis and on a geared basis it has increased by 1.6% versus the 0.8% in the ungeared basis. Do you understand what it does? In the same way it might really hurt you.

Illustrates on attached graph (refer to Figure CS1)

Gearing basically magnifies the effect of something in either direction. Does that make sense?

Researcher - Yes, I will definitely look into it more. It makes sense though.

R1a - So what some investors do when they look at a business is they try normalise the capital structure. They say well let's not try to be bogged down but what the actual distributable earnings is let's say what do we think the distributable earnings will be on a sustainable basis using the capital structure we are applying to other properties were comparing because you can't compare two properties with very different gearing structures. One is going to generate much higher returns than the other one will depending on how the gearing is working for them or against them. Actually this is a similar question to the specialisation question, the question 6 because you say which is better, specialised or diversified. So what's better unlevered, ungeared or geared or a low gearing or high gearing. The question is a question of appetite, what the investor wants. If the investor is wanting a share that's got very little exposure to gearing, because if you didn't have any exposure to gearing, all you will have is the underlying asset and you get the unlevered return. If you care about the financial risk because this is presenting an increased financial risk, investors needs to be compensated for this financial risk. He is taking in more risk here and the return should be higher. So it's a risk return story, and we will get to that just now I think.

Q12: How does the economic status of a country affect the sectoral performance of property?

R1b - Yes, how does the economic status of a country affect the sectoral performance of property? Well, so for example we spoke about a couple of trends today and is easiest one is to think about is what an economy does to consumers. Generally in a high inflationary environment or where there is stagnant economic growth you find that consumers struggle or you don't find as much spending power and usually what's first hit is retail. I'm using this as a rudimentary example and what you normally find is that you may have increased credit risk and tenants may not be able to pay their rent and as a result retail as an asset class may suffer. I think we are starting to see that in the UK right now with traditional retails and how retailers are suffering. What you may also find is that as an example, I'm just giving examples here because I don't have a specific answer to this. For example, this may not be an economic example but, with BREXIT there was a lot of uncertainty or there is a lot of uncertainty and one of the first hit asset classes was the office asset class. The international headquarters didn't know how BREXIT talks were going to pan out and they didn't know if the UK was going to be able to be the global headquarter anymore so a lot of them started planning where their global headquarters were going to be. Was it going to be in Amsterdam or was it going to be in France, where was it going to move from there. Ok maybe not France, but Amsterdam was one of the major contenders so what we saw immediately was that the office asset class was hit. So does a country's economic status impact, absolutely! How that plays out, usually you find… and I mean I guess On the flip side as well if it's a booming economy and there is tons of retail sales happening you'd find that counters building retail stock or retail buildings would be doing very well.

R1a - It's a loaded question. This course is construction economics and management right? The macroeconomic framework is absolutely critical to the performance of property sectors because a lot…

property rights are embedded in the underlying fundamentals of the country that I can't move the property rights of this building to another country. I can't, it's established and it is fundamental to this building which is very different to the other asset classes by the way. You can move a lot of rights to assets. They are fully transferable to other countries. You can't do that to property. So property largely resembles the underlying fundamentals of a country in which that right exists. The value of that right is drawn by whatever is underpinning that right and what's underpinning the law of property rights is the economics of the country. Now there's a purely economic perspective where you are thinking in terms of macros… Look say your acquisition yield is say 10% here, you couldn't demand the same yield in the UK for example because the underlying economics is very different. Our inflation rate is different, our interest rates are different, our GDP forecast is different, our unemployment is different, our unproductive capital therefore is different, there are so many factors that push that. Our relative bargaining power is very different, our ability to raise debt as a country is different, our balance of payments is different, we've got current account deficit issues in SA so there's a number of factors which will drive the economic status of a country and that will invariably have a knock-on effect on property. It will have an effect. The question is what is the magnitude of that effect? How significant is it and what factors will lend it to be less significant than others, I don't know. That correlation you are going to struggle to find but the economic status does definitely affect it.

Q13: May you briefly explain the company's diversification techniques used, if any?

R1b - Okay, Company's diversification techniques. We spoke about this earlier and that we are a specialist fund and 98% of our portfolio is industrial so we don't diversify in terms of asset class but we have diversified in terms of geographic location. We have noticed South Africa faces an immense amount of emergent market risk, political uncertainty therefore we have decided to diversify into highly developed markets. Do we diversify in terms of tenants? Not particularly so I guess it's just geographical.

Q14: What factors affect the risk and return of a REIT's investment and how is risk minimised and return maximised?

Researcher - Risk and return. What factors affect the risk and return of a REIT and how is risk minimised and return maximised?

R1a - What might be helpful here is to read our risk management report so there is a risk management report which state the risks that we are exposed to. I'll get you a copy. Both internal and external business risks. Obviously one of our key external risks will be our macroeconomic risk which affects our performance. So the risk register effectively will then show you what those risks are and how we address those risks.

Researcher - Can you highlight a few for the sake of the recording?

R1a - Yes, sure! I think it's worth distinguishing first external, and we spoke a bit about external risk around our country and where we are at in terms of forecasted growth and forecasted inflation, and as I said, interest rate drive the cost of debt. Which means that you are going to have to demand a higher return, a high yield from the property if your underlying cost structures is more expensive so that drives a significant amount of financial risk within the business which we need to make sure were able to mitigate. Then you have got your internal risks. This is effectively investment risk so when we thinking about what assets to buy, there's a risk that we buy the wrong asset. We buy an asset somewhere that in 5 years' time it's going to be in the area that's not worth anything and no one's going to demand that asset and there's going to be very little in that. Effectively we would have burnt a lot of shareholder value by doing that, by buying the wrong asset.

R1b - Development risk I mean we develop assets and incorrect costing. Or somewhere along the line we run into delays and the project is no longer feasible. Credit risk in terms of we have 50 assets and all of them are single tenanted and if anyone of those big tenants was to be declared bankrupt because of the struggling macroeconomic circumstances, what would happen to us as a property counter. Interest rate risk, exchange rate risk.

R1a explains an illustrations on page 36 to 39 of the CS1 Property Fund 2018 Integrated Report.

R1a - You can go through it and see what the impact of the risk is, how we assess and manage it and what has happened in the last year based on our assessments. Have a look at that, it should help you.

Researcher - Alright.

Q15: How would you describe the relationship between the REIT equity market and stock market?

R1b - What do you mean in question 15?

Researcher - Okay, is there any, say, correlation?

R1b - Okay.

R1a - Okay so correlation in between the market in terms of what?

Researcher - Maybe share price? I know it's qualitative but…

R1a - Yeah exactly you are going to be in a difficult situation trying to do a qualitative assessment on a quantitative measure but there is a concept in finance called beta. There is an equity beta and an asset beta. The equity beta is the quoted number here and it shows you the correlation between the volatility of that specific stock and the underlying market. So it says how volatile is this share in relation to the overall market using a statistical model which says if the market was to move by 1% this share is going to move by 0.4% if beta is 0.4%. It is a historical analysis so it is not necessarily relevant for forward information. I think our beta is around 0.5%

Researcher - Which means it is more volatile?

R1a - It is less volatile. So if the market was to move by 1% we would move by less than 1% and you would expect that for certain industries. You would expect that specifically for real estate because we are a lot more resilient in the sense that we would have signed a lease with a tenant to say you are going to pay us rent for the next 8 years. So if the economic conditions of the country deteriorates, it might have a much greater impact on the retail space or something like that than it would have on a REIT where we know that we have signed lease agreements and the rental we going to have is fixed say for any tenant failure happening. There is a lot more predictability in our earnings which means we would typically not be as volatile as other stocks.

Researcher - Alright.

R1b - (hands over documents to **Researcher**) So these are two presentations that we did recently. On this one just ignore the burning tax issues. I did it because the beginning bit just shows you the history of REITs in SA. There was another presentation which we did for Property Studies and this basically shows the change in the retail space so shifting from traditional retail space to online sales and how it has changed.

Researcher - Alright, thank you so much!

R1a - So who else are you interviewing?

Researcher - Am I allowed to disclose…

R1a - You are not allowed but you are not going to tell me what they are saying.

Researcher - I am not quite sure yet. I am still in talks with other people so I haven't really confirmed. I don't want to mention any names at this point but you are the only people that confirmed thus far.

R1a - That's fine but what I am saying is just try and make sure you don't commit the error in your analysis of throwing a blanket over specialised REITs or non-specialised. I would just be cautious in your analysis in doing that and try and establish some standard metric or some standardization across before you even start to the extent that that's possible. You don't want to be in a situation where you provide research… I am for this research and I would like to see how it pans out at the end but you don't want to provide research that's flawed in the sense that the comparison is one of apples and pears and you are trying to marry the two which doesn't actually work. Just make sure it is largely consistent to whatever you are doing so you are able to generate some results which we can use.

R1b - Also in the SA context, there is a lack of research, there is a lack of information available so you may run into problems with availability of information. I don't know if your research will be better if you do an international UK, US versus whatever you can find in SA because there is far more research available from the international counters.

R1a - But we need more research, so we want people to do more research because it provides greater transparency. I mean the reason why we went to the UK is because of transparency so we want more research so there is more transparency and that means that for us as a counter and other property stock there is honesty and openness and investors can then make an informed decision about whatever they decide to do. We want that.

Researcher - Similar studies have been done obviously in the US and the UK and it hasn't really been done in SA so that's why… See the only difference is that they were both quantitative and it's really interesting that I took the qualitative approach.

R1a - So you are going to have a completely difference stance, different perspective on it which I think is that challenge.

R1b - You are going to have to be very clear on what those characteristics are and what those characteristics are to define which is specialised or non-specialised.

Researcher - Definitely.

R1a - I am actually looking forward to how you conclude on the performance metrics because stripping out quantitative aspects which everybody focuses on and looking at the qualitative aspects and trying to come up with a synced list that enables you to make a good judgement call but also at the same time not being so long that it is confusing and misleading, I think that is going to be critical. I don't know how many factors you are going to include there.

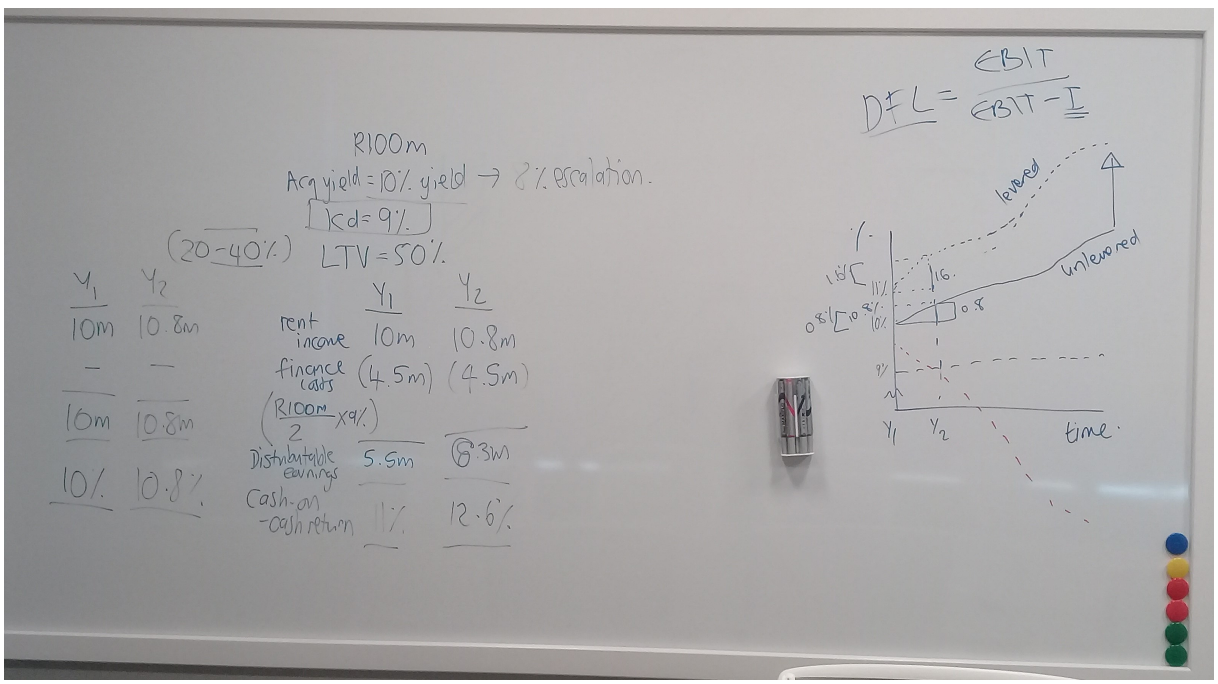

Figure CS1 – Financial Gearing illustration

Case Study 2 (CS2)

CS2 Interview

There are 2 Speakers:

Researcher
R2a – Respondent

Held on the 3rd of July, 2018 at the CS2 Offices in Cape Town.

