

Final Report

Study to Investigate Residential REITs and their
Potential to Increase Investment in and Access to
Affordable Housing Finance in Africa

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Abbreviations and Acronyms

AFHCO	Affordable Housing Company
CAHF	Centre for Affordable Housing Finance
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGT	Capital Gains Tax
CIS	Collective Investment Scheme
CIT	Companies Income Tax
CMA	Capital Markets Authority
CMBS	Commercial mortgage-backed securities
CMSA	Capital Market and Securities Authority
DPS	Dividends Per Share
D-REIT	Development and Construction Real Estate Investment Trust
DSE	Dar Es Salaam Stock Exchange
EPRA	The European Public Real Estate Association
FDI	Foreign Direct Investment
FSB	Financial Services Board
GOG	Government of Ghana
HCA	The Homes and Community Agency
HFH	Houses4Homes
HPET	Housing Partnership Equity Trust
HPN	Housing Partnership Network
HR	Human Resource
IAS	Investment and Securities
IFC	International Finance Corporation
IHS	International Housing Solutions
I-REIT	Income Real Estate Investment Trust
J-REITs	Japanese REITs
JSE	Johannesburg Stock Exchange
LIHTC	Low-income housing tax credit
LLC	Limited Liability Company
MBS	Mortgage-backed securities
MD	Managing Director
MSCI	Morgan Stanley Capital Group International
NAV	Net Asset Value
NHC	National Housing Corporation
NHIF	National Health Insurance Fund
NSSF	National Social Security Fund
PLS	Property loan stock company
PO-PSM	President Office-Public Sector Management
PSPF	Public Service Pension Fund
PUT	Property unit trust
REIT	Real Estate Investment Trusts
RMBS	Residential mortgage-backed securities
ROI	Return on Investment
RRI	Responsible Residential Investment
RSL	Registered social landlord
SA	South Africa
SEC	Securities and Exchange Commission
UK	United Kingdom
USA	United States of America
VAT	Value Added Tax
WHC	Watumishi Housing Company
WHT	Withholding taxes

1. Introduction

The growing population, and growing middle class in particular, together with rapid urbanisation in Africa, has created immense demand for affordable housing across African cities. According to the International Finance Corporation (IFC), African cities become the new home to over 40,000 people every day, which in turn puts significant pressure on existing urban accommodation.¹

This growing demand for affordable housing across the African continent has been met with scant supply, which in turn has given rise to a considerably increasing housing backlog.² This is because the formal channels through which quality housing is produced and financed in Africa face major constraints.³

According to the World Bank Group (2015), although the housing sector in Africa is highly heterogeneous with substantial differences between countries, some consistent patterns emerge as a function of overall poorly functioning housing markets. These include costly and time consuming land acquisition and development processes, limited network infrastructure servicing residential land; high cost of construction materials; and the lack of a robust construction sector.

Limited housing finance markets, which struggle to attract and retain significant investment, exacerbate these issues. Until now, these markets have largely failed to provide investors with targets in the residential real estate space that are sufficiently substantial to warrant their attention. Consequently, the majority of housing investment in most African countries comes from government debt or domestic savings rather than from international capital markets and domestic institutional investment markets, as is the case in developed economies.⁵ This contributes to limited financial resources being channelled towards Africa's housing developers.

A key challenge for policy makers is to improve housing delivery value chains – specifically, in a way that broadens access to finance for housing developers, and, in doing so, expands access to adequate housing for individuals.

The introduction of Real Estate Investment Trusts (REITs) is one innovative approach that policy makers in certain African countries are taking in an attempt to address finance constraints in real estate markets. While the REIT structure emerges in the context of real estate markets more broadly, it is its potential application in the affordable residential property market which is the focus of this study.

Legislation and the accompanying regulations providing for the implementation of the REIT structure, facilitate the emergence of vehicles designed to aggregate diverse sources of funding (from international and institutional investors through to households), and target them into a real estate portfolio that extends beyond the limitations of individual projects. The REIT structure allows for real estate investments to look and act like bonds,⁶

¹ IFC. Affordable Housing in Africa. Available at: http://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/trp_featurestory_africahousing

² Kenya's housing shortage is estimated at 2 million units, while Nigeria is in want of 17 million units (IFC. Affordable Housing in Africa)

³ World Bank Group (2015), *Stocktaking of the Housing Sector in Sub-Saharan Africa: challenges and opportunities*.

⁵ World Bank Group (2015), *Stocktaking of the Housing Sector in Sub-Saharan Africa: challenges and opportunities*.

⁶ A bond is a debt investment in which an investor loans money to an entity (typically corporate or governmental) which borrows the funds for a defined period of time at a variable or fixed interest rate. Bonds are used by companies, municipalities, states and sovereign governments to raise money and finance a variety of projects and activities.

and gives rise to an investment entity that investors understand and trust.⁷ The REIT structure further represents a tax-efficient and thus attractive investment vehicle.⁸

REITs thus potentially have an important role to play in channelling large-scale investment into the African real estate market. In particular, focused residential REITs (i.e. REITs that invest exclusively in residential property) are slowly emerging and present an opportunity to address the specific constraints (such as the lack of a mature mortgage market and access to capital for developers) that exist in the context of housing finance in Africa. Residential REITs targeting affordable housing further represent an intriguing conduit for channelling investment into an under-served market.

This study seeks to understand the REIT structure and to explore its relevance for affordable housing investment in Africa. We build a case for residential REITs as a mechanism in supporting affordable housing finance and increased investment in affordable housing in the continent based on specific, yet varying, contexts.

This report begins with a background review. It first seeks to understand the defining characteristics and investor benefits of a REIT (section 2.1). It then narrows its focus to residential REITs in particular, by exploring the unique advantages and disadvantages of investing in residential property, the role of residential property in global listed property markets, and the contexts in which residential REITs thrive (section 2.2). The final aspect of this background review explores residential REITs from a developmental perspective and presents some of the experiences of developed markets in which affordable housing REITs do operate (section 2.3).

The report then sets out the experience of REITs in Africa (section 3). This section outlines the implementation of the REIT framework in Africa to date. Through the presentation of four case studies, it investigates the experiences of selected residential REITs in Africa, with the aim of understanding the extent to which such REITs have had a meaningful social impact on the housing situation in their respective countries.

Section 4 of the report presents key findings regarding the critical enabling conditions for REITs in Africa, the challenges faced by residential REITs in this context, and potential approaches to increasing the financial viability of African affordable housing REITs.

Section 5 presents a number of suggested interventions that government and the Centre for Affordable Housing Finance (CAHF) could take to support the emergence of REITs that invest in affordable housing across the African continent.

Finally, section 6 concludes. It proposes that developing a viable financial model for REITs investing in the affordable housing sector requires private sector experimentation as well as government and NGO support. While the private sector needs to explore the impact of targeting various segments of the affordable housing market and of introducing varying levels of development into affordable housing property portfolios, government and NGOs should focus on approaches to minimizing the risks and costs associated with the affordable housing sector. The study concludes that a viable financial model would have the impact of making the affordable housing segment an attractive target market for REITs, which in turn would stimulate much-needed retail and institutional investment in affordable housing markets across Africa.

⁷ This description does not hold true in the case of a Development REIT. The implications of the atypical characteristics of a Development REIT are explored throughout the study

⁸ The defining characteristics and advantages of the REIT structure are explored in Section 2.1.

2. Background Review

2.1 History

The REIT (or Real Estate Investment Trust) structure was first established in 1960 in the United States (US),⁹ and arose in response to problems in the US property market.

At the time, banks in the US were finding themselves in the possession of large portfolios of income-producing properties, whose mortgages had not been repaid. In the process of attempting to off-load these properties, the banks found that they were unable to sell them to traditional investors – due to the inaccessible nature of large real estate assets.¹¹

The REIT concept was thus developed as a strategy to “unitize” property & permit collective investment by retail investors.¹² In other words, the REIT structure was established with the aim of providing individuals with a way to participate as investors in property.

In order to make the REIT structure more attractive to investors, the US government was persuaded to provide preferential taxation treatment for REITs. During a negotiated process, it was agreed that REITs would have to comply with specific regulations, in order to gain and maintain REIT status. These regulations included the requirement for REITs to distribute a high proportion of their net profit.¹³

Initially, the REIT structure emerged as a “fixed income instrument” i.e. an investment asset that provided investors returns in the form of fixed periodic payments – just like a bond. In addition, however, it offered investors the opportunity for equity gains (as do shares) – resulting from improvements in property values over time. The REIT structure thus sought to provide investors with an investment vehicle that generated both regular income and capital growth.¹⁴

The emergence of the REIT structure ultimately succeeded in changing the investment landscape in the US and widening the pool of capital available to income-producing property owners and developers.¹⁶

Over the last two decades, REITs have demonstrated large scale growth – not only in the pioneering market of the United States of America (USA), but globally through the introduction of REIT regimes in the majority of large capital markets.¹⁷ Today, the REIT structure can be found in 34 countries worldwide.¹⁸

⁹ Brounen, D., & de Koning, S. (2012). 50 Years of Real Estate Investment Trusts: An international examination of the rise and performance of REITs. *Journal of Real Estate Literature*, 197-222.

¹¹ Feng, Z., McKay Price, S. and Sirmans, C.F. (2011) An Overview of Equity Real Estate Trusts (REITs): 1993 – 2009. *Journal of Real Estate Literature*.

¹² Interview with Evans Osano, FSD Africa.

¹³ The requirement for the high distribution of profits arose in response to the removal of corporate tax. The rationale was that the high distribution would enable the investors to pay tax on their income / dividends – thereby ensuring that the government would not lose significant revenue. Interview with Evans Osano, FSD Africa.

¹⁴ There are two primary types of investment vehicles: shares and bonds. While shares primarily give rise to capital growth and gains, bonds give rise to regular income in the form of interest. REITs, on the other hand, strive to generate both rental income and capital growth. While they are traded as shares and provide the opportunity for long-term capital growth, they strive to give their investors access to consistent income streams in the form of dividends. They thus demonstrate characteristics typical of both bonds and shares. Interview with Keith Engel, Deputy CEO of SAIT.

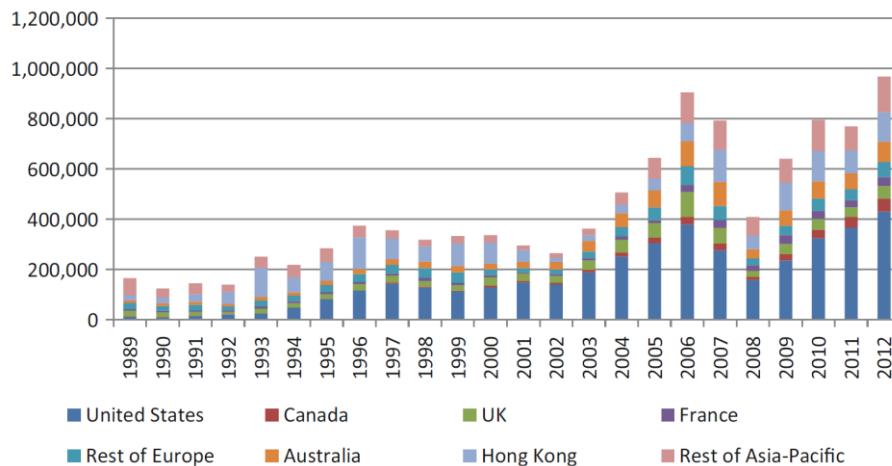
¹⁶ Packer, F., Riddiough, T., & Shek, J. (2014). A Global Tour of Commercial Property and REIT Markets. *International Real Estate Review*, 241-274.

¹⁷ Stevenson, S. (2013) *Real Estate Investment Trusts in Europe: Evolution, regulation and opportunities for growth*. Springer.

¹⁸ Outside of the US, the Netherlands was the first country to adopt the REIT standard (1969). While Australia was also an early adopter of the REIT standard, most Asian and European countries only adopted the REIT standard post-2000. - Brounen, D., & de Koning, S. (2012). 50 Years of Real Estate Investment Trusts: An international examination of the rise and performance of REITs. *Journal of Real Estate Literature*, 197-222.

According to research by the European Public Real Estate Association (EPRA), in 2013 the total market capitalization of REITs around the world reached a value of over \$1.1 trillion.¹⁹ Market capitalization of global listed REITs by year is illustrated in Figure 1 below.²⁰ Note that African markets are not included in the analysis as REITs are relatively new in our local context.

Figure 1: Market capitalisation of global listed real estate (US\$m)



Source: Stevenson (2013)

2.2 Defining Characteristics of a REIT

REITs are essentially companies or trusts that own and often manage a portfolio of mortgages and / or real estate properties, and operate in accordance with certain rules and regulations (explored below). REITs allow investors - both institutional and retail (i.e. individuals) - to invest in portfolios of mortgages or large-scale properties through the purchase of shares. The shareholders of a REIT, in turn, earn a share of the income stream produced by the investment portfolio.²² The primary factor differentiating REITs from other property investment and financing vehicles is the treatment of tax. The fact that REITs are exempt from certain forms of tax is a major incentive to investors seeking to maximise returns, and enables REITs to raise finance that might otherwise be reticent to engage in real estate markets. There are two main types of REITs - Mortgage REITs and Equity REITs.²³

¹⁹ Kennedy (2013) in Boshoff, D. and Bredell, E. (2013) Introduction of REITs in South Africa: Transformation of the Listed Property Sector. Advanced Research in Scientific Areas.

²⁰ Figure 1 illustrates that the REIT market recovered quickly after the 2008 financial recovery, as did global equity markets more generally. It is nonetheless interesting to note that mortgage REITs were typically better capitalized than other mortgage investors in the period before the 2008 financial crisis. Furthermore, mortgage REITs are positioned to play an important role in the post-financial crisis restructuring of the housing finance market due to the fact that they have the ability to raise private capital without government guarantees or reliance on FDIC-insured bank deposits. Mortgage REITs continue to play an important role in the recovery of housing markets, which require large sources of new capital, through their ongoing provision of residential and commercial mortgage credit. (Nareit. Guide to Mortgage REITs. Available at: <https://www.reit.com/investing/reit-basics/guide-mortgage-reits>).

²² NAREIT. What is a REIT? Available at: <https://www.reit.com/investing/reit-basics/what-reit>.

²³ Hybrid REITs are a combination of Equity and Mortgage REITs. They invest in both mortgages and properties.

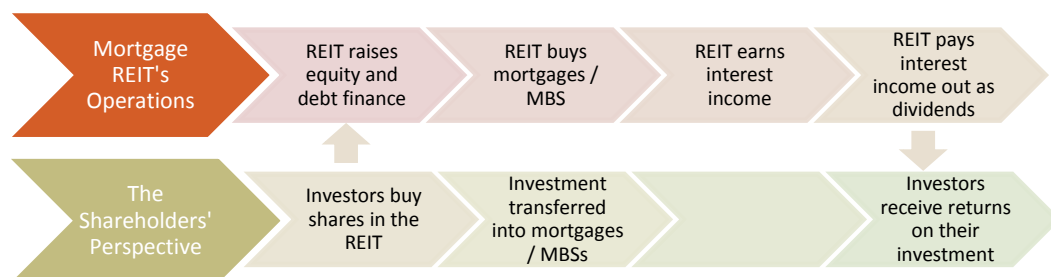
Mortgage REITs invest in mortgages or mortgage-backed securities (MBS) tied to commercial and/or residential properties,²⁴ and generate interest income from the properties that they help to finance.²⁵

Mortgage REITs raise equity and debt finance by issuing shares to investors²⁶ and by applying for loans from financial institutions. This finance is then used to originate mortgages to property buyers, to purchase mortgages that were originated by banks and then sold on the secondary mortgage market, and / or to purchase MBS. Mortgage REITs provide funding for mortgage credit for both homeowners and businesses. While Mortgage REITs typically focus on either the residential or commercial mortgage markets, some invest in both residential mortgages and residential mortgage-backed securities (RMBS), as well as commercial mortgages and commercial mortgage-backed securities (CMBS).²⁷

Mortgage REITs earn interest income from the mortgages and MBS that they hold on their balance sheets. They use this interest income to service their debt finance costs and to pay dividends to their investors. The general objective of a Mortgage REIT is to earn a profit from their net interest margin i.e. the spread between interest income on their mortgage assets and their funding and other costs. Mortgage REITs typically use less borrowing and more equity capital to finance their acquisition of mortgages and MBS than other large mortgage investors.²⁸

The figure below summarizes the investment cycle of a Mortgage REIT.

Figure 2: Investment cycle of a Mortgage REIT



Equity REITs generate income through the growth of equity in a property, through the collection of rent on and from sale of the properties they own for the long-term. One major distinction between Equity REITs and other real estate companies is that a REIT must acquire and develop its properties primarily to operate them as part of its own portfolio rather than to resell them once they are developed.

²⁴ A mortgage is a loan issued by an institution (which in this case is the REIT) to a prospective property owner in order to finance the purchase of a property. The borrower is then required to pay back the loan, plus interest, to the institution over a period of years. A MBS is a security (essentially a promise) backed by a bundle of previously issued mortgages with similar interest rates. An MBS arises when the institution that originated the mortgage loans sells the mortgage loans to a bulge bracket investment bank, which in turn bundles and transfers the pool to an SPV created for the purpose of issuing MBS to investors. When a REIT buys a MBS it isn't buying the actual mortgages – rather it is buying a promise to be paid the return that the bundle of mortgages would receive.