Researcher: Because it's a data collection process, I'm going to ask to record the interview.

R2a: Sure.

Researcher: If you don't mind. Okay.

Q1: What types of REITs are offered in SA and how do you decide on a specific type?

R2a: I may have to ask you, just to explain your thought process around your questions, REIT is a real estate investment trust, at least you have that. As I have it, you're previously at the property unit trust, and property loan stocks and the new legislation of REIT. REIT is basically a new version of a property loan stock and the property unit trust.

Researcher: Yes.

R2a: And that was mostly because of tax reasons, as I have it. Can you contextualize your questions for me? I just want to answer them the best way possible for you.

Researcher: All right. I'm not quite sure what kind of answer you expect.

R2a: What type of REITs are offered in this? I'd say the REITs on the JSE that you've got CS2. For instance, if I speak about CS2, is a diversified REIT. So within the CS2 listed share, you have exposure to retail, commercial, industrial, and specialized. Specialized being students accommodation and hotel, which makes up a very small part then some equity shelving in other companies like CS2 International and Cromwell to name two, also EPP which is retail share in Poland.

Researcher: All right. Now, I definitely do understand your question. This question was asked what the background – I'm going to keep referring to literature because at this point, that's mostly what I know versus being in the practical world.

R2a: Sure.

Researcher: I went through the South African REITs website and they stated there's only two in South Africa which is company REITs and trust REITs. So I think I was hoping for an answer in that regard.

R2a: Okay. I will be the wrong person to answer that question. I can try and find out for you some more details. So you're saying company REITs and trust REITs.

Researcher: Yes.

R2a: So REIT is a trust, as I understand.

Researcher: Yes.

R2a: So it's a real estate investment trust which resembles property loan stocks. Property loan stocks, as we have it, is different PTY effectively that sits within an entity. So each of these can then be sold off and you don't have a CGT issue, where previously where the property unit trust put everything inside the trust. So if you wanted to sell an asset, you would have a CGT issue.

Q2: Does a REIT structure affect the performance of a REIT?

Researcher: Okay. Now, that's clear. I don't know if I could add this on but I think let's obviously will just move on to the next question after. I think company, the two types: the company type is governed by something totally different, the Companies Act, I think; and the trust type is basically what the PUT and the PLS was changed into when the legislation was enacted. So yeah, that's, I think, as much as I know about that. So I just wanted to get your opinion around it but that's not a problem. We could move on to the next question which is, does a REIT structure affect the performance of the REIT? So structure in this case, I kept referring to the US setup in the legislation and the UK one as well, and I picked up that there is what they call a traditional structure and a paired share. So the traditional structure, they said the REIT owns the property themselves and lease out the property, then the tenant takes care of everything. And then under the paired share, the REIT is in a joint venture with the company. They call it a C-Corp. I just didn't investigate what the C-Corp means but I'm assuming it's just a separate company, which is then operated as one because it's a joint venture. I just wanted to get your opinion around how does CS2 do things in terms of that.

R2a: So the lease dictates that relationship between the tenant and the landlord because we are a diversified fund, we have different leases for different applications. For instance in a retail environment, you'll get elements like turnover clauses, terminal clauses which means where tenants vacates a national tenant, other tenants can cancel leases on the back of that because they rely on the larger tenants' for feet. And there's a covenant between the landlord and the tenant where the tenant relies a lot on landlord's performance and marketing common area responsibilities, et cetera. Similarly, commercial environments, we've got multitenant office blocks. The same is true where you have a common area share, landlord is responsible for common are and tenant's effectively responsible for the interior of the office area, with balconies, other exclusive use areas as well.

Researcher: All right. Yeah.

R2a: Industrial, that's my role. Our first prize is to what you mentioned as owning the property and the tenant takes care of everything. So the lease dictates and first of all, common law governs the relationship between landlords and tenants and your lease and steps in and changes those responsibilities, and that's why you sign these, otherwise you would use common law to dictate it. And there's a huge difference between having a tacit agreement with a tenant effectively relies on common law to their benefit and the alternative being full triple net fully repairing and maintaining lease where the tenant is responsible for everything, pays rental upfront, maintains the asset as if it was their own. And that's the best lease you can get when you are the landlord of an industrial property. It doesn't matter whether it's logistics and warehousing or manufacturing. So the tenant is responsible for everything, full triple net lease is the best.

Q3: What are the key performance drivers of REITs?

Researcher: All right. I think that's covered. The next question is, what other key performance drivers of REITs, just in general?

R2a: Well, I would imagine I will answer this, key performance drivers would be your efficiencies. So you deal with the efficiencies, keeping your utilities, loss, and cost as low as possible. And you'll see a lot of that happening with greening of buildings, grey water recycling, solar panels on the roof to generate electricity. There is a certain margin of upside to the landlord or the company installing those items and that influences the efficiency of the building. If you are rent something in like old Parow Industrial or Epping those old high bay mercury vapor lights that take some time to warm before they shine bright, very inefficient, draws a lot of power. Now, you can get high bay LED fittings, almost looks like a fluorescent light, length of tube. It's effectively LED diodes that sits within a lens and the lens gives you a similar arc to a fluorescent fitting and your light is on immediately. You can much easier switch on and off lighting. There's going to be little influence on your power demand.

Researcher: Interesting.

R2a: So as a tenant, when you rent – and we've spoken to tenants especially the last few years, the question is, what would it cost me to rent space from you? Conversation starts with, that's the rate per square meter. This is market rent et cetera, and very quickly, the conversation moves fast, what does it actually cost me? I want to know, is there a CID levy? Is there a Park levy? What's the rates? What's the demand on the building, power demand charge? Because again, it could be a matter of logistics type, warehousing tenant that moves into a historical manufacturing space. Previously, the guys may have used one MVA of power and these guys only need 200 KVA. There's this huge availability charge because of the connection to the property. That influences the key performance of the asset from the tenant side which makes the cost of occupancy higher. Similarly, when you look at your maintenance of roofs, it's all in the design side of things. So if you look at height, the higher you go, the more design elements come in from a fire safety point of view that pushes your cost up but in the same way, a very low-eved roof with a lot of columns inside the warehouse makes it very difficult to move around. That's why the designs have changed there. Roof design, we've got clip block systems which effectively give you a water type building. We previously you know it's a positive penetration fastening it onto the roof. You spend a lot of money on maintenance as a landlord keeping your roof water tight. You get leaks on those roof screws. And then it's about irrigation and landscaping as well, where you previously had lush gardens and beautiful landscaped areas around your office parks. There's been a move to more hardscape, more succulents, and less water usage on to those areas.

Q4: how would you define specialised REIT compared to a diversified REIT?

Researcher: All right. I like the fact that you're talking more about the industrial side which is part of the focus for my research. On to the next question. How would you define a specialized REIT compared to a diversified? It shouldn't be textbook. I mean, just according to you. And the next question would be, so that you don't mix them up, on the how does a REIT qualify to be specialized? So I want to understand if there's a certain split threshold officially in the industry that if CS2 has 60% industrial, then it's considered as specialized REIT in that regard. But then back to question 4, how would you define it?

R2a: You've got your hospitality REITs. You have industrial REITs such as – if I looked a company like CS2, for instance, I would, in my mind, buy it by equity share. That, to me, is a specialized REIT in that their primary focus is industrial. Previously, there was a company on the JSE called Capital Property Fund. They also pride themselves as being a specialized industrial REIT. They have since become part of Fortress Income Fund which is a diversified REIT that focuses on industrial and retail.

Researcher: Okay.

R2a: So I suppose you would want to look at the company's annual report to determine whether it's specialized, if it has a specialized focus. And from what I understand is, specialized REITs are regarded to have a better value offering than diversified REITs. But that has been the sentiment in America from what I understand. So in the US, there's a REIT, from what I understand, that specializes in data centers. So you could invest in data centers by buying that share. My view is that you want to spread your risk, as an investor you always want a diversified risk and why buy three shares when you can buy one that gives you the same risk exposure?

Researcher: Okay. All right. So basically, are you saying that it's all up to the company how they view themselves?

R2a: Well, first of all, I suppose the company's strategies will determine that it either wants to focus on diversifying the holdings or identifies the returns in each sector by giving the best yield and distribution. I mean if you look at ours, you can look at the CAP rates of our different sectors and you'll see that retail's CAP is at 8.49% exit CAP on assets. Industrials CAP is at 9.75%. So you'd look at that and say, well, industrial is high yielding than retail.

Researcher: Yeah.

R2a: Okay. So, it is really about the impression the shareholder gets in looking at the annual report to see whether it is aligned with the strategy. I'm pointing from the investor point of view.

Researcher: Yes.

R2a: I mean it's plain as daylight, CS2 is a diversified REIT. You can look at other group companies in SA that holds a couple of listed shares on the JSE. And as a group, they diversify but they've got specialized listing effectively within that group.

Q5: How does a REIT qualify to be specialised in SA?

Researcher: Okay. Yes, yes, yes. All right. And on to the next question, personally, would you say there's a certain threshold, the split threshold, let's say 60% or say the company's portfolio that qualifies that company to be specialized?

R2a: I would imagine that that's a rule or guidance, so I would suggest that you speak to entities such as the FSB. They got a new name now or did they change it? But FSB would give you the guidance on what is regarded as a specialized and non-specialized.

Researcher: All right. Okay. I did a bit of research on that. It doesn't seem like there is any, honestly. I'm going to choose one for myself in my thesis and just run with it, obviously supporting why I say that.

R2a: What you could possibly do is speak to a guy like (anonymous) at Resilient, because Resilient is a specialized retail fund.

Researcher: All right. So (anonymous), right?

R2a: (anonymous).

Researcher: Oh, yes. Okay. (anonymous)?

R2a: Yes.

Q6: Do property type specialist REITs outperform diversified REITs in SA?

Researcher: Got it. Next question, would you think property type specialized REITs outperform diversified? I think it's covered already. We already talked about it, right? All right. And the next question would be --

R2a: If I were you, I would actually draw up a spreadsheet, I haven't checked. To be honest with you, I can't tell you today whether specialized REIT performs diversified REIT on our board.

Researcher: Yes. That's exactly what my thesis is about, it's about the performance comparison in South Africa. The studies have been done in the US, in the UK, and a whole lot of conditions really – I remember off the top of my head, one paper said that it really depends on the economic state as well of that country. So if the economy in a recession, obviously you're going to yield a different result compared to when it's in a recovery mode or at its peak.