²⁵ NAREIT. What is a REIT? Available at: <https://www.reit.com/investing/reit-basics/what-reit>.

²⁶ There are several ways in which investors can invest in a Mortgage REIT (thereby contributing equity finance). They can purchase common or preferred shares of individual stock exchange-listed MREITs, or purchase shares in a mutual fund that focuses on Mortgage REITs. Investors can also purchase shares in a Mortgage REIT exchange-traded fund (ETF).

²⁷ NAREIT. What is a REIT? Available at: <https://www.reit.com/investing/reit-basics/what-reit>.

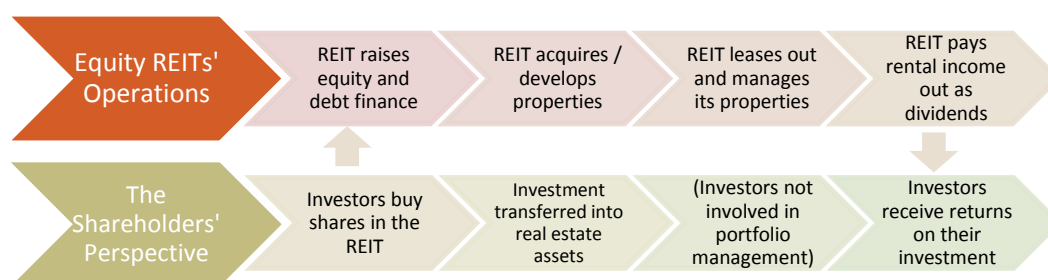
²⁸ NAREIT. What is a REIT? Available at: <https://www.reit.com/investing/reit-basics/what-reit>.

Equity REITs raise equity and debt finance by issuing shares to investors and by applying for loans from financial institutions. This finance is used to acquire existing properties (i.e. properties that have already been developed by developers) and / or to develop their own properties (either through internal development capacity or in partnership with an external property developer), which together form the REIT's portfolio of income-generating properties.

These properties, which may be office buildings, shopping centres, warehouses or apartment buildings, are then leased out to tenants. They are managed either internally by REIT employees or externally by a property management company. The REIT receives rental income from its tenants, and pays the majority of the resulting profit (i.e. the rental income less any management and debt financing expenses) to its shareholders as dividends. Capital appreciation from the sale of any properties also flow to shareholders in the form of dividends.

The figure below summarizes the investment cycle of an Equity REIT.

Figure 3: Investment cycle of an Equity REIT



Although traditional property development companies and Equity REITs both invest in real estate with the goal of generating returns, these entities can be differentiated from one another in a number of ways. A key differentiating factor is that while traditional property development companies often generate returns by selling off the properties that they have developed (instead of retaining them and renting them out), REITs generally generate the majority of their income through the collection of rent on properties that they own for the long-term.³⁰

The other key differences between traditional property development companies and REITs are primarily regulatory in nature and relate to divergent tax treatment approaches. These are summarized in the table below.

Table 1: The differences between a traditional property development company and a REIT

Traditional Property Development Company	Real Estate Investment Trust
Required to pay corporate tax on net income	Exempt from paying tax on distributable net income (most countries); or Subject to preferential corporate tax rates (a few countries)

³⁰ In some jurisdictions REIT regulations stipulate that the majority of income generated by a REIT is required to be rental income.

Traditional Property Development Company	Real Estate Investment Trust
Required to pay capital gains tax when selling off assets	Exempt from capital gains tax when selling off assets (most countries)
Required to pay stamp duty and transactions tax on transfer of property	Exempt from or subject to concessions on stamp duty and transaction tax on transfer of property (some countries)
Permitted to invest in any type of asset class ³¹	Prohibited from diversifying outside of real estate (most countries)
Permitted to retain net profits and to reinvest them in the company	Required to pay out majority of net income as dividends (most countries)
May source equity finance from a few private investors or from multiple private and institutional investors	Pools capital funds of multiple private and institutional investors ³² in order to build up its portfolio at scale
May or may not be listed on the stock exchange	Achieves liquidity and transparency through listing on the stock exchange ³³ (most countries)

The distinguishing characteristics of a REIT are further unpacked below.

As highlighted, **both Equity and Mortgage REITs are subject to taxation benefits**. More specifically, REITs are exempt from tax on distributable net income (i.e. the profit that they pay out as dividends to shareholders), or subject to preferential corporate tax rates. At the same time, shareholders may be required to pay tax on their dividend earnings, depending on how their investment is structured.

This means that, in the context of REITs, **double taxation is removed**, which results in a larger amount of profit being available for distribution as dividends. This gives rise to higher dividend pay-outs and increased rates of return. Furthermore, investors with different tax treatments are able to participate without losing their individual tax advantages. Additionally, this arrangement simplifies the investment process for the REIT managers, as they do not have to take into account tax issues. REITs are thus a relatively attractive investment vehicle for individuals and institutions looking to invest in real estate.

The implication of the differing tax arrangements for conventional property companies and REITs is illustrated through an example, in the box below.

Box 1: The differing tax arrangements applied to conventional property companies and REITs

Assume that net income (i.e. income after operating and debt finance expenses have been deducted) is equal to \$US100. In a traditional property company, corporate tax would be charged on this full amount. Consequently, assuming that the corporate tax rate is 30%, \$US30 of the total net income would go towards state taxes.³⁴ This would leave the company with a profit of \$US70. If the company

³¹ Property development companies, by definition, tend to invest primarily in real estate.

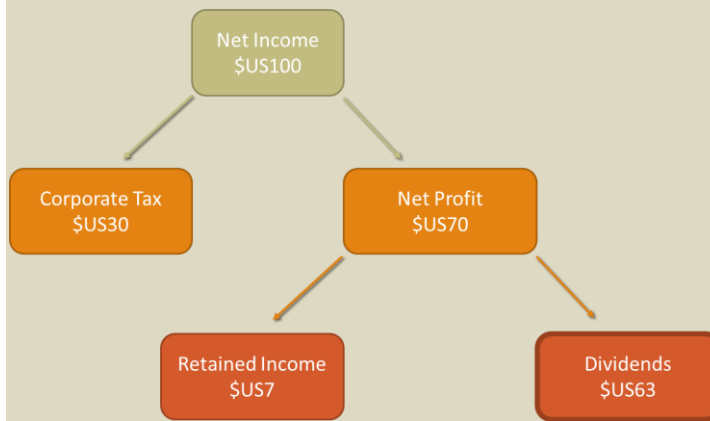
³² Institutional investors are endowed with large sums of money. They generally seek large investment targets where they can place their money and realize a steady return that isn't drained by the administrative and organizational weight of multiple projects. REITs, which seek to pool funds in order to invest in large asset portfolios, thus present an attractive option.

³³ The requirement for REITs to list on the stock exchange is relevant to some but not all jurisdictions.

³⁴ 30% of \$US100 is \$US30

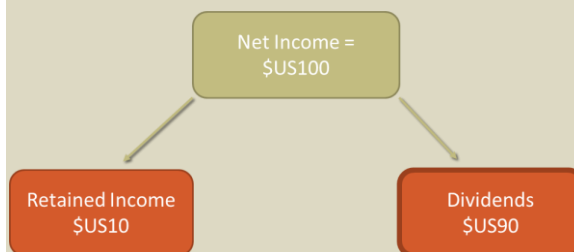
decides to distribute 90% of this profit to shareholders, total dividends (i.e. returns to shareholders) would amount to \$US63.

Figure 4: Revenue flow in a traditional property company



A REIT, on the other hand, would not be required to pay corporate tax on distributable earnings (in most countries). Consequently, if net income is equal to \$US100, \$US100 could potentially be distributed as dividends. If the company decides to distribute 90% of this profit to shareholders, total dividends would amount to \$US90. This illustrates that the tax arrangements available to a REIT result in significantly higher returns to investors.

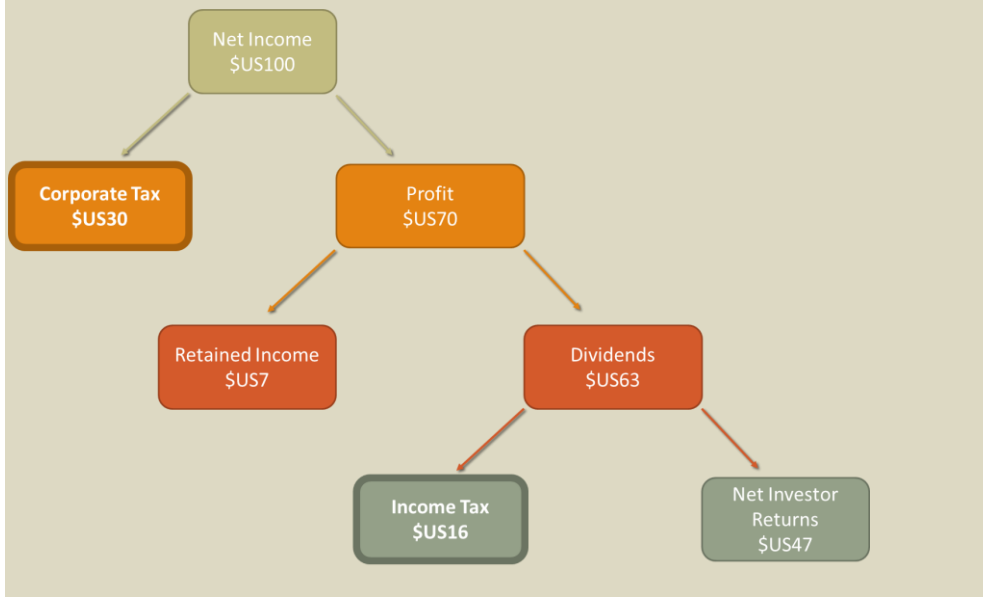
Figure 5: Revenue flow in a REIT



It is also important to illustrate how the various tax arrangements impact total government revenue. In the above example, the government would receive the \$US30 corporate tax from the traditional company plus the income tax payable by the individual investors on the \$US63. Assuming that income tax is 25%, government would receive total revenue of \$US46.³⁵

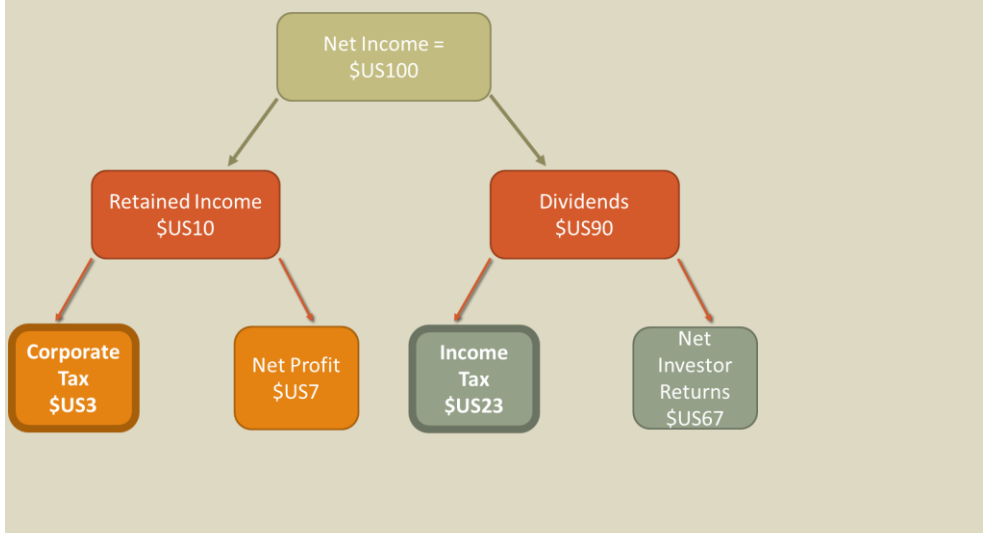
³⁵ \$US30 plus \$US15,75

Figure 6: Government revenue from a traditional property company



On the other hand, in the context of the REIT, government revenue would primarily flow from the income tax paid by investors on the distributed \$US90. Assuming once again that the income tax rate is 25%, government would receive \$US23 in revenue.³⁶ Additionally, in some jurisdictions, the government would receive the 30% corporate tax on the \$US10 of profit that the REIT elected not to distribute as dividends i.e. an additional \$US3. Government would thus earn a total revenue of \$US26. In this example, which assumes the income tax rate to be lower than the corporate tax rate, government income is negatively impacted by the REIT tax arrangements.³⁷

Figure 7: Government revenue from a REIT



³⁶ 25% of \$US23

³⁷ It is important to note that government revenue from a REIT would be even lower in a case where shareholders had structured their investment in a tax efficient manner. Pension funds, for example, are not subject to tax on such distributions in South Africa.

REITs are also **exempt from capital gains tax**.³⁸ This means that if a REIT decides to sell one of its properties, it will not be required to pay tax on the profits from the sale. Therefore, in theory, REITs can realise their portfolio in cash terms and do not need to have a built in discount to their Net Asset Value (NAV) per share. REITs will thus have a tendency to trade at prices closer to their NAV than property companies.⁴⁰

Stevenson (2013) argues that while this tax transparency certainly provides advantages to investors, it is “the regulations that REITs have to comply with to obtain tax transparency that endows them with their key investment characteristics”. The key regulations in place in the US market, from which most global regulations have followed, assert that:

- **75 % of the REIT’s assets and income must be derived from real estate, and**
- **a minimum of 90 % of the taxable income must be paid out as dividends.**

This dividend requirement makes the REIT vehicle particularly attractive to investors. Indeed, as a consequence of this requirement, REITs tend to pay out **high dividend yields** relative to conventional property companies. Furthermore, given the nature of the underlying assets in traditional REITs and their income flows, the **dividends tend to be relatively stable**.⁴¹ In other words, because REIT income often comes from rental properties with long lease periods, REITs can offer a relatively predictable revenue stream.⁴²

The high and regular nature of such dividend payments are similar in many respects to coupon payments in the bond sector. This results in REITs “having bond like characteristics in their investment dynamics”.⁴³ In other words, the REIT structure allows for real estate investments to both look and act like bonds, and thus gives rise to an investment entity that investors understand and trust.

Further REIT features attractive to investors include:

- **Diversification:** Through pooled capital funds, REITs are able to diversify their property portfolio. In other words, REITs allow individual investors (with limited funds) to balance their portfolios through diversification.⁴⁵
- **Liquidity:** Listed REITs allow for quick access to and exit from various investments via the share trading platform of a listed stock exchange.⁴⁶ This in turn results in a more efficient allocation of capital resources.⁴⁷
- **Regulation and good governance:** With respect to publically traded REITs, financial statements and other relevant information must be made available to investors and lenders, and must comply with strict reporting requirements and regulations.⁴⁸

The defining characteristics of a REIT, including the regulatory and tax frameworks and the benefits to investors, and the way in which these relate to the REIT’s operations and shareholders’ income flows are captured in the figure below.

³⁸ Capital gains refer to the profit realized on the sale of a non-inventory asset that was purchased at a cost amount that was lower than the amount realized on the sale. In the context of an equity REIT, for example, capital gains may arise when the REIT sells off one of its properties.

⁴⁰ Stevenson, S. (2013) Real Estate Investment Trusts in Europe: Evolution, regulation and opportunities for growth. Springer

⁴¹ Stevenson, S. (2013) Real Estate Investment Trusts in Europe: Evolution, regulation and opportunities for growth. Springer

⁴² Stevenson, S. (2013) Real Estate Investment Trusts in Europe: Evolution, regulation and opportunities for growth. Springer

⁴³ Stevenson, S. (2013) Real Estate Investment Trusts in Europe: Evolution, regulation and opportunities for growth. Springer

⁴⁵ Ball, M., Lizieri, C. and MacGregor, B.D. (1998). The Economics of Commercial Property Markets. London: Routledge.

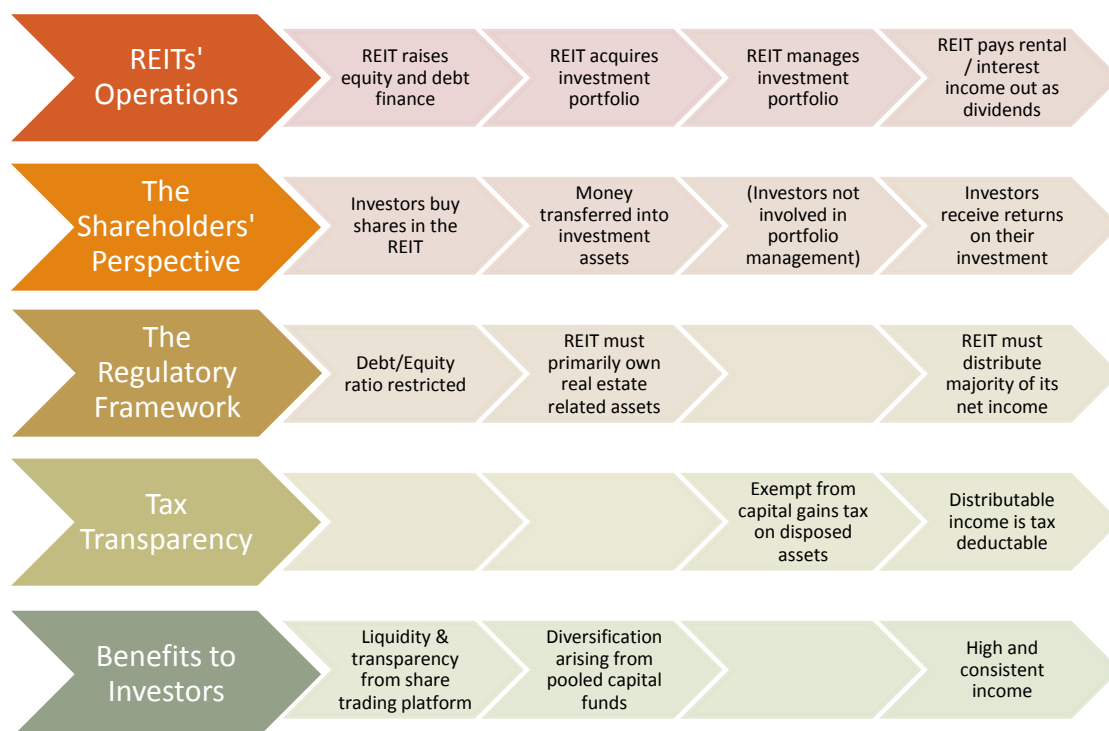
⁴⁶ The shares of REITs are more liquid than the underlying properties which constitute their portfolios.

⁴⁷ Popock, W.H. (2011) Reforming the Listed Property Investment Sector in South Africa: an analysis of the discussion paper issued by the National Treasury. University of the Witwatersrand.

⁴⁸ Ball, M., Lizieri, C. and MacGregor, B.D. (1998). The Economics of Commercial Property Markets. London: Routledge.

* In certain jurisdictions

Figure 8: Defining characteristics of a REIT



Internationally, REIT structures vary in respect of a number of factors. Each of these variations are in turn associated with distinct advantages and disadvantages.

Dividend pay-out requirements, for example, tend to vary between 85% and 100% of REIT net income. While jurisdictions requiring REITs to pay-out 100% of their net income as dividends ensure that investors receive maximum returns, they also restrict a REIT's ability to re-invest in its portfolio, and create a situation in which REITs are required to return to the equity and debt markets regularly in order to finance their expansion. Post the Global Financial Crisis, this aspect of the REIT framework has come under focus. Critics have highlighted that high pay-out requirements ignore the reality of the REIT's ability to fund capital investment requirements, and to comply with debt covenants requiring a degree of retained earnings. Furthermore, it is argued that high pay-out requirements reduce the REIT's flexibility to meet changing economic circumstances.⁴⁹

Similarly, proportional requirements with respect to the **percentage of total assets required to be invested in property** tend to vary between 50% and 100% internationally. This requirement emerges in response to the policy maker's desire to stimulate investment in real estate where it might otherwise be lacking. From a policy maker's perspective, therefore, the higher the proportional requirement the more effective the policy. There are benefits to a high proportional requirement for investors too, as the risk-return profile of an asset portfolio consisting primarily of real estate tends to be more transparent.⁵⁰ From the REIT's point of view, however, the disadvantage of a high proportional is that the REIT's liquidity is restricted, as properties cannot always quickly and easily be converted into cash.

⁴⁹ Interview with Evans Osano, FSD Africa.

⁵⁰ Property is associated with significantly different risks and returns than other types of assets.

Unlike US REITs, European and Asian REITs are additionally limited in the amount of **financial leverage** that they can use.⁵¹ Such gearing limits tend to range between 45% and 65%.⁵² REITs that are restricted by gearing limits are protected, to a certain degree, against potential cash flow problems in the context of rising interest rates or declining rental yields.⁵³ At the same time, however, such REITs' may be forced to turn to the equity markets in order to finance expansion. This in turn usually leads to near term dilution of Dividends Per Share (DPS).⁵⁴

The **management structure** of REITs also tends to differ across jurisdictions. While internally (or actively) managed REITs have the REITs' own employees managing the portfolio of assets, externally managed REITs appoint management companies or individuals who are not direct employees of the REIT to manage the portfolio of assets.⁵⁵ Proponents of the internal management model argue that such a model is better suited to ensuring that the interests of the asset owners and the interests of the asset managers of the REIT are largely aligned. Opponents of this model argue that internal management is more likely to give rise to opacity and poorer regulatory compliance. The evolution of REIT legislation has given rise mainly to actively-managed REITs in the US. While, Europe and Australia are similar in this regard, most of Asia has adopted the external management structure model.⁵⁶

Additionally, certain countries restrict the **extent of development** that a REIT can engage in at any one time to a given proportion of the REIT's total portfolio. The reason for this is that having a large amount of investment tied up in assets under development (i.e. assets that are not yet tenanted and income-generating) tends to dilute short-term returns to investors. At the same time, however, the development of new properties does have the potential to give rise to higher returns in the medium to long-term.

An alternative approach taken with respect to the issue of development by certain countries is to differentiate between **income REITs (I-REITs)** and **development or opportunistic REITs (D-REITs)**.

Income REITs, whose primary purpose is to deliver yields, invest primarily in already-developed, income-generating properties. Following their acquisition, these properties are rented out almost immediately in order to generate regular income flows, which are then distributed as dividends to investors.

Development REITs, on the other hand, are typically long-term funds that focus on capital growth. Such REITs invest in the development (i.e. construction) of properties and typically generate returns by selling off these properties once they have been developed. Development REITs are higher risk as investors don't see returns immediately, and thus require "patient capital".⁵⁷

⁵¹ Packer, Riddiough, & Shek, (2014). In Anderson, L. (2015). A Place for Residential REITs in the South African REIT market. University of Pretoria. South Africa. The term leverage refers to the phenomenon whereby a company or REIT elects to buy more assets using borrowed funds / debt finance, with the belief that the income from the asset or asset price appreciation will be more than the cost of borrowing. A gearing limit imposes restrictions on the extent of leverage that a company or REIT can employ by limiting the entity's debt to equity ratio.

⁵² A gearing limit of 65% means that a maximum of 65% of a company's total funding can be in the form of debt (as opposed to equity).

⁵³ In general, a company with excessive leverage, as demonstrated by its high gearing ratio, may be more vulnerable to economic downturns. This is because it has to make high interest payments and service its debt through cash flows that may be significantly lower due to the downturn.

⁵⁴ Using debt, on the other hand, usually leads to increase in DPS, as long as rental yield of the acquired property is higher than the interest of the debt.

⁵⁵ The effective result of this is that internally managed REITs became going concerns, as opposed to externally managed static pooled asset funds (Packer, Riddiough, & Shek, 2014).

⁵⁶ Anderson, L. (2015). A Place for Residential REITs in the South African REIT market. University of Pretoria. South Africa

⁵⁷ The fact that D-REITs often resell the properties they have developed instead of operating them as part of their own portfolios has given rise to a debate regarding whether or not D-REITs can really be considered to be REITs at all. Indeed, D-REITs typically

Finally, the precise regulations around REIT **taxation** tend to differ across countries. While some jurisdictions allow for the total exemption of corporate tax at the REIT level, other jurisdictions require REITs to pay corporate tax on undistributed income. Furthermore, the amount and type of tax that shareholders are required to pay on dividends differs across jurisdictions. Differences in taxation regulations ultimately impact investor returns (and thus the attractiveness of a REIT as an investment vehicle) and total government revenue.

Table 2 overleaf presents a comparison of the REIT structure across selected countries.⁵⁸

do not demonstrate the characteristics traditionally associated with the REIT structure, such as the generation of high and regular income and the provision of consistent, annual dividends. Development activity in the REIT context is discussed in Section 4.3.

⁵⁸ A comparison of the REIT structure across African countries follows in Section 3.8.

Table 2: REIT structure comparison across international countries^{59 60}

Countries	Management Style	Investment in Real Estate	Development	Gearing Limit	Dividend Pay-out	Tax Treatment
United States	Internal / external	Minimum 75%	Allowed	Unlimited	90%	<ul style="list-style-type: none"> Only undistributed income liable to corporate level tax. No withholding tax on domestic distributions. Resident unitholders liable to pay ordinary income tax on their distributions
Australia	Sample trust	Minimum 50%	Allowed	Unlimited	100%	<ul style="list-style-type: none"> Only undistributed income taxed at 46.5%. No withholding tax on domestic distributions. Resident unitholders liable to pay tax on their share of the taxable income.
Canada	Internal	Minimum 80%	Allowed	Unlimited	85%	<ul style="list-style-type: none"> Only undistributed income taxed at commercial federal & provincial rates. No withholding tax on domestic distributions. Resident unitholders liable to pay tax on their share of the income and capital gains.
United Kingdom	Internal / external	Minimum 75%	Allowed	65%	95%	<ul style="list-style-type: none"> Not subject to tax on income earned or capital gains tax realised in respect of rental assets. Unitholders liable to pay 20% withholding tax on dividends derived.
Netherlands	Internal	100%	Minimal	60%	100%	<ul style="list-style-type: none"> FBI's are exempt from corporate tax. Dividends paid by a FBI are subject to 15% dividend withholding tax. Dividends and capital gains derived by domestic substantial interest holders are subject to a flat tax rate of 25%. Income derived from non-substantial interest holders are subject to a 1.2% tax.
Singapore	External	Minimum 70%	Max 20% of assets	60%	90%	<ul style="list-style-type: none"> Only undistributed income assessed to final tax. No withholding tax on domestic distributions Resident unitholders liable to pay tax on their share of the taxable income.
Hong Kong	Internal / external	100%	Not allowed	45%	90%	<ul style="list-style-type: none"> Exempt from profits tax. But Hong-Kong based property subject to property tax. No withholding tax. Distributions received from a REIT are not subject to tax.

⁵⁹ Boshoff, D. and Bredell, E. (2013) Introduction of REITs in South Africa: Transformation of the Listed Property Sector. Advanced Research in Scientific Areas.

⁶⁰ Popock, W.H. (2011) Reforming the Listed Property Investment Sector in South Africa: an analysis of the discussion paper issued by the National Treasury. University of the Witwatersrand. Available at: <http://146.141.12.21/handle/10539/10491?show=full>

2.3 Residential REITs

REITs are classified according to the type of property that they invest in. Traditional property types include office, retail, residential and industrial property. In recent times, the REITs investment universe has expanded to include warehouses, storage, hotels, serviced apartments, theme parks, theatres, stadiums, hospitals, timber plantations, vineyards, airports, ports, army bases, and university buildings.⁶¹

Focused REITs invest exclusively in one type of property. A residential REIT, which is a type of focused REIT, invests exclusively in residential properties (usually rental apartment buildings), and traditionally owns and often manages these properties. Some residential REITs specialize in different geographic markets or classes of properties, such as student housing, senior housing, affordable housing and luxury housing.⁶²

Diversified REITs' portfolios, on the other hand, incorporate a variety of property types, and therefore may include residential property together with other types of property.

Occasionally, **a focused REIT may emerge from a diversified REIT.** For example, a diversified REIT may initially "incubate" a number of residential properties within its larger property portfolio before establishing an independent residential REIT. The purpose of such an exercise is usually to build the scale and develop the experience required for the establishment of a focused REIT that is able to attract investor interest.⁶³

Residential Property as an Investment Asset

The investment asset in the context of equity residential REITs is residential property. As an investment asset, **residential property is associated with distinct strengths and weaknesses.**

According to Newell et al (2015) the **principal rationale for investing in residential property** is the **returns profile. Development potential, stability of income, capital value stability, and lower obsolescence** have also been identified as major attractions for institutional investment in residential properties.⁶⁴ These advantages would apply to residential property in the context of direct ownership, traditional property companies, as well as the REIT structure.

A further consideration for investors is the **inflation-hedging effectiveness** of residential property investment. In particular, long-run institutional investors such as pension funds and insurance companies view inflation-hedging as a highly desirable attribute.⁶⁵ This issue has been thoroughly explored in the literature (Fama and Schwert's (1977); Anari & Kolari (2002); Bond & Seiler (1998); Huang & Hudson-Wilson (2007); Hutchison (1994); Stevenson (2000); Lee (2014)). This body of research largely indicates that in the US, UK and Malaysia, investment in residential property offers an effective hedge against inflation over the long

⁶¹ Interview with Evans Osano, FSD Africa

⁶² REIT.com. REIT Sectors. Available at: <https://www.reit.com/investing/reit-basics/reit-sectors>

⁶³ For example, SA Corporate Real Estate Fund, which already owns a large portfolio of rental flats in Johannesburg's inner city (many of which were acquired when SA Corporate bought over AFHCO in 2014), plans to separately list its housing interests once its residential portfolio has doubled in size to approximately R3bn (Muller, 2015).

⁶⁴ Newell, G., Lee, C.L. and Kupke, V. (2015) The opportunity of unlisted wholesale residential property funds in enhancing affordable housing supply, AHURI Final Report No.249. Melbourne: Australian Housing and Urban Research Institute Limited. Available from: <<http://www.ahuri.edu.au/publications/projects/p72031>>.

⁶⁵ Lee, C L & Reed, R 2014, 'The relationship between housing market intervention for first-time buyers and housing price volatility', *Housing Studies*, vol.29, no.8, pp.1073–1095.

term. However, research conducted in high-inflationary environments does not reach the same conclusion.⁶⁶

At the same time, investing in residential property is also associated with **certain disadvantages**. Research undertaken by Crook et al (1998) and IPF (2014) in the United Kingdom (UK), and Milligan et al. (2013) in Australia, indicates that institutional investor managers are reluctant to enter into the private rental market for a wide range of reasons including:

- poor and greater costs of housing management relative to commercial property;
- insufficient market size;
- illiquidity;
- reputational risk; and
- political risk.

Consequently, in the UK and Australia, institutional investors require a higher rate of return for investment in residential rental property as compensation for the perceived higher level of risk.⁶⁷

Comparable findings have been reported by Crook and Kemp (2002), Berry et al. (2004), Lawson, Gilmour and Milligan (2010), Lawson, Milligan and Yates (2012) and Milligan et al. (2004), in which **low rental yield, high taxes, poor liquidity, higher investment risk, reputational risk, management issues, a lack of sufficient scale, the dearth of market information, poor housing management and political risk** have been widely recognised as key obstacles for institutional investment in residential properties.⁶⁸

Most of these studies consider residential investment in the context of direct ownership and / or traditional property companies. The **REIT structure has the potential to mitigate some of these disadvantages**. For example the tax transparency of the REIT structure effectively ensures that high taxes are not an issue in the context of residential REITs. Furthermore, the trading of REIT shares on the stock exchange introduces liquidity into residential property investment. Additionally, the pooling of multiple investors' money in the establishment of a portfolio of properties addresses the challenge of scale.

Finally, it must be noted that the aforementioned papers **do not consider residential property investment in the African context**. Given the high rates of urbanisation in Africa and the growing African middle-class, residential REITs would emerge in the context of significant market demand and could potentially contribute to the development of a substantially sized residential market. Residential REITs in the African context are further explored in section 3.

Sectoral Growth Analysis

Despite the above mentioned disadvantages of investing in residential property, the residential property sector comprises a significant proportion of listed property markets in both developed and emerging markets. The figures below illustrate the breakdown in total

⁶⁶ For example, research conducted in high-inflationary environments in Turkey suggests that in such a context residential real estate does not necessarily provide an effective hedge against inflation (Onder, Z. (2010) High inflation and returns on residential real estate: evidence from Turkey. Available at <http://www.tandfonline.com/doi/abs/10.1080/000368400322255>)

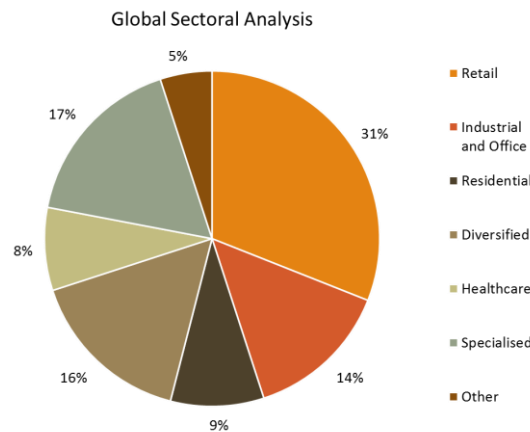
⁶⁷ Newell, G., Lee, C.L. and Kupke, V. (2015) The opportunity of unlisted wholesale residential property funds in enhancing affordable housing supply, AHURI Final Report No.249. Melbourne: Australian Housing and Urban Research Institute Limited. Available from: <<http://www.ahuri.edu.au/publications/projects/p72031>>.

⁶⁸ Newell, G., Lee, C.L. and Kupke, V. (2015) The opportunity of unlisted wholesale residential property funds in enhancing affordable housing supply, AHURI Final Report No.249. Melbourne: Australian Housing and Urban Research Institute Limited. Available from: <<http://www.ahuri.edu.au/publications/projects/p72031>>.

listed property market capitalisation by sector in developed (global) and emerging markets.