R2a: Quite right. I mean you would have dealt the property clock by now.

Researcher: Yes, yes, yes. Definitely. That's the first course we did.

R2a: And then you'll see – I mean, if you look at the property clock, you will, from there, say, where does retail sit now?

Researcher: Yes, yes, yes.

R2a: So super regional centers sits somewhere in the clock, convenience center sits somewhere on the clock, warehouse and logistics sits somewhere manufacturing, sits somewhere, heavy industrials. And you can spill it all around the clock.

Researcher: Yeah. He actually did that. He gave us a snapshot. That was early 2016, because that's when we started the program. I'm sure it has change, not much but it's definitely changed right now. I need to go back to it and --

R2a: He gave me economics in 2006.

Researcher: Nice. Which program was it? While he was in Wits right?

R2a: Yeah, before he moved out. Before he took up sailing.

Researcher: Sailing, he did?

R2a: Yeah, ask him about it.

Q7: Why do some REITs choose to specialise in a property type or geographic location?

Researcher: Wow. Okay. I'll definitely do that. Okay. I lost track. Question 7, why do some REITs choose to specialize in a property type or geographic location? They're quite general questions but --

R2a: Well, I suppose again, it is about – like for us, specifically within industrial, our focus is primarily investing in prime warehousing logistics nodes. So if you look at the MSCI index and the way it evaluates different categories within industrial, you can see which perform better. High tech industrial is what we call warehousing logistics. I don't know why we don't also call it high tech industrial. It makes our lives probably easier when we talk almost lay language. It's easier to bring it across than to tell somebody that doesn't know property, high tech industrial. What is high tech industrial? It's effectively a warehousing, logistics warehousing. So effectively, our focus is to own large box single tenanted warehousing logistics assets in prime nodes in South Africa. So we want to own, as we do, Bracken gate two business Park just off the R300, busy with a development there. We've got about 490,000 m^2 of land at a bulk factor of 0.6, looking at putting up predominantly warehousing logistics there. We have started some developments and staying to a better mixed use on the one side of the precinct but our focus is high quality warehousing logistics in that precinct and that's turning into quite a warehousing logistics now. It's next to Stickland opposite side of the road. So where our precinct is a relatively new still. We've only finished about 22,000

m^2, 3 boxes. We are busy with a Planet Fitness there. So you've got the retail that we don't own there across the road, and then we're also putting up a hardware DIY. So it's going to draw feet on the one side. It's also going to benefit any tenants within the precinct, I would imagine, that wants to go to gym. You can go to the gym early morning and you go to work, sort of mixed use offering. Right next door, you got the Shoprite Distribution Center, National Distribution Center 100,000m^2. And I bought some land from much opposite of the road. We are going to, I think, build storage on that side. Then we own land at past Montague Gardens on the N7. Part of that development, again, we are creating a quality industrial node where new warehousing can settle. B2, about 444,000 m^2, 0.5 bulk factor. It's going to get about 200,000 m^2 of high tech warehousing and related type of developments. Then other prime, we own some warehousing out in Epping, not prime but still warehousing. And then we'll look at KZN. In KZN, we're busy with industrial units development. They spoke to print media and we are looking at developing quite a large precinct just south of Germiston in Gauteng, also new node, new development, bringing that high quality into the market. And by doing that, we control the price on the land side as well. Okay.

Researcher: All right. And then just highlight why you choose a specific location instead of a property type.

R2a: Location is important because of road infrastructure, access to major highways, and that's where your heat map analysis comes into play for the users. So a logistics like a Shoprite. They decided all the storage why they want to take it to Bracken gate. They didn't want to be too far away from home, they stay in Stellenbosch apparently, and that was the reason.

Researcher: All right.

R2a: And the argument was, why don't you go to Montague Gardens? Because that is the logistics node. As you can see from experience, probably driving around the area, it is completely congested. So what was done in Cape Town, I don't know who did the congestion study but they've displayed congestion zones and we have these in our first brochure for Bracken gate, showing the congestion zones in Cape Town. It's about where you – the locations is important for a couple of reasons. First of all, to get in and out and on to the highways as quickly as possible, new infrastructure so you're not sitting with old dated substations, storm water, you're creating new. A part of that, I mean you can see how your old lot Parow is flooding. It can't cope with the infrastructure that's there and there's new that's being brought into those nodes. New nodes has got new building requirements, part of it is being attenuation. So you need to attenuate on stand, which means you have your own detention parts. And then you release the storm water into the system on a delayed basis. That helps the whole network of storm water around your precinct. So from a design point of view, new is better when you look at industrial property.

Researcher: Yeah, definitely.

R2a: And unfortunately, that's counted by nodal creep. So there's two factors, one is that you move out of old precincts and nodes and therefore the old nodes on that were maintained and then you've got this nodal creep of news being set up. If you go to Joburg, I don't know how well you know Joburg you've got nodes that formed around O.R. Tambo Airport, one in particular is called Plumbago. Plumbago used to be maize land, maize fields. It was bought from the farmer and then converted into industrial land and construction of the best warehousing in Gauteng. What makes it great is it's really close to the airport. It's on the R21 which is a major arterial route that links up with the N1 and the N12 and the N17. So that's where it comes in, it is all about long haul. South Africa has become a distribution hub not just for SA but also for the Southern African development community, the SADC countries.

Researcher: Yes.

R2a: So that's part of it. The other side of it is why don't we invest in warehousing everywhere? So if you bought a warehouse of say 10 or 20,000 m^2 out in Kimberly or in Sutherland. You said this thing is beautiful, look at it. 60 rand a meter, net, tenants paying for everything but its 8.5 Cap I would say absolutely not. The reason is I need to pay somebody salary to go and have look and make sure it is being maintained. So your load or demand on management becomes an issue as well then also your asset selection, why invest in single-tenanted buildings instead of multi-tenanted parks where if you look at your MSCI reports, it shows there's two asset classes that performed very well. High tech industrial and mini units, mini units yield well. Mini units are highly management-intensive so you need to careful when you buy those assets, that you're buying them for the right reasons. There is a tipping point in size of unit. I mean you don't want to buy a park with $60m^2$ units. You going to have somebody posted there full time to make sure the tenants do what they are supposed to, common areas are kept clean, etcetera and that labels your management within your business.

Q8: How is the Industrial Property sector performing relative to other sectors in SA and the world?

Researcher: Yes. All right. And then how would you say the industrial property sector is performing relative to other sectors in South Africa and the world? I know the world is just very huge but let's just start with --

R2a: The world, I can't comment. The best I can do is we took a tour of Poland about 2 months ago, I'll get on to subject for SA now. Interestingly enough there, where we in South Africa look at really getting into the value offering when we design to design buildings that's got very high eves, and the thought process behind that is your material handling equipment specifically your reach tracks can reach up to 13-14 meters height of forks so you can still put a pallet at that level. So you could look at the design height of around 15m clear out to eves. So we thought that's fantastic. Let's build that because the guys will use it.

Researcher: All right. Sorry. Just to jump in there, what's the standard before you --

R2a: 8 m.

Researcher: 8 m, okay. All right.

R2a: So when we went over to Poland, we expected to see a lot of it, high eve, big voluminous warehouse structures, and we didn't see that. We saw 12 m high to gutter, clear out 10 m. We asked why. He said, well, that's all that they need. Because you go above that height, you need to bring in inline sprinklers, your fire requirements got up dramatically. So it's all about the fire. Not all about the fire but that plays a large role in your warehouse design. So the fire sprinkler system is only overhead, you don't need inline sprinklers except in high hazard areas and you can move around racks as you wish. Because some guys Densify and have these VNI systems, where you've got 1 m between racking. Your picking units, forklift runs up and down only. There's no turning and its side loads with the forks. Some of the guys are 3 m and 2.5 m between records. And then they've got these old powered forklifts with rubber wheels. It's very informal but you look at a place like Poland but why, so brand new warehousing. Also, another reason, I would imagine, is they can only build for 6 months of the year. It snows and freezes in the winter. So they've put up a warehouse there within 4 months. So plan submission, everything and they build for 4 months, finish off in 2 months after that. So in 6 months, they've finished the warehouse. They've supplied the warehouse into the market.

Researcher: Yeah. It's pretty fast, right, relatively?

R2a: And there's one particular company that's a million square meters a year of new warehouse space into the market in Poland – it's vast.

Researcher: Why Poland? Why did you guys go to Poland?

R2a: We went to look at some assets there.

Researcher: Okay. I mean why specifically Poland?

R2a: Because Poland, from what I understand, has the benefit of very well-educated workforce, so people are extremely well-educated. There's a multitude of universities there. Also in particular, I think they're planning to build another large tertiary education facility and the guys are very driven to issue qualifications. It's not uncommon for someone to have a tertiary degree that you do business with.

Researcher: Interesting.

R2a: They get a lot of the blue collar workforce from Ukraine.

Researcher: Okay. That's probably a neighbor?

R2a: Yeah, that's south of Poland. And in addition to that, the labor laws apparently are not as strict as Germany. So what happens is they would get semi-completed units into Poland, finish their assembling and ship out. Especially on the automotive side, it's quite impressive. I mean we were in this one factory that the only thing this factory did was the trim on the windscreen. So somewhere else, in another facility, they would cast mold, manufacture windscreens. The head of the factory told us they manufacture, I think, 70% of windscreens in Europe, his business. And this factory where we walked around, basically bring these glass shield in and puts the trim on them. So the black trim around the sides basically gives you your sun blocker, where you fit it onto your car frame, they do the trim and they do the little knob where you stick you rearview mirror. That's the only thing that this factory does. Fantastic. So they great on the manufacturing side of things but that's Europe. So we went there with the expectation to find big volume warehouses, we didn't find it. We found 10 m clear height, large boxes up to 40,000 m^2 that we saw but not high. So in SA we thought we clever and said, listen, we will put up high volume buildings because the guys can use it. And here too, it's such a large capital investment for your logistics operators, the wrecking and the material handling equipment. And on the back of the risk on their contract, especially when you talk to your third-party service providers, your 3PLs, 4PLs; they're unable to secure these long term contracts that will allow them to depreciate that investment over a single contract. So being risk averse as well, they don't have HResearcher contract, for instance, for 5 years. So they file them annually or biannually and two yearly, rather. On that basis, they need to find a system that works for them from the investment point of view. That's why rack hiring businesses have sprung up in SA. They would install the racks and then rent it to the 3PLs. You basically rent your whole business. What's interesting too is there was quite a jump so long ladder businesses stayed in next to Edenvale up in Joburg. It's on the N3, close to Alex and between Sandton and O R Tambo but it's on N3. That's what makes it quite important. It's also past Gillooly's interchange which is heavily congested now. Gillooly's interchange basically handles traffic from N3 that comes up from Durban and ring road traffic that comes on the N2 around Joburg and then diverse that the interchange up to N12. Okay. Often, if you listen to 702 you'll hear about the traffic congestion at Gillooly's. So Longmeadow is between Gillooly's and the interchange that is the N3, N12, M1 which makes the very favorable logistics node. And there, the guys were building at 8m eves, and we're talking about 5-6-7-8 years ago. It happened quite quickly and when Longmeadow business estate was about 80% developed, the transition happened where reach tracks could reach up to 13 m and the design changed from 8 m to 13 m, and from 13 m to 15 m. There are even warehouses that can go up to 17-18 m accommodating high-reach tire tracks and reach tracks.

Q9: What are the Industrial property sector performance drivers in SA?

Researcher: All right. I'm assuming, yeah, we've touched on the SA part. The next question which I think we've covered already is what other industrial property sector performance – I think we've covered it with one of the first few questions.