Figure 9 illustrates the outcome of a sectoral analysis using the Morgan Stanley Capital Group International (MSCI) global property index. Globally, the residential sector comprises 9% of the global listed property market, whilst retail is the predominant sector.⁶⁹

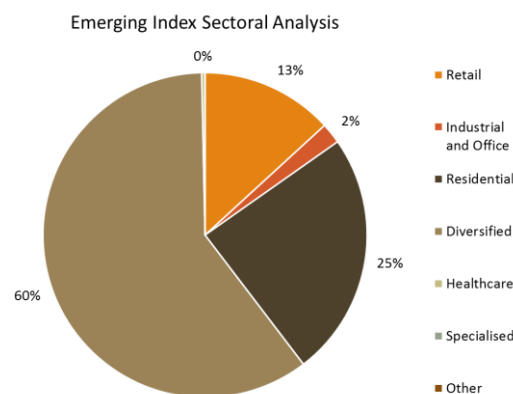
Figure 9: MCSI Global Index



Source: Mclver (2014)

Figure 10 illustrates that the residential sector comprises 25% of listed property markets in emerging countries. This is significantly higher than the relative size of the residential sector in the context of developed markets.⁷⁰

Figure 10: FTSE EPRA/NAREIT Emerging Index



Source: Mclver (2014)

⁶⁹ The country contribution weighting of the MSCI index is as follows: Australia (10.38%); France (5.96%); Japan (4.1%); UK (6.03%); USA (68.92%); other (4.61%).

Anderson, L. (2015). A Place for Residential REITs in the South African REIT market. University of Pretoria. South Africa.

⁷⁰ The emerging index is obviously much smaller in terms of scale. The country contribution weighting of the Emerging index is as follows: Brazil (11.9%); Chile (0.69%); China (28.71%); Czech Republic (0.03%); Egypt (0.18%); India (1.7%); Indonesia (5.48%); Malaysia (6.17%); Mexico (5.12%); Philippines (6.93%); Poland (1.15%); Russia (3.78%); South Africa (11.86%); Taiwan (0.14%); Thailand (4.8%); Turkey (2.13%); UAE (9.43%).

Anderson, L. (2015). A Place for Residential REITs in the South African REIT market. University of Pretoria. South Africa.

In the context of the residential listed property market, residential REITs in particular are proving to be an increasingly popular vehicle for investment in a number of countries.

Residential REITs make up the second largest REIT sector in the US, accounting for US\$95 billion and 15 per cent of the equity REIT market capitalisation as at June 2014.⁷¹ In fact, residential REITs in the US have doubled in number since 1980 and have grown at a rate of twice that of the full universe of REITs in the USA.⁷² The growing popularity of Residential REITs in the US can be explained by the strong performance that they have exhibited. Indeed, US residential REITs have given rise to an average return of 23.2 per cent per annum over the last five years, exceeded only by retail REITs (23.3% p.a.).⁷³ These residential REITs predominantly invest in apartments, with a focus on mobile, affluent markets and growth cities.

Canada and Japan constitute two additional countries in which residential REITs have flourished. In Canada, two of the top ten REITs are residential REITs. Together, Canada's three residential REITs have nearly 500 properties with over 87,000 apartments.⁷⁴ In Japan, residential REITs are the second largest REIT sub-sector, accounting for 14 per cent of the market capitalisation. Of the 45 Japanese REITs (J-REITs) at June 2014, there were 11 residential REITs and another five J-REITs with a significant residential component in their diversified portfolios.⁷⁵

Focused residential REITs have also begun to emerge slowly in Singapore and France, as well as in emerging countries such as South Africa, Nigeria and Tanzania.⁷⁶

Conditions for Residential REITs to Succeed

Although residential REITs are emerging in a number of markets, research suggests that not all markets possess the characteristics necessary for residential REITs to thrive.

The distinguishing features of markets that are conducive to the emergence and success of residential REITs are explored by Jones (2007). Jones investigates the challenges that arise when introducing residential REITs into new markets, by comparing the successful case of the United States of America with the unsuccessful case of Australia.

Jones suggests that in order to succeed residential REITs require a **high demand environment**, characterized by a **flourishing private rental sector**. At the same time, however, the presence of certain supply side factors such as **large-scale landlords** are also a necessary condition. Jones further argues that a **well-established rental market with depth** is a prerequisite for attracting large commercial owners.⁷⁷

Nevertheless, existing literature exploring the conditions required for residential REITs to succeed is limited. This study will, amongst other things, test Jones' (2007) findings, and

⁷¹ Newell, G., Lee, C.L. and Kupke, V. (2015) The opportunity of unlisted wholesale residential property funds in enhancing affordable housing supply, AHURI Final Report No.249. Melbourne: Australian Housing and Urban Research Institute Limited. Available from: <<http://www.ahuri.edu.au/publications/projects/p72031>>.

⁷² Cotter & Roll (2015 p. 214) in Anderson, L. (2015). A Place for Residential REITs in the South African REIT market. University of Pretoria. South Africa.

⁷³ NAREIT (2014) in Newell, G., Lee, C.L. and Kupke, V. (2015) The opportunity of unlisted wholesale residential property funds in enhancing affordable housing supply, AHURI Final Report No.249. Melbourne: Australian Housing and Urban Research Institute Limited. Available from: <<http://www.ahuri.edu.au/publications/projects/p72031>>.

⁷⁴ EPRA (2014) in Newell, G., Lee, C.L. and Kupke, V. (2015) The opportunity of unlisted wholesale residential property funds in enhancing affordable housing supply, AHURI Final Report No.249. Melbourne: Australian Housing and Urban Research Institute Limited. Available from: <<http://www.ahuri.edu.au/publications/projects/p72031>>.

⁷⁵ APREA (2014)

⁷⁶ REITs in Africa are explored further in Section 3.

⁷⁷ Jones (2007) in Anderson, L. (2015). A Place for Residential REITs in the South African REIT market. University of Pretoria. South Africa.

further elaborate on the conditions necessary for residential REITs to succeed in various African contexts.

2.4 The Developmental Potential of Residential REITs

At a macro-economic level, the introduction of the highly transparent, well-regulated, tax-efficient REIT structure into the real estate sector of a country has the potential to stimulate additional capital flows into the country's property markets, thus positively impacting the job market and business dynamism of an economy.⁷⁸

At a microeconomic level, REITs provide an opportunity for private investors to play a significant role in the provision of a country's commercial offices, industrial premises, retail real estate, residential units, and health care facilities. In other words, the REIT structure has the potential to serve as an effective policy tool for channelling professionally managed capital into the delivery and operation of the built environment.⁷⁹

Residential REITs in particular represent an alternative mechanism for attracting institutional investment and raising capital in the context of housing, thus increasing the quality, supply and affordability of residential properties.⁸⁰ Indeed, the US experience provides a prime example of the potential for residential REITs to support the creation of portfolios of rental properties to meet the demands of renters. The focus of this study is the extent to which the residential REIT structure represents a potential vehicle for channelling investment into affordable housing in particular.

Much of the existing research exploring affordable housing REITS has been undertaken with relation to housing markets in developed countries. In the context of such research, affordable housing generally refers to housing provided (often at subsidised rates) for low-income or disadvantaged households, and generally comprises a relatively small segment of the overall housing market.

This body of literature tends to emphasize the challenges associated with the use of the REIT structure in the context of low-income housing markets. Sceptics of "affordable housing" REITs argue that such REITs are financially unviable due to the low rentals necessitated by such markets, which in turn correspond to low returns. Consequently, it is argued that REITs investing in affordable housing would be less attractive to investors than the more traditional types of investment vehicles.

These concerns were effectively captured in a piece of research conducted by Newell & Lee (2014) that analysed the risk-adjusted performance of social housing in the Netherlands for the period 1999–2013. In the Netherlands, social housing is defined as the provision of housing at below market price to a target group of disadvantaged people or socially less advantaged groups, as well as to certain categories of key workers.⁸¹

⁷⁸ Darby, C. (2005) The economic impact of establishing a listed real estate industry. Available at: <http://www.nareit.com>

⁷⁹ Kenney, A. (2013). EPRA Releases Annual Global REIT Survey. Available at: <http://www.reit.com>

⁸⁰ Newell, G., Lee, C.L. and Kupke, V. (2015) The opportunity of unlisted wholesale residential property funds in enhancing affordable housing supply, AHURI Final Report No.249. Melbourne: Australian Housing and Urban Research Institute Limited. Available from: <http://www.ahuri.edu.au/publications/projects/p72031> and Milligan, V., Yates, J., Wiesel, I. & Pawson, H. (2013) Financing rental housing through institutional investment – volume 1: outcomes from investigated panel. Melbourne: Australian Housing and Urban Research Institute, AHURI Final Report No. 202.

⁸¹ Approximately 75% of the 3 million rental homes in the Netherlands belong to housing associations. These associations are responsible among other things for letting social housing, defined as homes for which the initial monthly rent is under the rent limit for liberalised tenancy agreements (private sector); the current limit is €710.68 (in 2016). Each year, housing associations must let 80% of their vacant social housing to people with an income of up to €35,739 (in 2016) and 10% to people with an income of between €35,739 and €39,874 (in 2016). The associations may let 10% of their social housing to households with higher incomes.

Government of the Netherlands. Housing. Available at: <https://www.government.nl/topics/housing/contents/rented-housing>

This research compared the performance of social housing, which comprises 35 per cent of total housing stock,⁸² against the other property sectors as well as shares and bonds. The risk-adjusted performance analysis between the years 1999 and 2013 is given in the table below.

Table 3: Risk-adjusted performance analysis (1999 - 2013)

Asset class	Average annual return	Annual risk	Sharpe ratio	Performance rank
Bonds	3.7%	1.12%	1.18	1
Property	7.49%	5.31%	0.96	2
Listed property	4.7%	4.01%	0.58	3
Social housing	4.3%	4.53%	0.43	4
Shares	2.1%	24.8%	-0.01	5

Source: Newell et al (2015)

Although social housing gave rise to a lower risk level (4.53%) than commercial property and shares, it ultimately demonstrated a relatively poor risk-adjusted performance due its low average annual returns (4.3%). It emerged as the #4 ranked asset, exceeded by bonds (#1), commercial property (#2) and listed property (#3). Interestingly, its risk-adjusted performance was still higher than shares. Similarly, when compared to other property types, social housing emerged as the worst performing property sector (ranked at #5).

While the above analysis brings to light the challenges facing subsidized, low-income housing as an asset class in developed countries, it is important to highlight that this type of housing cannot be directly compared with affordable housing in developing countries. This is because, in the African context in particular, the term 'affordable housing' more broadly refers to the market segment of accommodation that is affordable for the majority of the population – and not to accommodation that is necessarily subsidized or provided at below market prices. This change in context has implications for the risk-reward profile (and thus viability) of affordable housing REITs in Africa, which will further be explored in Sections 3 and 4.

Nevertheless, the experience of developed countries with affordable housing REITs still influences how investors approach what is called "affordable housing." The experience also contains valuable lessons for the broader implementation of affordable housing REITs. Presented below are three case studies exploring the ways in which the US, UK and Canada have experimented with various REIT models to support the provision and management of affordable housing.

⁸² Aedes (2013) Dutch social housing in a nutshell. Brussels: Aedes, Dutch Association of Social Housing Organisation.

Case Study 1: Housing Partnership Equity Trust - United States

Although there are now over 200 publicly traded REITs in the United States, of which 21% are residential in nature, affordable housing REITs were virtually unknown in the US until recently. In 2012, however, the Housing Partnership Equity Trust (HPET) was established as a private REIT⁸³ for use by members belonging to the Housing Partnership Network (HPN).⁸⁴

HPET is the country's first social venture REIT owned by non-profits. It operates in partnership with 12 high-performing, non-profit housing providers (i.e. the trust's members), who collectively own and operate 65 000 housing units in markets across the United States.

HPET's mission is to positively impact the communities in which it operates by preserving the stock of affordable and sustainable rental housing for low- and moderate-income residents. More specifically, it focuses on unsubsidized affordable rental housing properties in high-opportunity areas that are cash flow positive. In some cases, these properties are former low-income housing tax credit (LIHTC) properties whose income restrictions are expiring and which are in need of major rehabilitation.⁸⁵

What makes HPET's platform unique is its liquidity. Unlike a developer arranging an LIHTC deal that can take up to 18 months to close, HPET can deploy capital more quickly.⁸⁶ Participation in the REIT thus enables members to compete in a fast moving marketplace with for-profit developers by providing timely access to financing to purchase rental properties. Indeed, by aggregating capital from private markets, foundations and members, HPET participants can quickly bid on properties without needing to first assemble complex financing packages.

HPET was first launched with an investment of \$100 million from Citi, Morgan Stanley, Prudential Financial, the MacArthur Foundation, and the Ford Foundation. According to HPET's Chief Executive Officer (CEO), these "impact investors" were seeking triple-bottom-line returns — a return on the trust's mission to preserve affordable housing, sustainability returns through energy efficiency upgrades the trust makes to its portfolio, and an economic return through consistent long-term dividends.⁸⁷

The initial capital raise of \$100 million resulted in the purchase of six properties, representing over 1,100 units of affordable rental housing. In addition to maintaining the properties as affordable rental housing, HPET members took steps to upgrade the properties and keep them 'green'.

In 2015 HPET sought to expand its donor base with investments from a new class of social impact investors. Since then, the trust has raised another \$50 million, which it expects to deploy by the end of this year.

HPET is incorporated as a Limited Liability Company (LLC) and has four real estate finance professionals as staff. HPN, as sponsor, provides business and human resource (HR) services. A nine-member Board of Directors governs HPET. HPET is set up as a two-tier structure where the trust acts as the upper tier and the non-profit members are the lower tier. HPET makes joint venture investments with its lower tier members who acquire and operate the acquired properties.

⁸³ Private REITs issue shares that are neither traded on national exchanges nor registered with the SEC, but rather issued pursuant to one or more of several exemptions to the securities laws set forth in regulations promulgated and enforced by the SEC. These exemptions include rules set forth under Regulation D, permitting an issuer to sell securities to "accredited investors," and Rule 144A, which exempts securities issued to qualified institutional buyers (QIBs). (<https://www.reit.com/investing/reit-basics/guide-private-reits>)

⁸⁴ Housing Partnership Network is a member-driven business collaborative of the leading housing and community development nonprofits in the US. It seeks to combine social mission with private enterprise to develop solutions to challenging housing problems.

⁸⁵ Pyati, A. (2016) Impact Investing Platforms Create New Equity Streams for Affordable Housing. UrbanLand.

⁸⁶ Pyati, A. (2016) Impact Investing Platforms Create New Equity Streams for Affordable Housing. UrbanLand.

⁸⁷ Pyati, A. (2016) Impact Investing Platforms Create New Equity Streams for Affordable Housing. UrbanLand.

HPET recently paid out its first round of dividends—a total of \$1.32 million—to its investors.⁸⁸ HPET's CEO argues that the REIT is "well on its way towards acquiring and preserving \$1 billion in apartment buildings over the next five years with a combined 12 500 or more units available to police and teachers, waiters and nurses aides and people on fixed income".⁸⁹ He suggests that HPET's experience has proven that "impact investors can do the right thing for society, mitigate their risk and still make a decent return".⁹⁰

It is important to note that HPET targets a spectrum of investors. On the one end of the spectrum are impact investors with a complete mission focus, and on the other end of the spectrum are economic investors with more of a return focus. Although HPET's early investors were primarily impact-driven foundations, the REIT's strategy is to increasingly appeal to return-focused investors by growing the efficiency of the platform and increasing its profitability.

HPET perceives that the ability to expand its disclosures and increase the liquidity of the investment as key to expanding its investor base. With respect to the latter, investors need to feel confident that they can enter into and exit from the investment as they need to. According to HPET's director, Drew Ades, the early capital commitment from the MacArthur Foundation provided a degree of guaranteed liquidity and minimized risk for other investors. HPET is now focusing on demonstrating to investors that there is a plan and a path to further increase its size to a point at which it will have market-recognized liquidity.⁹¹

Additionally HPET is seeking to address existing negative perceptions regarding the affordable housing space. Ades states that while investors tend to perceive affordable housing as a riskier investment – because of the lower rent and the renting base at which it's targeted – this is a fundamental misunderstanding. In reality, there is "essentially an infinite demand for affordable housing", and a 10 million-unit shortage. Consequently, "if you've got affordable housing and you've got good operators that know how to keep the building operating appropriately, there's always going to be demand and the risk of any transaction is actually very low." Ades asserts that in practise affordable housing's risk profile is on par with other core assets. HPET is thus focusing on educating investors on the risk profile of what they're investing in.⁹²

Case Study 2: Responsible Residential Investment – Canada

Canadian residential REITs have been in wide use in the real estate sector since the early 1990's. At present, three independent organizations are pursuing the establishment of an affordable housing REIT: Responsible Residential Investment (RRI), Trillium Housing, and Affordable Rental Fund.

RRI is a standard limited partnership, whose purpose is to acquire mid-size multi-family rental properties in Quebec that need capital improvements. As of 2014, it was looking for capital investment that would enable the partnership to acquire unsubsidized affordable rental housing properties. In particular, RRI was targeting smaller rental apartment buildings with communal facilities, which were not professionally managed and suffered from deferred maintenance or poor leasing policies. RRI saw an opportunity to introduce professional management into such buildings, thereby improving residents' quality of life.

⁸⁸ HPET declared its first regular quarterly dividend for the third quarter of 2015 on its Class A preferred units of \$1,202.22 per unit, and on its Class D preferred units of \$236.06 per unit. The company also announced that the Board of Directors declared a special dividend on its Class A preferred units of \$5,987.54 per unit, and a special dividend on its Class D preferred units of \$15.30 per unit. Subsequently, HPET declared its first quarterly dividend for the third quarter of 2015 on its Class B common units of \$891.01 per unit. HPET also announced that the Board of Directors declared a special dividend on its Class B common units of \$4,800.88 per unit.

⁸⁹ Ades, D. Private Investment Can Earn a Return And Help Solve Our Affordable Housing Crisis. Your Mark on the World Center.

⁹⁰ Ades, D. Private Investment Can Earn a Return And Help Solve Our Affordable Housing Crisis. Your Mark on the World Center.

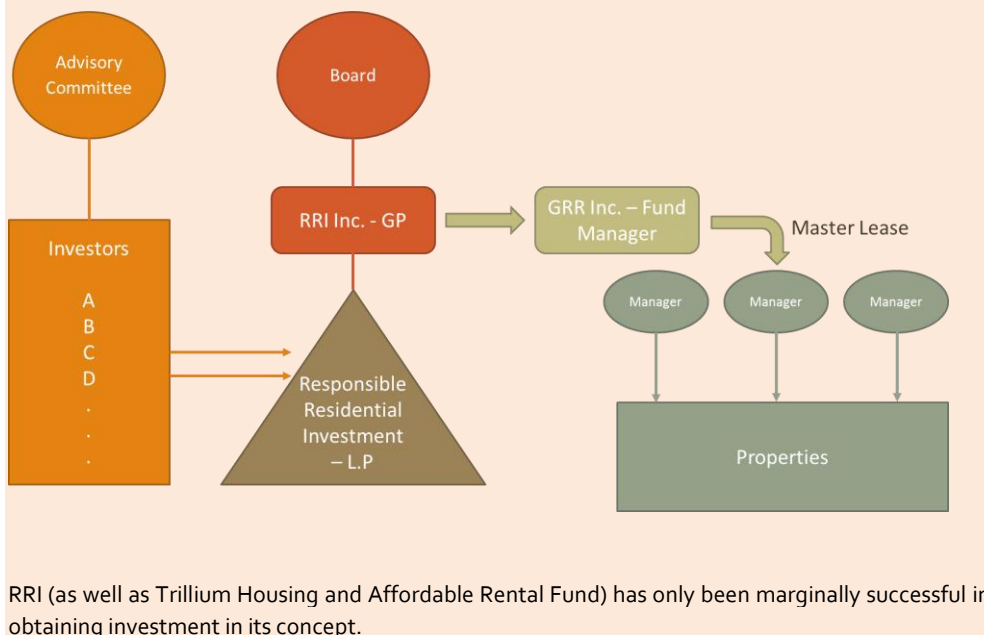
⁹¹ Ades, D. (2016) Q & A with Drew Ades, Housing Partner Equity Trust. Available at: <http://strengthmatters.net/blogs/news/q-a-with-drew-ades>

⁹² Ades, D. (2016) Q & A with Drew Ades, Housing Partner Equity Trust. Available at: <http://strengthmatters.net/blogs/news/q-a-with-drew-ades>

RRI is seeking investors such as pension funds, foundations and high net-worth individuals, as limited partners. It hopes to attract such investors by offering them positive and growing cash flow, and stable, counter-cyclical investment.

The following corporate structure (illustrated in Figure 11) is envisioned. RRI Inc, as general partner, would contract with GIRR Inc. as fund manager. It would then enter into a master lease agreement with non-profit affordable housing owners, who would manage the properties on an ongoing basis. The purpose of the partnership would be to acquire and maintain the properties for the long term, thus retaining them as affordable rental housing.

Figure 11: Envisioned corporate structure of RRI



RRI (as well as Trillium Housing and Affordable Rental Fund) has only been marginally successful in obtaining investment in its concept.

Case Study 3: Houses for Homes – United Kingdom

REITs in the UK, which were largely non-existent until 2007, face stiff competition from other investor options in the context of the social housing sector. Such investor options include bonds that provide a return of 5-6%, and equity investments that provide returns of about 7%.⁹³

In 2012, the government introduced significant changes to the law that simplified the process for companies converting into REITs. That same year, the UK government entered into a public consultation process, with the purpose of exploring the potential role that social housing REITs could play to support the social housing sector.⁹⁴

The first UK social housing REIT, Houses4Homes (HFH), was established in 2013. HFH represents an innovative solution to funding the development and provision of social housing stock via registered social landlords (RSLs) and local authorities. Its mission is to reduce the cost of housing, without compromising on standards, quality or choice, whilst at the same time providing a safe and ethical fund for institutional and private investors.⁹⁵

⁹³ Appendix A explores other funding structures that compete with the REIT structure in the context of housing.
⁹⁴ HM Treasury. (2012) Consultation on reforms to the real estate investment trust (REIT) regime. Available at: <http://www.hm-treasury.gov.uk>
⁹⁵ <http://www.housesforhomes.co.uk/funding/faq/>

HFH's business model seeks to raise capital from institutional investors (i.e. pension funds and insurance companies), and to use the capital to buy and develop housing stock (either freehold or leasehold). In addition to the equity received from institutional investors, HFH funds its housing through monies from the capital markets. As a listed company commissioning at scale, it accesses the capital markets obtaining better than retail rates.⁹⁶

With respect to the development of housing stock, HFH commissions housing to customers' specifications, develops strategic relationships with social house builders, and manages the process to ensure that the housing is delivered on time and on cost. Because HFH commissions housing in large numbers and due to its unique purchasing arrangement it obtains discounts. HFH then holds the housing stock in a trust, and leases the stock to registered housing providers on full repairing leases. The housing providers, in turn, lease the properties to their tenants and add on management charges to the cost of the original building leases.

Upon its establishment, HFH faced a "credibility gap". Investors wanted to see evidence that there was a real housing demand, and they wanted this housing demand to carry no development risk – in other words, they wanted to buy the output or rental yield. H4H thus had to demonstrate the demand by building up a development pipeline large enough to interest investors. In response to this need, H4H began forging relationships with the Homes and Community Agency (HCA), the social housing regulator, and local authority and housing providers, in order to agree terms to allow for the transfer of existing stock from providers in the sector. Furthermore, because the investors wanted development risk removed from the REIT, H4H began forging relationships with developers of a range of sizes to deliver housing immediately.⁹⁷

HFH has been working steadily for a number of years to source investors and real estate holdings, and recently closed a £130 million deal with a local authority to construct homes over an 18-month period. While the H4H REIT is currently utilising interim finance (it raised £30m from local authority pension schemes), it will soon be listed on the Alternative Investment Market of the London Stock Exchange. Local authorities are also considering the possibility of using their grant funding to purchase preference shares in the REIT.⁹⁸

The manner in which various countries have made use of the REIT structure to channel investment into meeting the housing needs of particular segments of the population is worthy of further exploration. In particular, the emergence of the Social Real Estate Investment Trust (S-REIT) in Asia, which has mobilised private sector involvement to undertake the re-housing, re-development and re-generation of urban Under Served Settlements with state facilitation, potentially holds important insights for the implementation of the REIT structure in the context of affordable housing.⁹⁹ It is proposed that the experience of Colombo, Sri Lanka with the implementation of the S-REIT constitutes a topic for a future case-study.

⁹⁶ While the larger housing providers may access bond finance at around 5.4 – 5.7%, the HFH REIT is funded at 5%.

⁹⁷ Shanks, P. (2012) A year in the life of our real estate investment trust. Housing Network.

⁹⁸ Typically, local authority grants would be paid as a form of capital investment never to be seen again. The Reit structure, on the other hand, theoretically allows grants to be invested and cashed in at the end of a social housing project's viable existence.

⁹⁹ Social Real Estate Investment Trust (S-REIT) refers to a process rather than a specific REIT. The S-REIT process works by using the market system with state action, required to ensure fair-play and orderliness and render legitimacy to the process. Interview with Evans Osano, FSD Africa.

3. The African Context

Since 1994, legislation / regulations governing REITs has been introduced into a number of African countries, including Ghana, Tanzania, Nigeria, South Africa, Kenya, Rwanda, and Morocco. While the institutionalisation of the REIT structure has given rise to around 30 REITs in South Africa since 2013, the emergence of REITs in other African countries has gone at a slower pace. Table 4 summarizes the current status of the REIT legal frameworks and REIT sectors in Africa, while Figure 12 visually captures the presence of REITs in Africa to date.

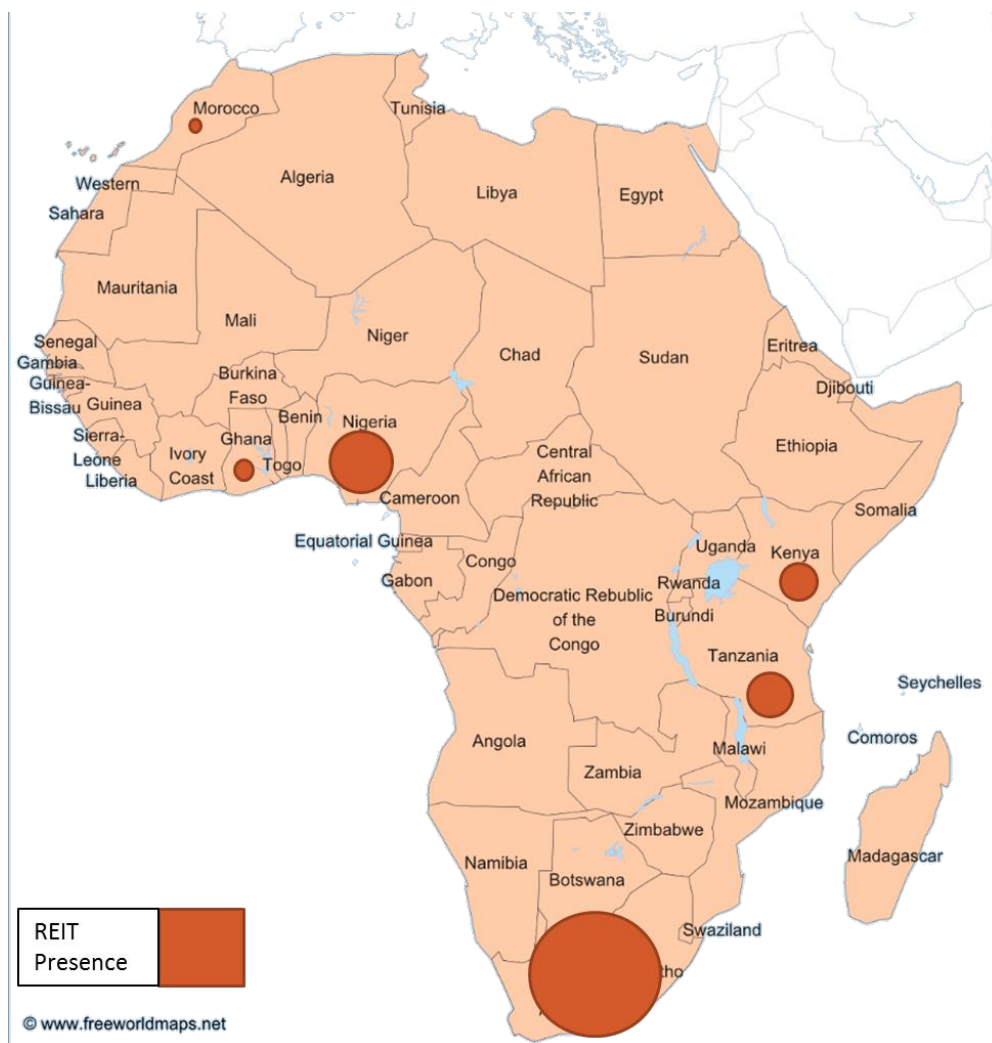
Table 4: REIT regulation and registered REITs in Africa¹⁰⁰

Country	REIT Legal Framework	Year of Establishment	Regulator	No. of Registered REITs	Size of Industry	Primary Sectors
Ghana	No specific REIT law; Securities Industry Law 1993; Securities Industry Amendment Act of 2000; the Unit Trusts and Mutual Funds Regulations 2001	1994	Securities and Exchange Commission (SEC)	1	US\$12.6 million	Residential; Commercial
Nigeria	Securities and Exchange Commission Rules and Regulations	2007	Securities and Exchange Commission (SEC)	4	US\$224 million	Residential; Commercial
Tanzania	CMS Collective Investment Scheme Real Estates Investment Trust Rules of 2011	2011	Capital Market and Securities Authority	1	US\$40 million	Residential
South Africa	25BB of the Income Tax Act No. 58 of 1962; JSE Listings Requirements for REITs	2013	Financial Services Board (FSB)	30	US\$16.1 billion	Residential; Commercial
Kenya	The Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations, 2013	2013	Capital Markets Authority	1	US\$35.5 million	Commercial
Rwanda	Regulation No. 14 on Real Estate Investment Trusts	2013	Capital Markets Authority	0	-	-

¹⁰⁰ Source: authors own compilation

Country	REIT Legal Framework	Year of Establishment	Regulator	No. of Registered REITs	Size of Industry	Primary Sectors
			of Rwanda			
Morocco	Information not available	2015 / 2016	Information not available	1	Information not available	Commercial

Figure 12: Relative presence of REITs across the African continent (by market capitalisation)



In the sections that follow, the history and characteristics of the REIT structure in various African countries are investigated. Furthermore, the health of the REIT market in each of these countries is outlined and the experiences of four selected African residential REITs are explored.

3.1 Ghana

In Ghana, a REIT is considered a Collective Investment Scheme and is governed by the Securities Industry Law 1993, Securities Industry Amendment Act of 2000, and the Unit Trusts and Mutual Funds Regulations 2001. The operation and regulation of Collective Investment Schemes fall under the supervision of the Securities and Exchange Commission (SEC) Ghana.¹⁰¹

It is important to note that in Ghana no REIT-specific regulations exists. Consequently, REITs are not subject to any tax exemptions. Rather, a REIT is governed as a Collective Investment Scheme (CIS),¹⁰² and is thus subject to the following requirements:

- With respect to capital requirements, the manager of the CIS is required to have a minimum issued and paid up capital of ₵1 billion (US\$250 million).
- Furthermore, every custodian of the CIS is required to have a minimum issued and paid up capital of ₵5 billion (US\$1.3 billion). Nevertheless, these capital requirements are subject to review by the Commission.
- The promoters of the CIS are required to set a minimum amount, subject to the approval of the Commission, referred to in these Regulations as the “minimum initial subscription” to be raised by the scheme the minimum initial subscription. The promoters are further required to guarantee the minimum initial subscription.

The board of directors of the CIS have the exclusive right to create and issue interests for the account of the scheme. The issues of interests may be subject to a prospective investor purchasing interests of a minimum number and value. The Fund Manager is responsible for the selection of assets and the management of the portfolio based on objectives stated in the trust deed.

In practise, the absence of REIT-specific legislation and regulations in Ghana has resulted in an unclear REIT framework and a tax regime that does not work well for the REIT sector. Furthermore, the REIT market faces significant challenges such as the general public’s lack of awareness and understanding with respect to REITs.¹⁰³ Consequently, only one CIS that invests primarily in real estate and classifies itself as a REIT has been established to date.¹⁰⁴

Significantly, a REIT Bill is in the pipeline and is expected to provide a better framework for the operations of REITs going forward.

¹⁰¹ Adika & Co. (2016) Real Estate Investment Trusts in Ghana.

¹⁰² Essentially, in Ghana, Collective Investment Schemes functions in place of what would be REITs. The HFC REIT, however, refers to itself as a REIT due to the fact that it invests primarily in real estate.

¹⁰³ Interview with Mr. Peter Larbi Yeboah, HFC Investment Services Limited.

¹⁰⁴ See Case Study 8: HFC REIT - Ghana

Case Study 4: HFC REIT – Ghana

Background

The HFC Real Estate Investment Trust (HFC REIT) was established by HFC Investment Services Limited in August 1994. It is an internally managed REIT, whose main objective is to provide investors with capital appreciation in a long-term diversified portfolio. Universal Merchant Bank, the trustee of the fund, is responsible for ensuring that the HFC REIT is managed effectively for the benefit of the unit holders.

HFC REIT primarily focuses on investing mobilized funds into securities of real estate companies or equity in companies that engage in real estate investment activities. The fund also holds property for rental income and engages in the development of real estate. It thus serves as an alternative investment vehicle for diversification into residential and commercial real estate activities. A proportion of the fund (39%) is invested in high-yielding short-term securities to provide liquidity.

While HFC REIT is open to the general public, and mobilises funds from individuals, groups, charities and corporate bodies, it is not listed on the Ghana Stock Exchange. Investments into the REIT and withdrawals out of the REIT are facilitated by HFC Investments or HFC Bank.¹⁰⁵ About 95% of the REIT's investors are local retail investors, while the remaining 5% are local institutional investors.

The REIT, which does not have any debt financing, does not pay out dividends or provide regular income to its investors. Rather, all income earned by the trust is added to its portfolio, which is valued daily. If investors choose to exit the trust they receive the value of their shares, which is determined during the daily portfolio valuation. In other words, HFC REIT is a long term fund. The CEO of HFC explains that this structure was chosen due to the flexibility that it provides with respect to cash flow: "One does not have to keep servicing debts or be under the pressure to return funds to investors".

Social Impact

HFC REIT was originally established with the purpose of channelling long-term funds into the development of affordable housing. It was set up to compliment the mortgage banking business of Home Finance Company Limited, which was discovering that there were not enough residential properties to finance. The fund was thus established to go into property development itself and also to finance real estate companies. More specifically, the aim was to mobilize long-term funds at a lower cost than construction finance, in order to provide developers with the flexibility required in the context of affordable housing developments. The REIT was also perceived to be an investment opportunity for prospective homeowners, who were looking to begin saving towards their down payment.¹⁰⁶

However, around 2010 / 2011, housing market dynamics shifted, making low end housing unattractive due to low return margins. Since HFC REIT's investment decisions are primarily guided by profitability, its focus subsequently shifted to the upper end of the market.