R2a: So performance drivers is different logistics. So you would have to keep an eye on what's happening with Transnet. There's been an upgrade in Cape Town Harbor of the Cape Town container terminal. So there's been upgrades, I read in the paper, 4.8 billion rand upgrade where they increase the number of cranes on the container side and these cranes could also better load on to the container vessels, increasing capacity by something like 40%. That's only in Cape Town. So in Durban, the Maydon Wharf seabed is being excavated, deepened, as well as Pier 1. So there's 2 main material handling piers. Pier 1 is being extended and deepened as well. So there's quite a bit of work they're putting around Durban. There's work happening at Richards Bay. There's work happening in kuger and that's part of the Transnet CAPEX of about 350 billion that they are spending over 10 years. I don't know where the guide used to see how much of the money they spend, where they're spending it. But that will definitely have a major influence in warehousing logistics, industrial sector in SA. As this infrastructure is developed further, you'll have the increased capacity. It doesn't just work for SA but also for the rest of SADC.

Q10: To what extent does the e-commerce industry affect the industrial property sector in SA?

Researcher: Okay. And then to what extent does the e-commerce industry affect the industrial sector, in essence?

R2a: So e-commerce is very much about the software side of it. So your online e-commerce platforms need to talk to your warehouse management systems so that you'd pick effectively. And the more automated your warehousing becomes, the easier it's going to be to pick and dispatch out quicker, accurately to your clients. From what I understand, speaking to my colleagues on the retail side, e-commerce hasn't really had a huge impact on the retail in SA. The centers are still where you go to shop. There's element of click and collect where you would buy online and you would go to the store to go fetch it. So you've done the shopping upfront, there's also a play around shopping. I don't know if you've done it. I've heard of people doing it, that go to the shop, check out the merchandise, then go online and buy, getting a sense of --

Researcher: Of the feel, yeah. Does it fit?

R2a: Does a medium or large fit?

Researcher: Yeah.

R2a: Do I like the fabric? And then you buy the 2 t-shirt, the pair of sneakers, and whatever else and then it gets dropped off. So there's definitely a dynamic around e-commerce. I'd to like to see more in SA. I was in a warehouse last week in Durban where they've designed a multilevel. So if you can picture this, you've got this massive 14 m clear high to eves, 100,000 m^2 warehouse. Within the warehouse, spreading to 2, you've got 2 businesses running here and the one business incorporates a 4 storey high picking platform, where you've got 5 picking and packaging within your warehouse as a live shop effectively, where you would pick in your merchandise, especially your smaller items, high value items, out of this capsule within the larger box. So it's definitely happening and it's definitely got to do with how do you manage and control and monitor your supply check? Effectively, what you're going to do is when somebody clicks and says, okay, I want a blue t-shirt and black pair of jump shorts and those new balance takkies and the guy will get the waybill in the warehouse and depending on which warehouse you get it from, it could even be automated, where it's barcoded and it is picked automatically into a box that gets a waybill on it and is shipped out to the truck. It can happen. I've seen this. Gone to a company called Fortna.

Researcher: Fortna.

R2a: F-O-R-T-N-A.

Researcher: Okay.

R2a: Google them. They designed these systems and they've done quite a few in SA already.

Researcher: Okay. All right. I have two questions. The first question is, sure because I'm from Botswana, I'm going to use a Botswana example, I think surely as a Southern African region, South Africa primarily, we're getting there because I think over the years, I grew up in business-oriented family so I took note of some things. Wholesalers are dead, I think, in our country. You find that people that were wholesalers initially are sort of like competitors but superstores or retailers, that's what we call them casually. I'd like to think this is a step in --

R2a: Are you talking about perishable items? Are you talking about – what?

Researcher: Yeah, in the sense of the groceries and perishables, yeah, basically. We find that wholesalers and superstores or hyperstores, depending how you call the, are effectively on the same level now. I was just curious because I haven't really taken notes in SA, is it like that here at all?

R2a: It depends on the customer, in my mind.

Researcher: Okay.

R2a: The reason I say that is we've got a big remittance receiver base with people that work on the mine and sending money home and receiving grants from government. There is a Spar in Thohoyandou, they effectively, with pallet handlers, they bring pallet-sized bags of fish produce into the store and it is bought up on a stock flow basis effectively. So you still get where people have to pull cash together to get the benefit of a bulk buy. It does happen. The more sophisticated shopper wants to buy the single item, the small packet this, the small packet that, and then you get things like the Shoprite super save where you can buy a small sachet of whatever, sugar, peanut butter, whatever the case may be, and then buy 2 onions and tomato like you would do next in the road at a taxi rank. So I would, in my mind, as you get more of a formalized workforce, the social spend changes.

Researcher: Yeah, definitely.

R2a: That's been my sense. Being from Botswana, what's happening with the Chinese investment of the highway into Walvis Bay?

Researcher: I haven't really read on that one.

R2a: Because that will have a major impact on the logistics side of things, especially into the Walvis Bay becoming a logistics hub for that Western Africa region, also supply into Angola, I would imagine.

Researcher: Yeah, definitely. I'll read on to that. My second question was, I was speaking to somebody yesterday and they were telling me that – I was just sharing my views and my research with them and they're telling that they actually lived in the UK for two years or so and they've never stepped into a shopping center because a shopping center was like more of a recreational activity. He got everything – that's groceries, by the way – online. So I'm here wondering, what will it take for SA to get to that point? Because, I mean, the online stores there, the retailers --

R2a: Stop allowing the zoning for shopping centers.

Researcher: Okay.

R2a: So I had a chat with a guy, a French retailer, not too long ago. We had a chat around e-commerce. He said to me, asking me, so does he see e-commerce – basically your question – impacting in SA compared to Europe? He said, you know what, in France, they don't allow the building of new shopping centers around major cities like Paris. You won't get new shopping centers but you have to make do with what you've got. And then, e-commerce have exploded to such a degree that if you get to the office in the morning and you buy something, it will be with you in the afternoon. That's how efficient the supply chain is. That's what makes e-commerce great, because of that last mile, same day - .

Researcher: Same day delivery.

R2a: If you went to have dinner tonight with a couple of mates and you need some utensils, not even the fresh produce – you might have a favorite grocery where you go buy your stuff.

Researcher: Yes.

R2a: But you need a casserole dish. You want to go online in the morning, I want that casserole dish in that colour that size, and afternoon you get home it should be there. That's the efficiency that you're looking for to make e-commerce really great.

Researcher: All right. My next question was going to be but how is it that there's still actually shopping centers in the UK, but I understand when you say stop them. I mean, when you stop them, what happens to those shopping centers that were there initially?

R2a: When you restrict the expansion.

Researcher: Yeah.

R2a: I mean, look at where retailers gone in SA. You've got these major super regional centers that's actually just bulked up. I mean, it's placed such a demand on resources, the storm water sewer utilities that has to be supplied in as you bulk up for a 20,000 m^2 to a 40 or 80,000 m^2. I mean, look at Century City. Look at what happened with – what's the one out in Durbanville?

Researcher: I've never been in that side.

R2a: Anyway, so there are two. So as these centers grow almost organically, they place a major demand on road infrastructure and other resources. They also bring a lot of benefit but there is a play between demand and the environment and the benefit it provides. So if you're going to continue to allow, as a country, the addition of more and more shopping centers because they are fantastic rates streams. You put up a billion rand shopping center, imagine the assessment rates that comes out of the development back into the council. So there's definitely a revenue play in my mind as you can see it. If you want e-commerce to work, you need to restrict the roll out. I think we're already saturated. We are past saturation. I mean, how many (anonymous) do you see? We see a (anonymous)every 2-3km's when going to dense areas.

Researcher: Yes, from the small ones, the express ones, to the big ones.

R2a: Yeah. I mean you can go and buy yourself dessert 12 o'clock at night from a (anonymous)food store.

Q11: How does the REITs gearing level affect its performance?

Researcher: Precisely. All right. The next question, how does a REITs gearing level affect its performance?

R2a: Well, a REITs gearing is limited to 40% if I'm not mistaken.

Researcher: The limitation, does it come from within the company or?

R2a: No. It's set.

Researcher: Okay.

R2a: Obviously it's controlled also by the board. The board can say this and we don't want the LTV high. And you know, you would have heard the lectures on finance that deals with where's the tipping point. During process, they will cost you too much money.

Researcher: Definitely.

R2a: You don't make the margin anymore. The margin only works on the LTV after about 30-35%. Anything above the cost of debt starts playing up against your returns.

Researcher: Yes. All right.

R2a: Okay. But again when you're already investing, you need to look at what works for you.

Q12: How does the economic status of a country affect the sectoral performance of property?

Researcher: Definitely. Right. I think I mentioned this one earlier. How does the economic status of a country affect the sectoral performance of property? Number 12.

R2a: Look, it takes you back to the property clock. When you've got a high level of vacancy because businesses are unable to sustain themselves in an economic environment like your manufacturing guys moving out of SA, you're losing jobs, you're losing markets in SA because it's easier and cheaper to import, then you can see the market change there. So then there's a reduction in demand and electricity and other resources and increase in vacancy as manufacturer businesses find it harder to operate within the economic environment. That's what happens first, so your manufacturers supply into markets. Let's call it a textile industry will supply into the retail markets, pharmaceutical industry into the health market, and a lot of that is exported too. So it depends on where does that manufacturers market sit? So if that market moves, you could lose your business and that does a couple of things for property. It increases vacancy or changes demand and it influences the obsolence index. So the is certain properties, especially all the older industrial areas that are functionally obsolete. You know this, you can go and say, I can't use this for anything. It's too expensive to fit this and change it to fit any current demand, so let's knock it down. That thing causes a drop in value which affects the rates bill which creates an opportunity to redevelop the site because the devaluation of the asset creates that new market environment. That's why you can also look at your old – like meat packing district in New York, where there's a whole a revival around retail there because there's a change of use due to the type of use that had come to an end. So it became obsolete for the application it was designed for in the first place but there's a new use. So similarly in South Africa, all the industrial areas suffer because the way the building was designed doesn't fit current demand. And if you look at which sector to focus on when you look at your investment strategy, it is about what works. What's driving it? Is mining and the steel industry driving it? Is automotive driving it? Is pharmaceutical driving it? Is retailers demand driving it? That will determine the kind of leases you effectively get, the kind of tenants you get into your building and now you need to design.

Researcher: Okay. All right.

R2a: Just to give you an example on design – we're probably running out of time.

Researcher: Yeah.

R2a: For instance, if you look at your old industrial, you've got no yards. You've got drive ways and then you got these big buildings sitting on a stand. So you have coverage of 80% on stand, then you move to normal warehousing and you move to a coverage ratio of about 50-60%, maximum 60%, and then you need to look at the yard but now you need circulation space. Sometimes, you can accommodate a truck reversing and moving out. Then one step further is express logistics which takes your coverage from 60% down to 40%. So now your efficiency in your bulk meter per square and cost of design changes dramatically when you have a crushed up facility that takes trucks on the one side or truck from both sides and bakkies from the other side, light delivery vehicles. Usually these very long buildings which creates inefficiency on smaller stands, they become less popular. All of that changes your demand and that's where your the demand changes all the time.

Q13: May you briefly explain the company's diversification techniques used, if any?