Since its establishment, the REIT has developed various low end and upper end housing projects, including over 80 executive houses and serviced plots in Communities 18, 20 and

¹⁰⁵ Once a redemption form has been submitted, the manager is obliged to redeem the units and make payments for them within a maximum of five working days at a prevailing price on the actual day of disinvestments as displayed by the manager.

¹⁰⁶ The down-payment was 20% of the property value at the time.

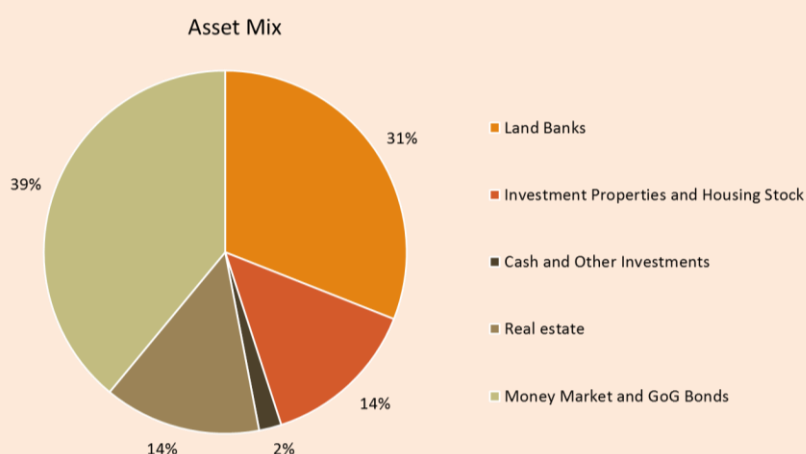
25 at Tema. HFC REIT employs the services of HFC Realty to develop and construct their properties. It develops both for outright sale and for rental.

Portfolio and Performance

HFC’s assets currently amount to GHS 50 million (US\$12.6 million). At present, 14% of the fund’s assets are in residential property.

The asset mix of the fund is illustrated in the figure below.

Figure 13: Portfolio / asset mix (2015)



Source: HFC REIT Annual Report 2015¹⁰⁸

Despite challenging economic conditions (characterised by rising inflation, high interest rates, and reduced disposable incomes), HFC REIT managed to return a yield of 24.26% in 2015. This was significantly above the year end inflation rate (17.5%), and slightly above the one year Government of Ghana (GOG) note against which HFC REIT benchmarks itself (22.5%). The REIT has consistently exceeded this benchmark, as illustrated in Table 5 below.

Table 5: HFC REIT yield vs 1 year GOG note yield (2013 - 2015)

	2013	2014	2015	3 year Average
REIT (%)	23.01	23.61	24.26	23.16
GOG 1 year Treasury Note (%)	21.19	21.52	22.51	21.74

Challenges and Opportunities

In the near term HFC REIT is pursuing the development of approximately 5 000 square meters of office space and the construction of 1 400 square meters of affordable residential units in Accra. These two accretive projects with estimated valuations totalling US\$6.6 million are expected to be commence in 2017.

At the same time, the CEO of HFC Investments highlights a number of challenges that the REIT faces. This includes the general public’s lack of awareness and understanding with respect to REITs, which hinders the flow of money into the REIT. A further challenge is that

¹⁰⁸ HFC Investments (2015) HFC REIT: Annual report 2015. Available at: <http://home.hfcinvestments.com/file/mf/HFC%20%20REIT%202015%20ANNUAL%20REPORT.pdf>

while the developmental focus of the REIT necessitates a long term fund, investors typically want a shorter maturity instrument (e.g. an investment that generates yearly returns). This mismatch between supply and demand further deters potential investors. HFC is thus engaging with a limited pool of interested investors.

Finally, since the REIT is structured as an open ended fund, it is required to keep a portion of the fund as cash or near cash investments in order to allow for enough liquidity for unanticipated redemptions during the year. This in turn limits what the REIT could be doing with the money and dilutes its returns.

Nevertheless, the outlook is positive. HFC's CEO envisions HFC REIT continuing to grow over the next five years as investors become more comfortable with the REIT structure, and the economy recovers and grows further. Furthermore, the Tier 2 and 3 pension funds are expected to channel further investment into the REIT and expand its portfolio.

3.2 Nigeria

In Nigeria, REITs are defined as Collective Investment Schemes (CISs) that enable investors to pool their resources to form, own and manage portfolios of real estate properties. While Section 154 of the Investment and Securities (IAS), 2007 empowers the Securities and Exchange Commission (SEC) to approve, register and regulate REITs and other CISs, the rules governing the operation of the aforementioned schemes are outlined in the Securities and Exchange Commission Rules and Regulations, 2011.¹⁰⁹

Three types of REITs currently exist in Nigeria, namely, equity REITs, mortgage REITs and hybrid REITs.¹¹⁰ A REIT typically adheres to the following characteristics:

- the SPV may be a corporation or an Investment Trust;
- it is either publicly traded on the stock exchange or owned by private investors;
- it is managed by a Board of Directors or Trustees;
- it has a minimum of 100 shareholders;¹¹¹
- it invests at least 75% of its total assets in real estate assets (typically investment properties from which rental income is earned) and in Government Securities;
- it derives at least 75% of gross incomes from rents and mortgages;¹¹²
- it pays dividends on at least 90-95% of taxable income; and
- it adheres to a maximum gearing ratio of 15%.¹¹³

It is important to note that REITs in Nigeria are still required to pay Companies Income Tax (CIT) at a rate of 30%. However, certain other pockets of tax exemptions exist, such as the waiver of taxes on asset and mortgage-backed securities.¹¹⁵ Additionally, the dividends of

¹⁰⁹ Deloitte. Are Tax Exemptions Available to REITs in Nigeria untapped? Available at: <https://www2.deloitte.com/content/dam/Deloitte/ng/Documents/tax/inside-tax/ng-are-tax-exemptions-available-to-reits-in-nigeria-untapped.pdf>

¹¹⁰ PWC. (2015). Real Estate: Building the future of Africa. Available at: <https://www.pwc.co.za/en/assets/pdf/real-building-the-future-of-africa-brochure-2-mar-2015.pdf>

¹¹¹ Additionally, not more than 50% of its shares can be held by 5 or fewer individuals.

¹¹² Furthermore, 90-95% of this gross income must come from rents, interest and capital gains on other securities.

¹¹³ Deloitte. Are Tax Exemptions Available to REITs in Nigeria untapped? Available at <https://www2.deloitte.com/content/dam/Deloitte/ng/Documents/tax/inside-tax/ng-are-tax-exemptions-available-to-reits-in-nigeria-untapped.pdf> and Omidire, D. (2015). Six Challenges facing the Nigerian Reit Industry. Available at: <http://www.estateintel.com/opinion-challenges-facing-the-nigerian-reit-industry/>

¹¹⁵ In 2010, the Debt Management Office approved a waiver of taxes on all categories of bonds, Mortgage-backed Securities, and Asset-backed securities. While these tax arrangements benefit Mortgage and Hybrid REITs, they potentially act as a disincentive to investing in real estate assets directly – and thus undermine the establishment of Equity REITs.

publicly traded REITs are exempt from withholding taxes (WHT) in the hands of the investors. Value Added Tax (VAT) and Capital Gains Tax (CGT) on sales of these units or securities are also not applicable.¹¹⁶

The Skye Shelter Fund REIT, Union Homes REIT, and UPDC REIT were launched in Nigeria 2007, 2008, and 2013 respectively. These were subsequently followed by the establishment of Sun Trust Hybrid. The total capitalisation of REITs in Nigeria is over US\$224 million.¹¹⁷

Table 6: Established REITs in Nigeria

	<i>Sectoral Focus</i>	<i>Size of Real Estate Portfolio</i>
Union Homes REIT	Commercial; Residential	US\$42.2 million
Skye Shelter Fund REIT	Commercial; Residential	US\$8.5 million
UPDC REIT	Commercial; Residential	US\$37.1 million
Sun Trust Hybrid	Commercial; Residential	limited

The prospects for REITs as an investment vehicle going forward is perceived to be strong, due to the high demand for and undersupply of real estate assets in Nigeria, and limited institutional investment exposure to real estate.¹¹⁸

Case Study 5: Union Homes Hybrid REIT – Nigeria

Background

The Union Homes Real Estate Investment Trust (REIT) is a close ended Unit Trust Scheme whose primary objective is to achieve long term capital appreciation of its assets. It was established on the 19th of August 2008 as a Unit Trust Scheme, and was registered and listed on the floor of the Nigerian Stock Exchange on the 2nd of July 2010. It is actively and externally managed by a fund manager,¹¹⁹ which reviews the acquisition, investment and disposal of the REIT's properties and assets in the context of an investment committee.¹²⁰

Union Homes REIT was established with the purpose of providing retail and pension fund investors with the opportunity to invest in a diversified portfolio of real estate assets. The REIT structure was chosen due to its status as a low risk, tax efficient investment vehicle that maximises returns and exhibits low correlation with other asset classes.

Its investors include pension fund administrators, financial institutions, individuals and corporates organisations. The REIT distributes 90% of its annual returns from all investments, annually.

Portfolio

Union Homes REIT is a Hybrid REIT which invests in both properties and mortgages, allowing investors to benefit from a two-pronged asset approach. It seeks to maintain a

¹¹⁶ Deloitte. Are Tax Exemptions Available to REITs in Nigeria untapped? Available at <https://www2.deloitte.com/content/dam/Deloitte/ng/Documents/tax/inside-tax/ng-are-tax-exemptions-available-to-reits-in-nigeria-untapped.pdf>

¹¹⁷ PWC. (2015). Real Estate: Building the future of Africa. Available at: <https://www.pwc.co.za/en/assets/pdf/real-building-the-future-of-africa-brochure-2-mar-2015.pdf> and Olanrele, O.O., Said, R. and Daud, N. (2015). Comparison of REIT Dividend Performance in Nigeria and Malaysia. African Journal of Business Management. Vol. 9 (16).

¹¹⁸ Interview with Agbaje Omosola, Head Corporate Service & Investor Relations, Union Homes REIT.

¹¹⁹ Union Homes Savings & Loan Plc, a subsidiary of Union Bank of Nigeria Plc, was originally the fund manager. However, they subsequently went bankrupt and the majority of their shares were acquired by Aso Savings and Loans.

¹²⁰ The investment committee comprises independent members & representatives of the fund manager and trustees.

diversified portfolio by investing in residential and commercial sectors that have attractive investment fundamentals. Also, a small proportion of the fund's assets (less than 10%) is held in money market instruments to provide liquidity and diversification.

The REIT does not prioritise, or even promote, socio-economic developmental impact. Rather it makes investment decisions based on factors such as the location of the property, and the investment's potential to deliver high, regular returns and high capital growth. Its residential portfolio, which comprises 69% of the total portfolio, predominantly lies in luxury apartments. The REIT owns and manages nine luxury residential apartments and four commercial properties in Lagos and Abuja.

Union Homes REIT focuses on growing income returns through rental escalations, building re-tenanting and more efficient utilization of space. It also occasionally engages in the redevelopment of properties to enhance value and support longer-term income and capital growth. However the extent of the development that it can undertake is limited by investor guidelines.

Challenges and Opportunities

In 2014, there was no profit distribution due to the REIT's negative net performance of N1 291 191 474 (US\$4.4 million).¹²² This was attributed principally to the revaluation loss suffered on the trust's investment properties during the year. Furthermore, two of the REIT's key properties were vacant during 2014 due to major repairs on them.

Union Homes REIT's head of corporate service and investor relations further suggests that the regulatory rules that limit investments in real estate development pose a challenge to the REIT, and hinder its ability to achieve longer-term income and capital growth. He asserts that increased flexibility in the investment guidelines, would give rise to higher returns.

3.3 Tanzania

The REIT structure was implemented by the Capital Market and Securities Authority (CMSA) of Tanzania in 2011. The REIT regulatory framework, known as the CMS Collective Investment Scheme Real Estates Investment Trust Rules of 2011, provides rules relating to eligibility, responsibility, key players, listing procedures, and the operationalization of REITs.¹²³

Sections 117 and 118 of the Act prescribe that a REIT must appoint a management company that has been approved by the CMSA. The management company, in turn, is required to appoint a trustee, which must be a bank or financial institution. In addition to the appointment of a trustee, the management company should "establish and maintain additional arrangements to provide an oversight over the operation and management of the fund, such as appointing an investment committee for the fund..."¹²⁴ The initial size of a REIT is required to be at least TZS 10 billion.

According to the Act, at least 50% of a fund's total asset value ought to be invested in real estate or single-purpose companies at all times. Real Estate acquired by the fund is required to:

¹²² 2014 Financial Report. Available at: <http://unionhomesreit.com/investors-centre/result-center/>

¹²³ Marwa, M. (2015). Market data Review: Alternative channels of financing real estate projects.

¹²⁴ The Capital Market and Securities (Collective Investment Schemes Real Estate Investment Trusts) Rule. (2011).

- be tenanted;¹²⁵
- have a good track record and good prospects of future net rental income of reasonable levels;
- be competitive and located within good catchment areas, as evidenced by market studies; and
- be free from encumbrances at the time of acquisition.¹²⁶

When it comes to real estate under construction, on the other hand, a REIT may acquire the real estate, provided that:

- income from real estates within the fund's investment portfolio is sufficient to ensure that there is no substantial dilution to the fund's earnings per unit during the construction period;
- the prospects for the real estate to be acquired upon its completion is reasonably expected to be favorable, and
- the total value of real estates under construction acquired by the fund does not exceed 10% of the fund's total asset value (after the acquisition).¹²⁷

Furthermore, REITs are permitted to acquire real estate located outside of Tanzania, provided that the acquisition is in the best interests of the fund and its unit holders.

REITs in Tanzania can be listed or unlisted funds. The prices of listed REITs are determined by the price on the exchange, while the prices of unlisted REITs are determined by the NAV of the fund. Importantly, REITs are required to distribute at least 90% of their annual net income after tax to unit holders as dividends each year.

The commercial REIT market in Tanzania is perceived to have huge potential. This potential is illustrated by the four to five recent initial public offerings (IPOs) done locally which were oversubscribed. Immense interest in REITs is likely due to the fact that, at present, developers are too reliant on debt and their own (often limited) capital.¹²⁸

Despite the fact that the only existing REIT in Tanzania at present is a residential REIT,¹²⁹ the future of residential REITs in Tanzania is more uncertain. This is because Tanzania currently has a limited stock of existing housing (and affordable housing in particular) for REITs to acquire. In addition, there is only a handful of private developers in the residential sector.¹³⁰ Consequently, there is limited development capacity in the residential sector, and REITs focusing on housing would face challenges building up a significant property portfolio.¹³¹

Nevertheless, the Capital Markets & Securities Authority is prepared for the establishment of new residential REITs, and it is anticipated that a company could move from start to market listing and full capital raising within 6 months.¹³² It is predicted that residential REITs positioned with a good marketing story could enlist strong interest from individual

¹²⁵ REITs may only acquire fully developed real estate that is not fully tenanted provided that, amongst other conditions, there exists a good potential to secure tenants and the acquisition is forecasted to provide a reasonable return within a reasonable period of time.

¹²⁶ The Capital Market and Securities (Collective Investment Schemes Real Estate Investment Trusts) Rule. (2011).

¹²⁷ The Capital Market and Securities (Collective Investment Schemes Real Estate Investment Trusts) Rule. (2011).

¹²⁸ Interview with Heri Bomani, Managing Director of Pangani Group.

¹²⁹ See Case Study 10: Watumishi Housing Company – Tanzania.

¹³⁰ All of these developers have traditionally focused on residential stock aimed at the prime segment. Interview with Patrick Mususa, Projects and Business Development Manager at the Dar es Salaam Stock Exchange.

¹³¹ Even Development REITs typically need to partner with established developers in order to undertake development activity (unless they already have in-house capacity). A property market lacking a number of developers with experience in residential development would therefore act as a constraint on a Development REIT's operations.

¹³² Interview with Patrick Mususa, Projects and Business Development Manager at the Dar es Salaam Stock Exchange.

investors – as seen by recent local bank bond placements which drew investors with small capital amounts.¹³³ In order to attract private investment, such REITs would need to deliver returns that surpass government paper returns (18-19%) and private sector bond returns (such as NMB Bank and Exim Bank trading at 13-14% yields).¹³⁴

Case Study 6: Watumishi Housing Company – Tanzania

Background

WHC-REIT was established in 2014 and was licensed by the Capital Market and Security Authority (CMSA) in 2015, thus becoming the first fully-fledged REIT to be established in Tanzania and East Africa. It is managed by Watumishi Housing Company (WHC), which is a public entity property developer and the main implementer of the Tanzania Public Servant Housing Scheme.¹

WHC-REIT was established with purpose of providing the general public with an opportunity to participate and create personal wealth as well as contribute towards overall social and economic development. The REIT structure was also implemented in order to provide institutional investors (such as pension funds), who had reached their cap on real estate portfolio allocation, further opportunity for investment.¹³⁵ As a mission, WHC-REIT seeks to work with other national and international fund managers and other stakeholders to develop the REIT market in a manner that is beneficial to all parties.¹³⁶

The REIT received initial funding of TZS 68 billion (US\$ 31 million). Currently, it is unlisted and is fully owned by shareholders of WHC. Unit holders of WHC-REIT include seven public institutions namely; PPF Pensions Funds, National Social Security Fund (NSSF), Public Service Pension Fund (PSPF), LAMP Pensions Fund and GEPF Pension Fund, the National Health Insurance Fund (NHIF) and National Housing Corporation (NHC).¹³⁷

This lock-in period, however, is planned for only three years, of which one year is left. After this, WHC-REIT units will be traded on the Dar Es Salaam Stock Exchange (DSE). Through this channel, the general public will be able to invest in the REIT. It is proposed that listing the REIT on the stock exchange will allow the company to expand its capital base and will channel foreign investment in the company.¹³⁸

WHC is governed by the Board of Directors which comprises the CEOs of all the unit holders. The Government of the United Republic of Tanzania is represented in the board through co-opted members from the Ministry of Lands and Urban Development, the Bank of Tanzania and the President Office-Public Sector Management (PO-PSM). The day to day activities of WHC is managed by the Managing Director (CEO) who is assisted by the Chief Operating Officer and the Chief Financial Officer (CFO). Three other senior managers

¹³³ Interview with Heri Bomani, Managing Director of Pangani Group.

¹³⁴ NMB is a top bank in the market and thus perceived to be lower risk than government. As a result, lower returns have still appealed to investors. Interview with Patrick Mususa, Projects and Business Development Manager at the Dar es Salaam Stock Exchange.

¹³⁵ In Tanzania investments in the stock market have relaxed regulations compared to direct investments in property. For example, in the case of the Government Employees Provident Fund the max investment in domestic property is 8% whereas for domestic equity it is 55%.

¹³⁶ AUHF. (2016). Real Estate Investment Trusts: Watumishi Housing Company. Available at: <http://www.housingfinanceafrica.org/blog/real-estate-investment-trusts-watumishi-housing-company/>

¹³⁷ These agencies were encouraged by government to put in capital to fund the REIT.

¹³⁸ AUHF. (2016). Real Estate Investment Trusts: Watumishi Housing Company. Available at: <http://www.housingfinanceafrica.org/blog/real-estate-investment-trusts-watumishi-housing-company/>
<http://whctz.org/>

oversee the autonomous departments of procurement, legal, and marketing WHC seeks to maintain a lean but a dynamic workforce in line with the objectives of the company.¹³⁹

Social Impact

Tanzania has a housing shortfall in excess of two million units. The need to accelerate the rollout of houses and specifically affordable homes was a key motivating factor behind the establishment of WHC. The REIT was conceptualised as a platform to fund the development of such affordable homes. More specifically, the WHC-REIT aims to mobilise funding for the development of low-middle income housing, both for sale and for rent. The target house price is between US\$ 10 000 and US\$ 40 000.¹⁴⁰

The first phase of development, launched in December 2015, consists of 1 500 units spread across 11 regions. The houses are to be sold under mortgage arrangements to public servants. According to Tanzania Invest, only 1.5% of public servants are provided accommodation through mortgages or any other type of housing finance. The WHC-REIT has attempted to mitigate this by entering into agreements with various banks so that workers can access mortgages at lower interest rates (11 to 13 percent, as opposed to 22 percent) for longer bond terms (up to 25 years), making the cost of accessing mortgages much lower.¹⁴¹

Portfolio

WHC-REIT's property portfolio currently sits at around US\$ 40 million, with 100% of this in residential real estate. Its investment decisions are guided by the need to build affordable homes, while simultaneously providing investors with a return of 15%. WHC-REIT has not distributed returns as of yet, due to the fact that it has not reached its first year end.

The REITs gearing ratio is currently at 60% (with debt being 60% and equity being 40%).

Challenges and Opportunities

The CEO of WHC-REIT is optimistic about the REIT's future and expects it to grow gradually to TZS 358 billion (US\$ 164.7 million) in the next five years. He believes that the REIT is a powerful vehicle for funding the delivery of homes, and asserts that it has been successful in supplying units at cheaper prices than seen previously. According to the CEO, thus far, WHC-REIT has enhanced the supply of affordable homes, contributed towards job creation, and supported market deepening through enhanced choice of unit types.

However, at the same time, WHC-REIT has faced certain challenges such as high construction costs¹⁴³ and unrealistic consumer expectations about house pricing.¹⁴⁴ Tax uncertainty, resulting from the election of a new government focused on widening the tax base through the introduction of new taxes and the enforcement of existing taxes, has also disrupted the housing market. For example, VAT relief on housing was expected to be introduced in the new financial year but was never been implemented. The government's implementation of tighter monetary and fiscal policies has also resulted in market liquidity drying up. Consequently, investors have limited capital pools at present to channel into

¹³⁹ <http://whctz.org/>

¹⁴⁰ Tanzania Invest in AUHF. (2016). Real Estate Investment Trusts: Watumishi Housing Company. Available at: <http://www.housingfinanceafrica.org/blog/real-estate-investment-trusts-watumishi-housing-company/>

¹⁴¹ Tanzania Invest in AUHF. (2016). Real Estate Investment Trusts: Watumishi Housing Company. Available at: <http://www.housingfinanceafrica.org/blog/real-estate-investment-trusts-watumishi-housing-company/>

¹⁴³ Despite the fact that both Tanzania and Kenya have ports and therefore should have similar import costs, it is at least 10% more expensive to build a house in Tanzania than in Kenya.

¹⁴⁴ The majority of Tanzanian consumers are seeking housing but are finding prices to be out of their reach. The affordable segment is looking for units below USD50k, however the majority of units supplied are at much higher prices. Consumers are thus enticed into schemes but on further enquiry often establish that the prices are beyond what they can afford.

investment vehicles such as WHC-REIT. This in turn calls into question the extent to which there is space for growth for REITs in the Tanzanian market.

Furthermore, many investors do not have a good understanding of the REIT platform and are thus hesitant to invest in it. This is exacerbated by the fact that the affordable housing space offers lower returns than other property asset classes and is thus not an obvious investment target.¹⁴⁵ Furthermore, according to the REIT's CEO, investors in WHC-REIT need to have patient capital, and be willing to receive more flexible returns on capital. In other words, in the affordable housing context the REIT structure does not give rise to the same quick investment vehicle that it gives rise to in other contexts. According to the CEO, further work needs to be undertaken in order to convince private investors that affordable housing is an attractive investment class.

This calls into question whether the WHC-REIT will be successful in attracting private capital from investors purely targeting financial returns once the REIT is listed on the Dar Es Salaam Stock Exchange (DSE). Indeed, it is important to highlight that the existing institutional investors in the REIT were largely coerced by the Tanzanian government to invest in the REIT.¹⁴⁶ Put another way, for these institutions investing in WHC-REIT was a social investment decision – as opposed to an investment decision based purely on expected financial returns.

Nevertheless, both the CEO of WHC-REIT and representatives from the DSE are confident that the REIT will be able to attract investors once listed. Indeed, bilateral development partners have already expressed interest in investing in the REIT as a means to stimulating housing delivery in the Tanzanian context. Representatives of the DSE further assert that listing WHC on the stock exchange will subject the REIT to stronger governance process protocols and thus indirectly enhance its performance.

3.4 South Africa

Prior to the introduction of REIT legislation in South Africa in 2013,¹⁵³ two alternative forms of publicly traded property entities were recognized. These were referred to as property unit trusts (PUTs) and property loan stock companies (PLSs). While both PLSs and PUTs were funds that invested directly into property, they were unevenly regulated and subject to different tax treatments.¹⁵⁴ Both entities had their weaknesses.

PUTs were regulated as Collective Investment Schemes (i.e. mutual funds) and required administration and fund management to be separate. This gave rise to a passive investment vehicle, which deterred many investors. Such investors argued that since real estate is an active business, management should not be separated from the overall fund.¹⁵⁵

PLSs were regulated under the Financial Services Board (FSB). Although PLSs were internally managed, they were poorly regulated and were generally treated as companies with respect to tax regulations. Indeed, "a degree of uncertainty prevailed over whether

¹⁴⁵ Interview with Fred Mswemwa, CEO of Watumishi Housing Corporation.

¹⁴⁶ Interview with Heri Bomani, Managing Director of Pangani Group.

¹⁵³ 25BB of the Income Tax Act No. 58 of 1962; JSE Listings Requirements for REITs

¹⁵⁴ Miller, C. (2015) REITs as Applied in South Africa. Available at: <http://www.thesait.org.za/news/226215/REITs-as-Applied-in-South-Africa-.htm>

¹⁵⁵ Interview with Brian Azizahaloff, MD of Capstone Property

PLSs were legitimately entitled to deduct interest on the debenture component of linked units issued to investors”.¹⁵⁶

Additionally, both PUTs and PLs were problematic as they were unfamiliar to foreign investors.¹⁵⁷ The REIT legislation was thus introduced to establish robust regulation, and to provide clarity to the market with regards to how real estate entities and their shareholders would be taxed.¹⁵⁸ In other words, the REIT structure was introduced into South Africa with the purpose of providing “transparency, simplicity, flexibility and tax certainty”.¹⁵⁹

Following the introduction of the REIT legislation all of the existing PLSs (approximately 15) and most of the existing PUTs (approximately 6) converted into REITs.¹⁶¹ The South African REIT legislation provides for two distinct types of REITs, namely Company REITs and Trust REITs. Existing PLSs converted into Company REITs, which may be internally or externally managed and are regulated in terms of the Companies Act, while existing PUTs converted into Trust REITs, which are externally managed and are regulated in terms of the Collective Investment Schemes Act. Both types of REITs are ultimately listed property investment vehicles that are similar to internationally recognized REIT structures.¹⁶²

According to the SA REIT Association,¹⁶³ all JSE-listed REITs must:

- own at least R 300 million of property
- keep debt below 60% of their gross asset value (leverage ratio)
- earn 75% of their income from rental or from property owned or investment income from indirect property ownership¹⁶⁴
- have a committee to monitor risk
- not enter into derivative instruments that are not in the ordinary course of business
- pay at least 75% of their taxable earnings available for distribution to its investors each year

Section 25BB of the Income Tax Act effectively allows a REIT to achieve tax neutrality. According to this section of the Act, a REIT can deduct for income tax purposes all “qualifying distributions” to shareholders, which include dividends paid or payable, or interest incurred in respect of linked debentures.¹⁶⁵

At the same time, “qualifying distributions” received by shareholders are not exempt from income tax and consequently, depending on the nature and tax profile of the shareholder concerned, may be taxable in their hands.¹⁶⁶ Dividend tax is imposed on “qualifying

¹⁵⁶ Miller, C. (2015) REITs as Applied in South Africa. Available at: <http://www.thesait.org.za/news/226215/REITs-as-Applied-in-South-Africa-.htm>

¹⁵⁷ Anderson, L. (2015). A Place for Residential REITs in the South African REIT market. University of Pretoria. South Africa.

¹⁵⁸ The establishment of the REIT structure came about as a result of a partnership between the PLS and PUT associations and DTI. DTI was very supportive of the idea, as they perceived the introduction of a REIT structure as a good way to encourage savings. DTI thus provided the political backing for the decision to establish a REIT structure.

¹⁵⁹ SA Commercial Property (2013) in Boshoff, D. and Bredell, E. (2013) Introduction of REITs in South Africa: Transformation of the Listed Property Sector. Advanced Research in Scientific Areas.

¹⁶¹ Interview with Keith Engel. Deputy CEO of SAIT

¹⁶² SA REIT Association Website. Available at: <http://www.sareit.com/index.php>

¹⁶³ SA REIT Association Website. Available at: <http://www.sareit.com/index.php>

¹⁶⁴ The South African REIT regulations do not allow for REITs that buy and develop to sell. REITs are however allowed to develop to hold.

¹⁶⁵ Miller, C. (2015) REITs as Applied in South Africa. Available at: <http://www.thesait.org.za/news/226215/REITs-as-Applied-in-South-Africa-.htm>

¹⁶⁶ Pension funds are not subject to tax on such distributions.

distributions” to foreign shareholders subject to a reduction in terms of an applicable double tax treaty.¹⁶⁷

The REIT legislation has been successful in giving rise to a recognisable and understandable structure that has been able to attract foreign investment. Since its introduction, REITs have grown significantly as an asset class – they now comprise 4% of the Johannesburg Stock Exchange (JSE). The REIT market is liquid and active and has given rise to deal-flow and immense corporate activity.¹⁶⁸ As of January 2017, the South African REIT market comprised of 31 listed REITs with a market capitalisation of R320 billion.¹⁶⁹ These REITs are summarized in Table 7 below.

Table 7: Established REITs in South Africa

REIT	Sectoral Focus	Size of Portfolio	Management Type
Arrowhead Properties Ltd	Diversified - with residential	R7.3bn	Internal
ACUCAP Properties Ltd	Diversified - without residential	R7.5bn	Internal
Ascension Properties Ltd	Diversified - without residential	R3.8bn	External
Capital Property Fund	Diversified - without residential	R16.9bn	Internal
Delta Property Fund	Diversified - without residential	R10.5bn	External
Dipula Income Fund	Diversified - without residential	R5bn	External
Emira Property Fund	Diversified - without residential	R13bn	External
Fairvest Property Holdings	Diversified - without residential	R1.4bn	Internal
Fortress Income Fund Ltd	Diversified - without residential	R6.6bn	Internal
Fountainhead Property Trust	Diversified - without residential	R14bn	External
Equites Property Fund	Industrial	R4.1bn	External
Freedom Property Fund Ltd	Diversified - with residential	n/a	Internal
Growthpoint Property Ltd	Diversified - without residential	R79bn	Internal
Hospitality Property Fund	Hospitality	R5.1bn	Internal
Hyprop Investments Ltd	Retail	R18.7bn	Internal
Indluplace Properties	Residential	R2.35 bn	Internal
Investec Property Fund Ltd	Diversified - without residential	R5.8bn	Internal
Octodec Investments Ltd	Diversified - with residential	R11.6bn	External
Oasis Crescent Property Fund	n/a	n/a	Internal
Premium Properties Ltd	Diversified - with residential	R3.58bn	n/a
Rebosis Property Fund Ltd	Diversified - without residential	R6.59bn	External
Redefine Properties Ltd	Diversified - without residential	R25bn	Internal

¹⁶⁷ Miller, C. (2015) REITs as Applied in South Africa. Available at: <http://www.thesait.org.za/news/226215/REITs-as-Applied-in-South-Africa-.htm>

¹⁶⁸ Interview with Laurence Rapp, Chairman of SA REIT Association

¹⁶⁹ SA REIT Association (2016.) SA REIT Conference 2016.

REIT	Sectoral Focus	Size of Portfolio	Management Type
Resilient Property Income Fund	Retail	R21.1bn	Internal
SA Corp Real Estate Fund	Diversified - with residential	R10.7bn	Internal
Safari Investments	Retail	R1.75bn	Internal
Sycom Property Fund	Diversified - without residential	R8.4bn	External
Synergy Income Fund Ltd	Retail	R2.4bn	n/a
Tower Property Fund	Diversified - without residential	R3.9bn	External
Transcend	Residential	R942 m	External
Vukile Property Fund	Diversified - without residential	R13.3bn	Internal
Vunani Property Inv. Fund	Commercial	R1.4bn	Internal

However, growth opportunities in the larger REIT sector in South Africa have been shrinking. Economic growth has stalled and the cost of capital has gone up. It is also getting harder to push up rentals in the office, retail and industrial sectors, due to an oversupply of space.¹⁷⁰

Many REITs have responded to these challenges by investing offshore – particularly in Australia, Europe, and the US.¹⁷¹ At the same time, certain real estate experts suggest that the residential property market represents a new opportunity in the context of the stagnation of the more traditional property sectors.¹⁷² Indeed, increasing rates of urbanisation and the declining availability of home mortgages has resulted in substantial demand for rental housing and growing levels of rental prices.¹⁷³

Some experts assert that the South African REIT sector is now becoming large enough to specialise, and that the next big opportunity for REITs is in the residential property sector. It is suggested that the structure of the residential property market, which currently consists of large privately owned properties, presents significant opportunities for new players.

The emergence of three or four new residential REITs within the next three years has been predicted.¹⁷⁴ Transcend, an off-shoot of the well-established private equity firm International Housing Solutions (IHS), listed on the JSE on December 1 2016, thereby becoming South Africa's second focused residential REIT. The company's focus is to acquire yield-accretive rental properties, with a specific focus on the affordable housing market and middle-income households.¹⁷⁵ Transcend currently holds a portfolio of 13

¹⁷⁰ Interview with Keith Engel. Deputy CEO of SAIT.

¹⁷¹ According to Engel, internationally interest rates are historically low, markets are liquid, there are opportunities to build scale quickly and there are niche markets within which South African REITs can play. Although REIT investment in other African countries was popular in 2014 / 2015, many South African REITs have since pulled back out of the rest of Africa.

¹⁷² Interviews with Francois Viruly (Professor of Economics at UCT) and Renney Plitt (CEO of AFHCO).

¹⁷³ Interview with Laurence Rapp. Chairman of the SA REITs Association.

¹⁷⁴ Interview with Francois Viruly. Professor of Property Economics at UCT.