Researcher: All right. That's clear. All right. The next question, if any may briefly explain the company's diversification techniques. Obviously --

R2a: So if you read our last year results, we talk in there about where do we deploy capital. So we will look at talent of assets, those assets that are secondary to the fund, non-core, we don't see a long life for them. Those will sell out. When we sell them out, returns we get from the sales are then brought in and evaluating and what is our investment strategy per sector. So we are doing quite a bit of A-grade office development up in Gauteng, particularly in Sandton and Rosebank. So one could say listen it make sense to build another A-grade office building. Some people might disagree with you but as part of our strategy, there's still opportunities for us in that in the level of tenants that we can attract into those assets. Similarly, student housing and other asset classes are also considered. As a diversified fund, we don't only look at this, we look – I would say not globally is a bit wide but – into Europe and into Australia and to see where is our money best spent. We are selling in Australia where we sold out of the office holding we had.

We are still invested and looking at the student housing model for Australia because that actually works for us. So it's very much about where you are going to get the best returns in investing your capital.

Q14: What factors affect the risk and return of a REIT's investment and how is risk minimised and return maximised?

Researcher: Okay. What factors affect the risk and return of a REIT and how is risk minimized and return maximized? Number 14.

R2a: Okay. So I would say liquidity. Tenant covenants, liquidity, funding available to you. Those are your main factors, and then legislation.

Q15: How would you describe the relationship between the REIT equity market and stock market?

Researcher: For sure, definitely. And the last question would be how would you describe the relationship between the REIT equity market and the stock market? Is there any correlation? I know this is a qualitative research but we're going back to the numbers. Is there any correlation and then maybe share price performance between the two?

R2a: So when you look at typical REIT presentation by guys that you should be talking about what is a REIT engine room like. I would expect you to hear the same story I've been hearing in that a REIT tracks the bond market. So you look at your bonds and the bond performance which is your best security from a risk perspective. REITs track the bond market relatively well or has in the past. I think at the moment, it's a bit debatable because our bonds haven't done it well since we've been re-rated by the rating agencies.

Researcher: The status, yes.

R2a: So that's how the impact on the bonds. But that's it. It doesn't sit very nice next to other equities, especially your retail shares and your REITs far apart if you look at security. The one thing about a REIT is it's underpinned by NAV. So you can look at the net asset value, you know there's bricks and mortar behind it. You can't do that with any other share really as you can with a REIT.

Researcher: All right. So which basically make it a whole lot less volatile than the stock market?

R2a: It is supposed to be less volatile. And if you look at the stability of CS2 share price, it's been relatively stable over the past few years.

Researcher: Okay. All right. I think that's it. Thank you.

R2a: I hope you got what you came for.

Researcher: I did, definitely.

Case Study 3 (CS3)

CS3 Interview

There are 2 speakers:

Researcher
R3a - Respondent

Held on the 11th of July, 2018 at the CS3 offices in Cape Town.

Researcher: Alright, so let's get right into it. The question would be…

R3a: Okay, first of all, so you are doing this paper, okay, and it is on different types of REITs by the look of things.

Researcher: Yes, so basically what I'm doing is I'm comparing specialized REITs, specialized industrial REITs to diversified REITS, performance-wise, which one outperforms the other.

R3a: Okay, so just as a kind of overall, I guess, introduction as far as my comments are concerned, I can really only speak from my perspective sitting here at CS3, which as you know is a diversified REIT. It's not like I – I don't spend a lot of time running around, looking at what other REITs are performing or what kind of returns they're giving. You might think in my spare time I might be interested in doing that, but really, my job in Cape Town is running CS3, so I'm not really worried too much about what other types of REITs are doing or whatever else. There are other people within Growth Point who kind of worry about things like that.
Let's just... Okay, I'll answer it, okay? *[side conversation on phone]*

Quick, just two seconds, sorry.

Researcher: No problem.

R3a: Okay, so I was busy saying before you recorded all that conversation, so obviously, my perspective is not to go around looking at how different types of REITs perform. Obviously, I have got a personal opinion to a certain extent, but within CS3, there's, I guess, an analyst resource who looks at that in terms of how we are performing against different types of properties and different types of REITs. So, just to lay it out on the table before I mislead you, perhaps.

Researcher: It shouldn't be a problem. I think what I was doing is I was just collecting data from senior management in the few REITs that I chose. So, yeah, it shouldn't be a problem, I think.

R3a: Okay.

Researcher: Yeah, can we go on?

R3a: Yeah, sure, go ahead, right.

Q1: What types of REITs are offered in SA and how do you decide on a specific type?

Researcher: Perfect. So basically, just bear in mind that these questions are from a literature point of view. I don't have that much experience in the practical world. So, yeah, they're just solely for that data collection. So, the first question is what type, what types of REITs are offered in South Africa and how do you decide on this specific type?

R3a: Alright, so –

Researcher: So, according to the SA REITs website, there is two types of REITs which is a company REIT and a trust REIT. I'm not sure if you're aware of that.

R3a: Well, I'm actually not, but – yeah.

Researcher: Okay, so maybe –

R3a: I would have thought you mean more diversified REIT or a focused REIT, or where – So, a diversified REIT would be like CS3, so we invest in different types of property or a focus on a specific REIT, may invest in industrial, they may invest in residential only, or may invest in a small segment of the industrial market, or residential, so to the extent, there are different types of REITs. I would say there's quite a lot of different types, depending on the type of property, but I don't know about the difference between the trust and the…

Researcher: The Company REIT. Okay, there's no problem with that. Actually –

R3a: I would imagine CS3's a company REIT, is it? Yeah, because it's a listed limited company, so I'd imagine that's a company REIT.

Researcher: Alright. Just as a background because of what I got from that from the website was, I think it's a trust REIT but basically governed by two different acts. I'm not really informed on that.

R3a: Alright, so we will have to kind of be the blind leading the blind then.

Q2: Does a REIT structure affect the performance of a REIT?

Researcher: Yeah, and to address – the response to the answer you just gave right now, the questions are, I think, will follow regarding diversified and specialized. Okay, the second question is, does a REIT structure affect the performance of a REIT? So, by structure, I mean, still from a literature point of view, this is, I think, in the US and they say it is what you call a traditional structure where the REIT owns the property and leases it out. So basically, the tenant takes care of everything. I think that's a triple net lease or something like that, and there's a paired share REIT which the REIT joins forces so it's a joint venture with another separate company and it's operated as one. I'm not really...

R3a: Okay, well, I don't know if this is the answer to the question. I'm not aware of the different structures. I could say that as a REIT, it definitely can make a difference to your performance if you are a REIT as opposed to a company-owned property listed – a property company that's listed as not a REIT, if you know what I'm saying because specifically, there's different tax legislation that affects both of them, and the principal one being that in a REIT as CS3 is, you're kind of exempt from tax. So, the taxation, the condition, I think, of CS3's REIT status is that they distribute 98% of the income. So, what that means is that the rental income flows through the REIT, you deduct the expenses, and then you pay the rest out in distributions. So, those distributions are fully taxable in the hands of the people who receive them yet as rental income, okay, where in a company-owned structure, the company itself will pay tax on the net income of the property, and after that, it distributes dividends or what have you to the property owners, which if it's a dividend, it's tax free. So, that's my understanding of the difference.

Q3: What are the key performance drivers of REITs?

Researcher: Okay, alright, and what would you think are the key performance drivers of REITs in general? I think let's just keep it to South Africa, but I think it's...

R3a: Well, I mean, it's obviously performance. So, performance you're talking about returns really, at the end of the day, aren't you? So, in relation to your share price, what sort of return are you going to be paying your investor? So, that's a key performance driver. What's your return on what you're paying for the share? What's the capital growth potential for capital growth? What else? What's the size of the fund, I guess? I guess, the size, the bigger it is, the potential is that if you have a hiccup in a building, it's not good to make as much of a dent in it as if it's a smaller fund and one of your buildings goes vacant and you get no income from it, then they'll have a huge effect on your performance, something like that, which where are you invested? Are you invested in retail, industrial, office, residential? What's happening in the marketplace? The situation at the moment, for example, where retail is really down, so ideally, you're not going around shopping for a retail REIT because your returns aren't going to be as good at the moment because the economy's depressed. So, I guess performance drivers of REITs have got a lot to do with what's happening in the economy, what's happening outside of the actual buildings themselves. What Mr. Ramaphosa is saying out there, what Donald Trump's doing, even, because the performance of a REIT often follows an inverse relationship what long bond yields are doing. So, long bond yields are going up, okay? That means that the returns - let me get this right now. **So,** long bond yields are going up, so that means that interest is more - they're paying more interest, okay? So, they're paying more interest. The property shares in particular get compared to that interest rate that's being applied to the long bond rate, so the higher interest rates are going up and the income you're paying out is the same, then to get your share price, you would multiply one against the other, so the yield's going up, the profit's staying the same, so the share price is going to go down. So, when long bond rates go up, share prices go down. So, sometimes, we've got no control over that because it's something the president does. He might fire the finance minister, so we've done nothing about that, but everything becomes unstable; all of a sudden, the long bond rate goes up, share prices go down. So, we're actually very aggrieved about that in the property industry because it's a developing economy kind of a reality that you have to live with. So, all these economic things matter: where you invest, what type of property is it, and the other things that I said, so I'll stop waffling on that one.

Q4: how would you define specialised REIT compared to a diversified REIT?

Researcher: Alright, I think we've got enough information on it. Alright, and how would you define a specialized - not necessarily textbook-wise but just according to you, how would you define a specialized REIT compared to a diversified REIT? Just before you go on there, I was reading the Cape Times newspaper right now by the reception, and I noticed that they have their own way of grouping or categorizing these things, so what's your take on that? How do you categorize these?

R3a: A diversified REIT is one which invests in more than one type of property, so for example - I'll keep coming back - CS3 is retail office and industrial. All our assets are divided basically into those three categories, okay? But a specialized REIT is one which is invested into one type of property, so you can get residential REITs, you get, as I said, retail REITs, Hyprop, Hyprop are retail REIT, you get hospitality fund which is a REIT, which is invested into hotels and casinos, stuff like that, we have an unlisted property vehicle which is invested only into healthcare assets, so it's like a hospital fund. So, they are the differences in my view. Specialized is one specific type of property. Diversified is more than one type of property, in a nutshell.

Q5: How does a REIT qualify to be specialised in SA?

Researcher: Okay, alright, and that leads me to my next question: How does a REIT qualify to be specialized? Is there a certain official split threshold out there in the market?

R3a: I would imagine that there probably is some kind of rule about how much of your assets have to be invested into one category of assets. I don't know what the threshold is, and obviously, you want to be compared to assets of a similar class. So, it will be a bit stupid if you're a REIT that was just invested into industrial, to want to go and be listed against diversified REITs, you know what I'm saying? Just for like, you or me looking at that page of share prices, you kind of wonder about the different performance because they're all in the same sector of the stock exchange, but they're actually very different.

Q6: Do property type specialist REITs outperform diversified REITs in SA?

Researcher: Alright. So… Okay. Do property type specialized REITs are performed diversified REITs in SA?

R3a: I guess that depends on what's happening in the economy and very possibly, they could do. It depends on what you're invested in, I suppose, at the end of the day.

Researcher: Yeah, because normally –

R3a: If I invest in a specialized REIT and as I said to you, the retail market's down, then your returns are going to be pulled down, whereas if you're in a bit of retail, a bit of office, and a bit of industrial, and they are both performing better, chances are, you're going to perform better in a diversified REIT. If you're all invested in, let's say the office sector's booming and the other two sectors aren't doing that well, so if you're all invested in an office-specific REIT, then you're going to totally outperform the market compared to the diversified REITs because you'll have the other two sectors bringing you down. So, I think the answer to the question is, it depends what sector you are investing in and what's happening in the economy to the other sector.

Researcher: Definitely. So, not necessarily saying, but people believe that if you're specialized, you're bound to outperform that other person who diversifies, so certainly, that doesn't apply here.

R3a: Well, why would you do this? It's all about risk at the end of the day. So, a diversified asset is spreading its risk. It doesn't put all its eggs in one basket because especially in, I would think in a… What's the word? In an economy such as ours which is so volatile, you never know what's going to happen next, so it's maybe better to be diversified, although if you get it right and you're specialized, you can score big time.

Researcher: For sure, the same way the quite specialized REITs aren't – I think, for instance, in Equites, as one.

R3a: Yes, there are logistics, so absolutely, and they're doing very well at the moment. They have always done very well, and who's to know how that's going to continue, although everyone's talking about it, because that seems to be satisfying the need for large scale distribution of consumer goods, I guess, more than anything else with the rise of the Internet shopping and all that kind of stuff.

Researcher: We will get to that.

R3a: We're getting to that, right.

Q7: Why do some REITs choose to specialise in a property type or geographic location?

Researcher: Alright, so why do some REITs choose to specialize in a property type or a geographic location?

R3a: Again, it's an expectation or an opinion that the time is right or that specific type of asset has got better prospects or even that area of the country, like Cape Town at the movement is far outperforming the rest of the country in terms of vacancies and rain tools, and whatever else. So, a fund like Spear, for example, which is based totally in Cape Town, you would expect them to be doing better than funds that are diversified around the country. It also might be that your management expertise is here and you're comfortable here, you don't want to take risks in other areas in the country that are physically away from where you're based. So, it's not just always about what's happening in the economy and what the returns are going to be. The simple things are some guys just don't like to travel.

Researcher: Yeah, definitely, yes, some don't like it at all.

R3a: Also, you probably know the market better in your own environment.

Q8: How is the Industrial Property sector performing relative to other sectors in SA and the world?

Researcher: Yes, with regards to the geographic location, right? Yeah. According to you, how is the industrial property sector performing relative to other sectors in South Africa and the world? The world's a bit broad, but yeah.

R3a: I think the industrial sector is doing pretty well at the moment, certainly, compared to office and retail, and I'd certainly go from my experience with our portfolio which is pretty large. In Cape Town, we've got about close to 500,000 square meters, like 50 buildings. We've got hardly any vacancies. Rental is a bit challenging from time to time but it has, I think, been increasing, and some areas are better than others, so I think industrial has been doing quite well, is doing quite well in Cape Town.

Researcher: Alright, and then I've always wanted to ask this question: You just said the industrial sector is performing better than the office and the retail.

R3a: Yeah, and then retail, yeah.

Researcher: So while we are next door, why are building the P grade office versus a student…?

R3a: Because again, I could say to you, it’s in general, but Claremont has got less than 2% vacancies. We've got five other buildings in Claremont. We've got no vacancies, so we have –

Researcher: And these are still office?

R3a: Sorry?

Researcher: And these are all office, the other buildings?

R3a: The other buildings are all office. You can’t build industrial – alright, you could take your money and invest it somewhere else, but the Claremont is one of the best areas, and Claremont, where rentals are holding up. It’s not - maybe as an overall thing that I say to you, that industrial is doing better than the office, but there's areas where office is still doing very well also, so as long as you choose where you're spending your money, that's what we do. We haven't got an unlimited amount of money, and whatever opportunities we have at a time, we have to decide where we're going to invest in, and in this particular case, this was the right option for us given what else is going on in the market.

Researcher: Alright, and then I've noticed that the trend is - do you guys do any residential?

R3a: No.

Researcher: Not at all? Okay, so that was out of the picture, because I noticed the trend in - on the main road, especially, they’re building student residential...

R3a: Yeah, that’s the latest, yeah.

Researcher: Yeah, and I mean, you couldn't have possibly built a student accommodation block here when there's another one just next to it.

R3a: Or Redefine one just down the road, yeah.

Researcher: Yeah, buy Shoprite there.

R3a: And also, it makes sense for us to have the offices next. Yeah, we’re going to make use; we can have some common facilities between this building and the one we're building as well, and we're sharing the sharing a bore hole, and we’re sharing some of the parking, so kind of, it was the right thing for us to do in this particular instance.

Q9: What are the Industrial property sector performance drivers in SA?

Researcher: Okay, and this question might be a very tricky for you because you said you operate from an overview perspective, but what are the industrial properties sector performance drivers, specifically industrial? Would you highlight a few?

R3a: Yeah, look, I think which area you're going to operate in. Obviously, you got to be near main roads, you got to have good access, you want to have good security, so you're looking for areas like that. You then look into what's going on in the economy, like logistics. Everyone's running around looking - we're doing, we're building some logistic stuff out in Bellville South for Laser Transport, own, like Don Wing and all these other companies, so one of the drivers is, I guess, what industries are booming, and it's a bit of a big ask to say that logistics is industrial. I suppose it is. When you think of industrial, you think of heavy engineering, and there's not a hell of a lot of that really happens in Cape Town anymore. So, yeah, you've got to look and see what's happening in the economy, where's the growth going to come from? That's another reason why just being in the property industry at the moment is very difficult to show growth, is because most of the leases that come up for renewal, depending on when they started, often, rentals, they're not- if your lease started in an industrial, say 10 years ago and you've been escalating every year, and it comes up now for renewal, chances are, there's going to be some kind of market reversion, so your rate is going to go backwards. So, if you look at the performance, and I'm going off the question a bit here, but if you look at the REIT, we're always worried about what's our growth and returns going to be year on year, but if you think of leases that are negotiated at the moment, generally have got anything from a 7% to 9% escalation in it, okay? So, there's no chance that your growth and your net income's going to be more than 7% and 9%. Given that there's a lot of leases that come up that will go backwards, there's a lot of leases that come up that won't escalate by 7% or 9% once they get negotiated on renewal, so how can you expect the fund to grow at 7% to 9%? That's the absolute best they can do, is if everything falls into line and everything keeps escalating – it never does. Something always goes backwards, plus, you have vacancies, so that's another way of looking - if you look at the Resilient situation, how are they coming up with 20% return, increases every year, year on year, on year, and obviously, this will come out of that there was a bit of a shenanigan going on. So, to get back then, industrial sector property drivers are about location, it's about what's happening in the marketplace, it's about what the economy's doing. It's about, I guess it's about exports, the strength of the Rand, all these things, if they're all kind of falling into line, then you should find that there's some industrial growth happening.

Q10: To what extent does the e-commerce industry affect the industrial property sector in SA?

Researcher: Yeah, alright. Yes, to what extent does the e-commerce industry affect the industrial property sector?

R3a: Yeah, okay, it's starting to, I think as the answer, I think that South Africa is a long way behind what's happening in the rest of the world from what I understand, but everybody's got a cell phone. I think we've got six - as a country, we've got the six most number of cell phones.

Researcher: Users or like – yeah.

R3a: Cell phone owners and users as a percentage of the population or something like that. So, all being that we're behind the rest of the world in owning computers and whatever else. We've all got cell phones, so if you've got a cell phone, you've got access. So, it's definitely on the up and as you said, Equites, have focused on that, and they've done it successfully, I think, in South Africa. They've done it in England. I'm not sure if they've been to eastern Europe as well. They might have been also, but no, there's only so much space for Amazons and Take-a-lots, or what have you.

Researcher: Take-a-lots, yeah.

R3a: I mean, Take-a-lot have already got a huge one out in Montague Gardens.

Researcher: In Montague, yeah.

R3a: And, Amazon - the talk is that Amazon's gone RFP out and they are looking for a 90,000 square meter facility. So, everybody's running around doing that, but there's a limit.

Researcher: Yeah, but why would you say we're still behind? Because I was talking to a friend yesterday and he was saying that he used to live in England for two years, and those entire two years, he's never been to the shopping center because he did all his grocery shopping and everything online. What's the difference here in South Africa? And he said - oh, the other thing he said, grocery shopping – I mean, going to the shopping centers is more of a recreational activity.

R3a: I think the biggest difference is how do you get it delivered? I don't think that we've got a sophisticated delivery, reliable suppliers of those facilities. We haven't – I don't know, I don't know. I mean, if you want to get something couriered, how many reliable courier companies are there in South Africa and do they operate properly outside of Joburg, Durban and Cape Town? There's a lot of population that spread rurally and everything else, and I think that's probably the biggest hindrance to this thing taking off as big as it has elsewhere in the world.

Researcher: For sure, because I was reading a lot of literature, and they're talking about the same day delivery, same day delivery, especially in the US and the UK, that's what's really important.

R3a: Yeah, yeah, and that's just delivery, and then if people don't want it, you've got to get it back. You've got to have a proper policy for bringing things back as well. So, I think those types of businesses, there's a lot of scope for them, but they've got to get it right because if you get it wrong, no one's going to use you again, and as I say to you, it's to do with the population spread, and also, as opposed to the poorer income groups who rely on grants and stuff like that, who could still buy all their stuff if they wanted to on their cell phone or what have you. I don't know if there's a sufficient trust for that kind of thing.

Researcher: Yes, and trust is another thing, yeah, and I was talking to another friend of mine telling me that once we get to that point, once we're ready, the government should stop, as a way to help the e-commerce industry, we should stop the said shopping center zoning, something like that, do you think, how far are we from that stage?

R3a: From not building any more shopping centers?

Researcher: Yes, and looking at the shopping centers that maybe closed down, is there any?

R3a: Look, I think America is going through some of that at the moment. I think there are downsizing of shopping centers and shopping centers that are failing, and I think in South Africa, as we sit here at the moment, there are too many shopping centers. There's definitely an oversaturation, but at the end of the day, it's all driven by the retailers, so as long as the retailers want to go and be shopped in traditionally, you're still going to have shopping centers. What you might find is they use the space differently: people might look things up on their phone, they might be able to actually – I think there's still an element of touchy – I want to touch it, I want to feel it, I want to see it. So, you might find shopping centers becoming like big showrooms. We actually go and see the stuff, and you can look it up on your phone, but you want to go somewhere where you can actually see it, and then you'll still buy it there, but it's definitely under pressure. There's no doubt about it, and then South Africa, there's too many shopping centers.

Q11: How does the REITs gearing level affect its performance?

Researcher: Alright, okay, and how does a REIT's gearing level affect their performance? Is it -?

R3a: Look, I think REITs, I think they have a regulation that says that they're gearing is limited, or if it doesn't, it's not the REIT that says it's their memorandum of articles or whatever the equivalent is that they have a percentage in terms of gearing that they can't go beyond. I guess it depends at any point in time how much the cost of funds are, what is your gearing cost? If it's favorable to what your properties are yielding, then by all means. If it's not, then don't. I guess it's as simple as that.

Q12: How does the economic status of a country affect the sectoral performance of property?

Researcher: Straightforward, yeah. Alright, and on this one, you actually did mention it, how does the economy status - I think we've addressed that already, the economic status of a country, how does it affect the sectoral performance of a country?

R3a: Yeah, well, it does. I mean, as I said to you, if you're living with no growth in your economy, how can you expect growth out of your properties. It's very difficult.

Q13: May you briefly explain the company's diversification techniques used, if any?

Researcher: Definitely, definitely. I was reading another literature, I think it was from the UK, who are telling me that – it was actually on a similar topic, but obviously based in the UK, and the conclusion to it was, I think, overall, it just depends on how the economy is doing at that point, whether it's in a recession, recovery stage, or was at its peak, so it's definitely going to yield different results at each and every stage. Right, may you briefly explain the company's diversification techniques, if any?

R3a: Look, we have a… it's kind of an - you have an ideal idea of how much you want to be invested in retail, how much in office, and how much in industrial, and I guess you always keep that in mind when you're making an investment, but some, for example, two years ago, we bought a listed fund called Acucap. Now, we bought Acucap specifically because they were overweight in retail and we were underweight in retail. So, it was a way of us trying to balance the diversification. So, I suppose that was a technique that we went - we were on the acquisition trail and we bought something that would complement what we had, to give us a kind of ideal spread of assets. So, it's something you've always got to review because the economy does different things to different sectors, and that's why at the moment, you probably think, well, you want to be a bit less invested in retail or maybe a bit more invested in industrials than you would normally be, but the thing about retail is also, what are the types of businesses that are your customers, or retail, generally, you're dealing with shopping centers, with large nationals, they're strong companies, so you're taking a bit of a bet that they're going to be more solid and stable than an industrial market where companies tend to have problems financially and they're not as big and not as spread geographically around the country. So, yeah, so you look at, again, I would say you look at one of the mixes in your own portfolio, what you decide is your ideal mix to spread your risk, and take it from there, and I guess, in Cape Town, Joburg and Durban, we also look at what our geographical split is in terms of how much of the fund is in Cape Town, how much is in Joburg, and how much is in Durban so that we will have kind of ideal idea of what the weighting should be used as far as that's concerned as well.

Researcher: Alright, I can't help but wonder, say you're looking at property to buy, maybe for a year, then renovate, then maybe lease it out or something. Does it differ in each and every sector, like the criteria that you use to assess if that buy is lucrative?

R3a: Look, ultimately, it comes down to what does it cost, how much it's going to cost if it hasn't got a tenant, how much it's going to cost to fix it up, what rentals are you likely to get, and what return are you going to make? Have you got a tenant for it? Haven't you got a tenant for it? Ultimately, it comes down to return, but I think you'll always keeping an eye on not - in CS3, we have 130 billion worth of assets - no one transaction in itself is going to sway that balance. You know what I'm saying? But the only way you can sway the balances to go buy other funds, multiple assets. So, individual buildings, you're looking at what's your return, but that has to be what's the return, how long is the lease? How long have you got a tenant tied up for? It is what's happening in the area, all the normal things that you would apply.

Q14: What factors affect the risk and return of a REIT's investment and how is risk minimised and return maximised?

Researcher: Okay, and yeah, I think we have also touched on this one because these questions overlap, and what are the factors that affect risk and return of REIT investment and how is risk minimized and how is return maximized? So, that's question 14.

R3a: Yeah, look, I think as I said to you before, I think that the biggest risk is the one that you've got no control over. So, you operate in an environment where you can't control what the government's going to do, you don't know what's going to happen to interest rates, you don't know what it's going to happen to the Rand, so barring that aside and forgetting about those risks which you can really influence, you then have to apply the normal things that you would think about when you invest in any property - where is it? How much does it cost a square meter, or what are the rentals going to be? What's happening in the vicinity? Have you got tenants lined up for it? Is the building in good condition, bad condition? What is your assessment of it in terms of fire, and then HVAC, and all that kind of stuff. So, I think you have to do proper due diligences, and then you have to use your common sense when you're managing them, and we develop quite a lot of buildings, and we develop for our own use, so you don't take corners, you apply best practice, you apply the green building principles, you're always looking at ways now to save water and to reduce water, and all those kinds of things, so you have to make sure your product is relevant to what the market's looking for, your BEE structure has to be correct. Otherwise, certainly large international tenants won't touch with a barge pole. You've got to be very aware of that. Even the government now, we've got a three-year transformation plan that we have to submit with them and we have to account how we're doing every year in terms of that plan to the employment equity, whatever they call themselves these days. So, all those factors affect risk and return, I guess at the end of the day, if your BEE status gets higher, then less people are prepared to do business with you, and there's chances that you'll lose tenants when leases come up, so I guess all these things are going on, and not just what's happening in your property, but how much has your funds costing? Are you raising money from all the sources that you can? We've done a green bond, we've done a euro bond, we raised money through rights issues, we offer the shareholders, instead of taking their dividends as cash, we offered them shares instead of - they can take extra shares instead of the cash from the dividend. That raises funds for us as well. So, all these kind of things, you have to look at what your cost of funds are, be very aware of what your cost of funds are, and what your return is on your buildings. What's the point of building an office building that gives you a return of 7% if it's costing you 9%? Then, you're impairing the performance of the fund because you're negative – it's called negative gearing, yeah. So, yeah, in a nutshell.

Q15: How would you describe the relationship between the REIT equity market and stock market?

Researcher: In a nutshell? Okay. Alright, the last question would be, how would you describe the relationship between the REIT equity market and the stock market? Is there any correlation in their performance?

R3a: Well, I suppose to the extent to which some of these things, some thing, some other categories in the stock exchange perform according to, like I said, what's happening in the economy, so if interest rates are going up, is that good or bad for us? It's bad for property. Why else is it bad for us? It's probably bad for everybody else, except maybe banks or I don't know. So, there is some - probably, I know some, there is correlation. Again, if you're invested into something else that maybe there are minerals or something like that, and China aren't buying them anymore, so the mineral market will crash, but it shouldn't really make much of a difference, I don't think, on the REIT market. I don't know if I'm getting that question.

Researcher: Yeah. No, I think you are, I think you are. Yeah, I think that's about it.

R3a: Sure, sure. I don't know if that was any good.

Researcher: It was, definitely.

Case Study 4 (CS4)

CS4 interview

There are 2 Speakers:

Researcher

R4a – Respondent

Held on the 13th of July, 2018 at the CS4 Offices in Cape Town.

Researcher: And just to give you an idea of what the project is about, so I'm basically doing a qualitative approach. I'm doing a qualitative approach to comparing the performance between specialized and - well, specialized industrial, and diversified REITs.

R4a: Okay, so you're not doing like a hardcore number thing?

Researcher: Not really. I bet you it was important to mention that they're considering that you're from a finance department, but it's not really much of a problem if you give a financial answer or solutions to the question. I mean, that's the whole point of this interview challenge: you get your personal opinion.

R4a: That's fine. So, I mean, are you the lead, you'll lead the interview?

Researcher: Yeah, for sure.

R4a: Okay, fine.

Q1: What types of REITs are offered in SA and how do you decide on a specific type?

Researcher: So, let's get right into it. The first question, what types of REITs are offered in South Africa and how do you decide on a specific type? Okay, just to elaborate on that question, pardon me because all I know right now is probably just literature. It's obviously different from the practical world. And I did a bit of reading from the South African REITs website, they mentioned that the two types in SA which is a company REIT and trust REIT. So, I was asking in that sense.

R4a: Yeah, so the trust REITs that - a REIT is called as Real Estate Investment Trust, it's called a real estate investment trust but it's actually just a company. So, in South Africa, if you are a REIT, then you are company. You are a REIT or you're not a REIT. So, in South Africa, there are two types of property companies. There are Property companies that are REITS, property companies that aren't REITS. You don't decide on what you – it's best to be a REIT; it's a best practice, but in order to be a REIT, you have to be listed for with over 300 million in assets or 75% of your revenue needs to be rental income. It's quite a difficult thing to be a REIT. So, there really are - if there are questions around, I mean, that is what a REIT is, REIT. I think more of a question is about what kind the REITs are there in South Africa. So, I mean, what the property companies are there, there's generally probably five types of REIT. There's industrial REITs, retail REITs, office REITs. That'll be the specialized natures, and then self-storage. Then there is hospital REITs. There's actually a lot more specializing, but that's the five main ones, I reckon in South Africa. Overseas you get hospital REITs, you get the electricity REITs or REITs that just own power stations.

Researcher: Alright, an example of that would be?

R4a: I don't really know the example of it but they just own the power stations, and then they just own the power station, and then Eskom rent it from them, but the land is owned by – the land and the building are not owned by the operator.

Researcher: Alright, so that would probably be maybe an industrial REIT, maybe.

R4a: That's actually specifically for like, Electricity REITs, because I mean, you get those kinds of live REITs as well because it's a real estate company as well, as we said, and then there's obviously diversified which means normal everything, and then there's specialized. Really, mainly in South Africa, you are a REIT, you are not a REIT. If your REITs aren't specialized, or you are diversified.

Researcher: Alright, and with regards to regulations or legislation or laws that govern these companies, because I think, if I remember well from the types they mentioned that the company was governed by the Companies Act, something like that, and then the trust REIT was regulated with something.

R4a: So, referring back to old trusts, it's called the PLS and the PUT. So, PLS was a Property Loan Stock company, and then a Property Unit Trust, PLS and PUT. Those structures have fallen away; they don't exist anymore. They don't exist, you are either REIT or you're just a company. You can be a Trust as well that earns property, but that's not really like a way of doing things. I mean, that's very old school structure that you're doing that. If you're talking about like a large commercial, like listed environment, listed environments, old REITs, the old companies they don't list the trust, even like Sycom which is a property – it was PUT. It was a company that was listed and was managed by a trust. Okay.

Q2: Does a REIT structure affect the performance of a REIT?

Researcher: I think that's quite clear, and do you think a REIT structure affects the performance of a REIT?

R4a: The performance of a REIT? I don't think it does.

Researcher: Just before you get into it, what kind of structures are there? What kind of structures do REITs use or what kinds of setups? For example, I'll keep referring to you to literature, and if this was in the US, I don't know what's relevant here. They say it is what you call a traditional structure which is where the REIT owns a property, and then leases it out then the tenant obviously manages. I think that's a triple net lease and there's a paired-share which its joint venture between the REIT and another company, but it's operated as one. That's all they're saying about it, so.

R4a: The question's very wide. So, there's lots of structures you can structure a company, so there's, I mean, I heard something one of the other guys are saying, like you have to get location property right, you have to get the actual property right, so you build it correct then you have to get the right structure right. So, there are multiple ways to structure a company, to structure a REIT. You can structure a REIT as it owns the property, you can structure a REIT like it's a joint venture; it owns some of the company. It can own it with another REIT as well, okay? You can have an undivided share of property. It all depends on what's needed for that particular point in time, to drive its revenue. So, I can't really answer the question with a definitive yes or not, I'll just say, yeah, the way you structure your company is very dependent on how you want returns, you want to get from that, or how much capital you have because you might be capital-drained, and you want to buy a bigger asset and the only way you can buy the bigger asset is by entering into a structure to get in order to buy it, and that's really what it comes down to it as well.

Q3: What are the key performance drivers of REITs?

Researcher: Alright, and then what are the key performance drivers of REITs?

R4a: So, it is space related. It's rental growth year on year, so like, it comes back and basically it's your NAV growth, NAV, and then asset value growth, your gearing ratios, how much debt you have, whether it would be less than 40, around 30 – 40% of a company, you never really want to go into much further than that. You're your dividend growth, DPS, is highly important for REITs. Everyone lives and dies by how much they're growing their dividend by, dividend percent – it's really important. Your revenue growth, you want to know how much you're growing your revenue in outgoing year by year, and a life to life basis, you want to say, how much am I am growing – how much better is this property growing year on year, with last year, and what your costs are for the properties. So, to be able to get that right, then that talks to your structuring, being cap, being the debt, okay? And then your debt capital, your finance property, and then how you're driving certain aspects of the income to grow.

Q4: how would you define specialised REIT compared to a diversified REIT?

Researcher: Alright, and then, you've already touched on this, but how would you define – not necessarily a textbook definition - just you, how would you define a specialized REIT compared to a diversified REIT? Because the other day, I was reading *Cape Times* and it looks like they have their own criteria of grouping these REITs, and surprisingly though, only two specialized REITS in the table, and a lot of them were diversified, some that I thought were specialized were actually considered diversified. So, is there an official way of grouping these or qualifying the REITs?

R4a: So, in South Africa, there only are actually - there's Equites, which is specialized industrial fund, Hospitality which is specialized, hospitality that own hotels and casinos, rather just the hotels. There's Hospitality, there's Stor-age, there's self-storage, and it's Indluplace which does residential. Those are the only ones that are specialized in South Africa. Every other asset in South Africa is diversified because I'll own any kind of other property, so while it might be a retail focused REIT, like a Hyprop, Hyprop own office blocks. So, they're not truly specialized. Specialized means you only do one type of asset; you are specialized in that.

Researcher: Strictly?

R4a: Yeah.

Q5: How does a REIT qualify to be specialised in SA?

Researcher: So that drives me to my next question: How does a REIT qualify to be specialized? Because for example, Equites, would you say that they're specialized because it's 100% industrial, there's no office at all? Because some of the properties there, nothing, one of the latest developments, it was mostly industrial, then there's a bit of office space.

R4a: So, the office place on an industrial block is called still industrial, so, like a specialized office block. They would add like a shared with a shop working office, there's still have an office component to that where managers of the warehouse and other have their space. You don't qualify to be specialized – there's no qualification; you choose it, so yeah, you choose it, say, I want to be only in industrial - I only want to be in office, and that's how you become specialized in those fields.

Researcher: Alright, so there's not necessarily an official portfolio split, maybe of the sector?

R4a: No.

Q6: Do property type specialist REITs outperform diversified REITs in SA?

Researcher: Alright, got it. Do property-type specialist REITs outperform diversified? That's number 6.

R4a: I don't have the information to hand. I can't say yes or no.

Researcher: Yeah, because there's a belief that anything that's specialized has to outperform Diversified. Is it the same in the property industry?

R4a: I don't know if it's true or not, but in the US, which is probably the biggest property market, they specialized all the REITs there, and it depends on what – it doesn't really make a difference, I think the question is about, specialized REITs may or may not outperform diversified REITs It depends on what sector the property of said market is on fire. If offices are like everyone wants an office in Sandton, then we going to be cruising. In six years' time, there's a million extra square meters of office space available in Sandton, and people can't rent square meters, anyone, because the economy is dead and there's no one who wants an office. Everyone wants to work from a coffee shop, then that's going to be a dead space. Same thing as industrial: everyone wants industrial properties right now. It's the niche thing; it's great, it's cool, it's amazing, but in six years' time, no one wants industrial property. Okay, so there's not a real life diversified/specialized. You can't really say which one will outperform. It depends on what's happening in the environment at that point in time.

Q7: Why do some REITs choose to specialise in a property type or geographic location?

Researcher: Alright, yeah, and then why would some REITs choose to specialize in a property type or geographic location, or what are the reasons?

R4a: So, it links to number 6 and 7, it depends what is happening in that particular market. So, maybe people only want to be in rural township areas because that's where the growth is. They believe they can run a smaller mall, costs less to put up, and they've got a cap market to some extent in that area. People want to be in self-storage because that's the only thing they've done, that's the only thing they know – there's no competition, and they want to be the big ruler in the area. That's why people would choose, particularly the property type, it's about opportunity that's available at one point in time that they want to go after and all they believe, that that will provide them with better access to capital, and you get access to capital, you can build cheaper and you can make better returns. So, those are the two reasons why you would want to choose a particular property type or geographic location.

Q8: How is the Industrial Property sector performing relative to other sectors in SA and the world?

Researcher: Alright, and how would you say the industrial property sector is performing relative to other sectors in South Africa?

Speaker 2: So, the past probably three, four years, it's probably the best performing sector, and it is the best performing sector around the world. It's due to changing things we're doing. Your next question answer's why, in number 9, why it is, it's due to e-commerce industry. So, people are wanting – Amazon wants performance centers near towns, near the user. Retail spaces getting smaller. So, people want bigger industrial areas, big industrial space, more modern units. You don't want to be in Epping. They want to be closer to town in the area that they can run That's what they want to see, they want quicker access and better access to do the shipping yards, to railway trains, and to towns because things need to be delivered faster, just in time, and you've worked this whole e-commerce thing which is growing at a ridiculous pace. Now, people are no longer keeping clothing in a shopping center, but they're keeping clothing in a warehouse; it needs to be delivered in time. So in a modern warehouse, it's closed, it can fit, access in and out is easy, and it's safe and secure, and that's the reason why it's growing. It's growing, you know what I mean? That's mainly the reason why it's growing.

Q10: To what extent does the e-commerce industry affect the industrial property sector in SA?

Researcher: Alright. I think number 9, we've addressed that already, and yeah, so just to elaborate on that point, the last point, to what extent does the e-commerce industry affect the industrial sector?

R4a: So, South Africa is a very small e-commerce environment, so it's really worked with one player, Take-a-lot, basically in the market. It's growing. But what the industry is doing is changing the way retail spaces happen. So, the retail space now and the pressure is getting smaller, it's cheaper to rent a website, and then go get a nice industrial property outside Cape Town, and instead of paying a 100 rand a square meter – you pay 50 rand a square meters for an industrial unit versus up to 1,000 rand a square meters for a shop at the waterfront and you managing your stuff online. So, it's having an effective industrial sector but it's also making industrial sector a much more needed sector, but it also like – in Cape Town, we have really small industrial areas. They're very old, and now with the growing South African markets, rather than the Epping low-cost housing than an industrial area, and it moved industrial out to Black heath or further outside, like Durbanville and those areas there. So, that's why the industrial property is performing well in South Africa.

Researcher: Alright, and then just the other day, I was talking to a friend, and he told me he was living in England for two years and the entire two years he was there, he has never really been to a shopping center to do grocery shopping. He does everything online. What would it take for South Africa to get to that point?

R4a: To go fully online? Cheap access to data.

Researcher: It’s definitely one. Do you think that's the only thing? It’s a really important point.

R4a: Well, one’s access to data and high-speed data. Number one, number two is and also, just the logistics environment in South Africa is not great. I mean, if I want to order a top from Old Khaki, it takes four days to arrive, okay?

Researcher: So, we need that same day delivery?

R4a: Same day or next day delivery. I think those are the two main things. I think people also don't trust the internet as much as they should, but that will come.

Researcher: Alright, and with regards to - because I've heard as a way to –

R4a: Also, lastly, in South Africa; there’s not many safe spaces that we can go too. One of the safe spaces people go to is the mall, and the mall shopping, it’s actually somewhere you go to; it’s an outing. You spend a day there, you walk around the shopping center, and it’s actually a destination of a person who was supposed to just shop. If you want something online, if you want like a Woolworths shop, just order it online, okay? But if you want to spend four hours walking around, you can go to Canal Walk and mess around, it’s a safe environment to walk around. It’s a little bit like a shopping center. So, it’s a point why e-commerce is not as much, but it will come.

Researcher: And one of the ways to promote this e-commerce industry I read was they actually maybe stopped the shopping center zoning. With regards to the activity, do you think, how far are we from that? And are shopping centers closing down at the rate at which they’re closing down in South Africa or do we have a saturated market with regards to...?

R4a: I don't know. I don't know the retail space. I can't give you an answer, and I mean, I will just…

Q11: How does the REITs gearing level affect its performance?

Researcher: Alright, it is no problem, it’s no problem. Okay, yeah, next question, how does a REITs gearing level affect its performance? You touched on it as well.

R4a: So, I mean, it also talks to the structure of the REIT, so I mean, the structure of the company? I mean, the higher your gearing is the less ability that you have to do – yeah, you have capital constraints to some extent. If you have cheap debt, that’s great. If you have expensive debt, then it’s not great: then, you become owned by the bank and you become constrained on what you can do and what you can’t do. So, I mean, a healthy gearing level is around a 20% mark. An unhealthy gearing mark is at 40%. If you play within that range, you’re fine.

Q12: How does the economic status of a country affect the sectoral performance of property?

Researcher: Alright, cool. Do you think the economic status of a country affects the performance…?

R4a: Yes, 100%.

Researcher: Yeah, because I read somewhere as well, and they were saying that... It was actually a similar research to this. It was in the UK though, and I think the conclusion that I got from that was, it really depends at which state that the economy of that nation is, I mean, so if that nation is in a recession, it's obviously going to yield different results versus when the nation is recovering or it's at its peak, so does definitely affect...

R4a: Yeah, definitely, yes. How does it perform? The country's doing well, the property's doing well, that's what happens. There's a huge difference here.

Q13: May you briefly explain the company's diversification techniques used, if any?

Researcher: Alright. May you kindly explain the company's diversification techniques, if there are any?

R4a: Yeah, we don't have any. We are a specialized self-storage REIT. We only do self-storage and that's all we'll do.

Researcher: Yes, yes, 100%.

R4a: Well, diversified for geographically. So, I mean, somebody needs to have gone overseas and looked elsewhere, but we won't go out of self-storage.

Researcher: Got it, and how are those going?

R4a: UK? I'll tell you what, it's a different environment; it's much more competitive. It's a different kind of market. We have to be – we are getting used to what we are going to be doing on that side, but it's a good place to invest, yeah.

Q14: What factors affect the risk and return of a REIT's investment and how is risk minimised and return maximised?

Researcher: Alright. What factors affect the risk and return of a REITs investment and how is risk minimized and return maximized?

R4a: Yeah, I mean, so there's a couple of factors its property location, it's the type of property you're investing in, it's the geographic location as well, so I mean, what's happening in Durban will affect your property return in Cape Town. It is inflation, it is interest rates, it is currency risk, and I mean, also, e-commerce as well. People have been keeping more stuff, buying less stuff. There's a general risk and return of investment. How well is risk minimized and maximised. From an interest rate risk, you're obviously using financial instruments – interest rate and hedging, and I mean, to keep yourself away from the risk that side there. From management, you obviously know what's happening in the market, trying to predict consumer behavior and how we are going to be affected. Obviously, we can use discounts and specials, discounts to pull people in. On a cost management side of things, you just manage your costs as well as you can, so you're constantly monitoring and looking for exceptions and looking for ways to save Rands and cents because that's what makes a difference at the end of the day.

Q15: How would you describe the relationship between the REIT equity market and stock market?

Researcher: Alright, and lastly, how would you describe the relationship between the REIT equity market and the stock market, and the correlation in the…

R4a: I think that there is a correlation. I don't think it is - well, the REIT sectors now is not because of the past years it has really become big in itself. It used to be a smaller thing; it wasn't really run, and over the past few years, it's grown into its own like, 500 million – I think it's 500 million, 500 billion Rand owned stock market, kind of like environment. I don't think their correlates with any of the other sectors in the JSE. I mean, the price of gold is not going to affect the price of the property. Interest rates will affect it, high interest rates. If you pay more money in interest rates and haven't fixed it, it means we're less motivated shareholders, which means that your stuff will be worthless. That is a clear correlation too. Inflation goes up, I mean, if you're not pushing, if you've got to set, set, set escalations in your interest rates, then inflation goes up and you'd have – you will return less than what inflation grew by which means that you share with shareholders less. Those are clear indications.

Researcher: Alright, and then would you say it's safer to maybe fix your own interest rate?

R4a: That's one of the key points about returning or return – one of the key risk management, the key risk for REITs is always a risk because you have high levels of gearing, and if you fix it with financial instruments, then you minimize that risk, and shareholders want you to be 80 – 100% fixed at all points in time.

Researcher: Okay, alright. Okay, yeah, I think that's about it.

R4a: Anything else you want to ask now?

Researcher: Yeah, I don't think there's anything, but if there's any clarification I want on these points, I'll definitely pop in an email.

R4a: That's fine.

Researcher: Alright, thank you so much, Pinny.

R4a: Okay, cool, man.

Researcher: Thank you for making time to meet.

R4a: No problem at all man. Good luck on your Masters.

Researcher: Yeah.