¹⁷⁵ Makhlaka, R. (2016) Affordable housing heads for the JSE. Available at: <http://today.moneyweb.co.za/article?id=628762#.WC26jLJg68G>

properties, comprising 2,472 units, which fetch rentals of between R3 000 to R7 000.¹⁷⁶ The REIT is offering an initial forward dividend yield of 8.5%.¹⁷⁷

Additionally, the diversification of traditionally commercial REITs into the residential sector is foreseen.¹⁷⁸ Such a redirection of strategy has already been demonstrated by SACorp, which acquired AFHCO's residential portfolio in April 2014.

Real estate players also perceive opportunities for South African REITs to invest in residential property in other African countries such as Zambia and Mozambique.¹⁷⁹ Indeed, SACorp recently acquired residential property in Zambia, where there is a desperate shortage of housing.¹⁸⁰ Transcend also sees expansion opportunities throughout the African continent.¹⁸¹

However, the residential REIT market is still in the early stages and the market has yet to fully buy into the concept.¹⁸² Indeed, Octodec, Redefine Properties, SACorp Real Estate, Transcend, and Indluplace are the only South African REITs significantly invested in the residential sector.¹⁸³ Scepticism with respect to the residential sector's ability to deliver appropriate yields is still prevalent.¹⁸⁴

The experiences of Indluplace are explored in the case study below.

Case Study 7: Indluplace Properties – South Africa

Background

Indluplace, South Africa's first focused residential REIT, was listed on the JSE in June 2015, with a portfolio of ZAR1.6 billion (US\$118 million). Since listing it has increased the value of its properties to over ZAR2.3 billion (US\$170 million) and currently owns 115 residential properties, consisting of almost 5 400 residential units and about 12 600m² retail area, spread mainly across Gauteng.¹⁸⁵

Indluplace emerges in the context of a South African listed residential property market that is substantially under-represented relative to developed countries,¹⁸⁶ and which is failing to meet the high demand for affordable, well managed rental housing. Indeed, Arrowhead

¹⁷⁶ Transcend's portfolio of residential properties were all completed within the past 6 years and are located within secure estates. These assets differ from conventional inner-city residential rental housing in that they are predominantly 2 and 3 storey walk-up apartments located in desirable and high demand neighbourhoods and are often equipped with lifestyle-enhancing facilities. Transcend Property (2016) Company Profile. Available at: <http://transcendproperty.co.za/company-profile/>

¹⁷⁷ Mahlaka, R. (2016). Affordable housing heads for the JSE. Available at: <http://citizen.co.za/business/business-news/1348524/affordable-housing-heads-jse/>

¹⁷⁸ Interview with Renney Plit. CEO of AFHCO.

¹⁷⁹ While a South African REIT doesn't need REIT legislation to be in place in other countries to acquire property there, they do need to be careful with the country-specific tax legislation.

¹⁸⁰ SACorp is considering creating a specialised residential fund once its residential portfolio is large enough.

¹⁸¹ Mahlaka, R. (2016) Affordable housing heads for the JSE. Available at: <http://today.moneyweb.co.za/article?id=628762#.WC26jLJg68G>

¹⁸² Interview with Laurence Rapp. Chairman of the SA REITs Association.

¹⁸³ At the same time, however, other property development companies that generate profit through the development and sale of large-scale residential estates are present in South Africa. Such companies, many of which are listed on the JSE, do not have REIT status due to the fact that the REIT regulatory regime is intended for companies focused on income distribution, rather than returns on capital employed (although this may change in the future). Balwin Properties, for example, did not seek REIT status when it listed on the JSE in October 2015 due to the fact that it does not focus on the distribution of net rental income to shareholders. Rather, Balwin's business strategy targets investors who are seeking growth through development. Available at <http://www.balwin.co.za/jse-investors/shareholder-centre/>

¹⁸⁴ Interview with Keith Engel. Deputy CEO of SAIT.

¹⁸⁵ <http://www.indluplace.co.za/index.php>

¹⁸⁶ While South African listed residential property comprises less than 2% the total listed property market, listed residential property makes up over 15% of the total listed property market in the USA.

Properties took the decision to establish Indluplace, as a result of the significant opportunity for growth that it saw in the listed private rental sector.¹⁸⁷

The REIT's primary objective is to give investors growing yields and returns. It is Indluplace's intention to aggressively grow its portfolio by acquiring yield enhancing properties and portfolios that provide income from the day of acquisition, and to pay growing distributions to its shareholders on a quarterly basis. In the process, it also seeks to deliver high quality products and bring a superior level of management into the residential property sector.

Indluplace follows the Arrowhead model. While they have executive directors and a small internal asset management team, their property management and accounting functions are outsourced. They believe that it is better to outsource these functions during the growing phase of a company as it provides flexibility and allows one to bring in a variety of expertise when investing in various geographical locations and markets.

Indluplace's investors are primarily local. While Arrowhead owns 60% of the REIT¹⁸⁸ and Indluplace's management owns 7.5% of the REIT, the remaining investors are largely professional fund and investment asset managers. Large institutional investors in Indluplace include Stanlib and Investec.¹⁸⁹

Social Impact

Indluplace invests purely in residential property. Within the context of the residential property market, it invests in a variety of products and building types, and targets a diversity of income groups and markets. While it only invests where the yield works, it is simultaneously conscious of the potential role that rental accommodation could play in solving the shortage of affordable housing accommodation in South Africa.

Currently 38% of Indluplace's portfolio consists of apartments in the Johannesburg Inner City, which primarily cater for the lower to mid-end of the property market. These units are on average rented out for around ZAR3 900 (US\$288) a month, and serve households earning between ZAR10 000 (US\$739) and ZAR15 000 (US\$1109) a month.

While these units serve an important market, Indluplace has not significantly invested in accommodation suitable for households earning less than ZAR10 000 (US\$739) a month, despite a desperate need for it.¹⁹⁰ Indluplace's CEO highlights that it is extremely difficult for private investors to play in this sphere of the market as, while the goal of all REITs is to provide their shareholders with high and regular incomes, low-income housing tends to yield low returns.¹⁹¹ Nevertheless, he suggests that the management and renting out of these low-end housing units can work when part of a larger residential portfolio. For example, many of Indluplace's inner city buildings contain a few small rooms (with shared bathrooms and kitchens), which are rented out for about ZAR800 (US\$59) a month and are

¹⁸⁷ <http://www.indluplace.co.za/index.php>

¹⁸⁸ In this context, the tax arrangements of the REIT structure are particularly advantageous to Arrowhead, which receives dividends from Indluplace before tax has been deducted.

¹⁸⁹ Mahlaka. R (2015). Indluplace: Growing aggressively since listing. Available at: <http://www.moneyweb.co.za/investing/property/indluplace-growing-aggressively-since-listing/>

¹⁹⁰ According to 2014 stats, more than half of working South Africans earn less than R10 000 a month.

<http://www.timeslive.co.za/local/2014/09/25/more-than-half-of-working-south-africans-earn-less-than-r10000-a-month>

¹⁹¹ REITs buy the net income stream of a property (i.e. rental income less management expenses). While rental income is lower for affordable housing units than for higher-end units, management expenses are not lower. Therefore, affordable housing investors will only be able to generate returns equivalent to those generated by higher-end units, if they are able to make significant savings on the initial capital expenditure of the property (i.e. the cost of acquiring / developing the property). To date, very few (if any) property investors / developers have succeeded in developing a financial model for low-end affordable housing that yields returns equivalent to those generated by prime residential property. See section 4.3 for further discussion around this issue.

thus affordable to a household earning less than ZAR10 000 (US\$739). These rooms, however, are a small portion of Indluplace’s portfolio.

It is important to note that Indluplace has effectively shied away from the actual development of residential property and, instead, has preferred to invest in income producing properties with reliable track records. This is because, while Indluplace is an income fund that promises its shareholders quarterly distributions, development activity has the potential to drain distributions. Indeed, undertaking even a ZAR500 million (US\$37 million) development would result in a quarter of the fund being tied up, and this would have the effect of diminishing short-run investor returns. Nevertheless, the REIT is currently considering undertaking small developments and is open to entering into an agreement with a developer in the future.

Although Indluplace has not yet contributed to an increased supply of rental accommodation, it is positively impacting the residential property market in other ways. Importantly, through the acquisition of ready-developed property, Indluplace offers an exit for developers of residential stock or portfolios. This facilitates the release of capital for developers, which can then be channelled into further housing developments. In other words, Indluplace serves to expand the residential funding pool, and thus plays an indirect role in relieving the rental housing shortage.

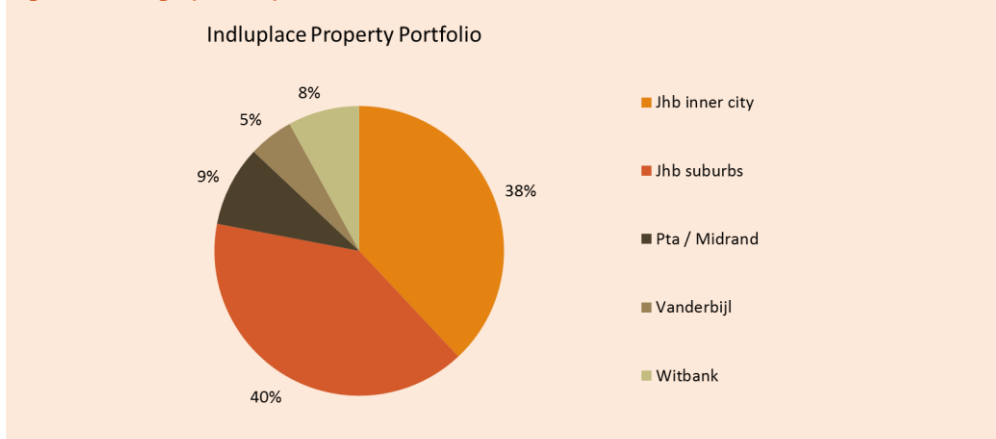
Additionally, Indluplace’s presence has contributed to an enhanced quality of management within the rental market, and has had a positive impact on the improvement districts. Indeed, since Indluplace is a long-term investor (i.e. it is not in the market of buying and selling), it has an interest in investing in the surrounding environment and buildings. Consequently, a large focus of Indluplace’s board is to be involved in improvement districts and social programmes, in the context of their residential properties.

Portfolio and Performance

The tables and figures below capture the size and breakdown of Indluplace’s residential portfolio.

Figure 14 illustrates that the majority of Indluplace’s property portfolio is located in Johannesburg, with 38% being in the inner city.

Figure 14: Geographical Spread of Portfolio (units)



Source: Indluplace.co.za

Table 8 demonstrates that out of the 5 447 residential units owned by Indluplace, only 269 (5%) fall into the category of student housing

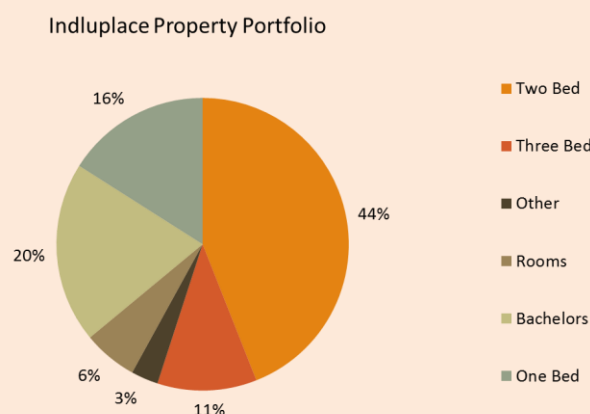
Table 8: Indluplace Portfolio (March 2016)

	Number of Units	Proportion of Portfolio
Normal Residential	5178	95%
Student Accommodation	269	5%
Total	5447	100%

Source: Indluplace.co.za

Finally, Figure 15 illustrates that the largest proportion of Indluplace’s portfolio comprises of two bed units (44%), followed by bachelor units (20%) and one bed units (16%). Only 6% of Indluplace’s portfolio consists of communal rooms targeted at very low-income earners.

Figure 15: Residential Unit Types



Source: Indluplace.co.za

Indluplace pays 100% of its profits as dividends, and is the only REIT besides for Arrowhead that pays quarterly distributions. To date its annual return has averaged at around 9.5%.¹⁹²

Currently, almost 100% of Indluplace’s funding is in the form of equity and it has no bank debt. While it would be willing to take on a degree of debt if a good opportunity came along, it would not exceed a LTV of 34%.¹⁹³

Challenges and Opportunities

Indluplace has been criticised by its competitors for acquiring poor quality, sporadically located properties in order to reach the critical mass required to attract investor attention. The effectiveness of out-sourcing property management in the context of residential property has also been questioned.¹⁹⁴

While Indluplace’s CEO is largely happy with the progress that has been made with respect to growing the fund and paying out dividends, he too acknowledges that there is still work to be done. He notes that the REIT faced a number of challenges during its first year, including:

¹⁹² 9.5% exceeds both the 2016 inflation rate, which was 6.5%, and the average return on commercial REITs, which sits at about 9% per annum.

¹⁹³ Since Indluplace distributes all of its profits, it would be required to go to the market or take out a loan in order to finance further investments.

¹⁹⁴ Interview with Renney Plit. CEO of AFHCO.

Markets conditions – funding became more expensive towards the end of 2015,¹⁹⁵ and it became more challenging for the REIT to purchase stock at the correct price. Additionally, the weakening of the macro-economy impacted tenant affordability levels, which in turn restricted the REIT's ability to escalate rentals.

Misperceptions regarding residential REITs – Indluplace experienced difficulties with respect to explaining the residential REIT market to investors. Most investors tend to think of risks (specifically, evictions) when they think of residential property,¹⁹⁶ and fail to understand that the fundamentals in the residential market are good.¹⁹⁷ These misperceptions are exacerbated by the fact that there is very little information available on residential property in the form that property investors are used to. Indluplace is working on changing perceptions, and has started provided residential information in a format that property investors understand.¹⁹⁸

Management challenges – Indluplace has found it difficult to change the management culture of newly acquired buildings. Some portfolios that Indluplace acquired were previously poorly run, and it was challenging to re-align management philosophies and reporting structures.

Nevertheless, Indluplace's CEO remains positive about the REIT's growth potential due to the strong fundamentals of the residential property market, with respect to vacancies, arrears and growth in rentals. Furthermore, the high demand for well-priced, well-managed, well-located properties, means that if Indluplace's properties are priced correctly they will have low vacancies, and if they are managed properly they will have low arrears.¹⁹⁹

The demand for focused residential REITs such as Indluplace is thus projected to grow as investors become more comfortable with the concept and seek to diversify their portfolios accordingly.²⁰⁰

3.5 Kenya

In 2013, Kenya became the third African country to establish a real estate investment trust (REIT) as an investment vehicle. Kenyan REIT regulations (The Capital Markets (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations, 2013) provide for two types of REITs, namely IREITs and DREITs.

An IREIT is an Income Real Estate Investment Trust Scheme, in which investors pool their monies for purposes of acquiring long term income generating real estate including housing and commercial real estate. An IREIT is characterized as follows:²¹³

¹⁹⁵ Towards the end of 2015, the president of South Africa unexpectedly fired the Finance Minister plunging the country's economy into uncertainty.

¹⁹⁶ In reality, Indluplace has evicted only two people in two years.

¹⁹⁷ E.g. demand is high and vacancies are low

¹⁹⁸ Interview with Carel de Wit and Terry Kaplan, Indluplace. Examples of Indluplace's approach to annual reports and investor presentations can be found on its website: <http://www.indluplace.co.za/index.php>

¹⁹⁹ The high indebtedness of South African consumers also means that people struggle to get bonds, which further increases the demand for rental.

²⁰⁰ . Paradoxically, more focused REITs actually help investors to diversify; because investors know exactly what segment of the market they are investing in and can build their portfolio accordingly.

²¹³ Legislative Supplement No. 46 (2013). The Capital Market (Real Estate Investment Trusts) (Collective Investment Schemes) Regulations, 2013. Kenya Gazette Supplement No.46.

- It invests at least 75% of the total net asset value in income producing real estate;
- it earns at least 70% of its income from rent, license fees or access or usage rights or other income streams of a similar nature generated by eligible investments in income producing real estate;
- it adheres to the restriction that borrowings cannot exceed 35% of the total asset value;
- it distributes a minimum of 80% of the net after tax income of the fund from sources other than from realized capital gains on the disposal of real estate assets;²¹⁴ and
- offers to invest in it can be made either as a restricted offer or an unrestricted offer.²¹⁵

A DREIT, on the other hand, is a Development and Construction Real Estate Investment Trust Scheme, in which investors pool their monies together for purposes of acquiring real estate, with a view of undertaking development and construction projects and associated activities. In the context of DREITs, returns mainly come from sales proceeds. A DREIT is characterized as follows:

- It invests at least 30% of the total asset value directly in development and construction projects, or income producing real estate which the D-REIT has developed or constructed;
- it adheres to the restriction that borrowings cannot exceed 60% of the total asset value;
- it has the option to either distribute any realized capital gains, or retain and invest any realized capital gains in new acquisitions or developments;
- it has a minimum of seven investors; and
- offers to invest in it may be made only to professional investors.

Both an IREIT and a DREIT are required to have a trustee who is independent of the REIT manager and the promoter. A trustee may be a bank, bank subsidiary or company / corporation that has the experience and the financial, technical and operational resources required to conduct business effectively as a REIT trustee. Additionally, both the REIT trustee and the REIT manager must be licensed by the Capital Markets Authority (CMA). To date, the CMA has approved and licensed five REIT Managers, namely; Stanlib Kenya Limited, Fusion Investment Management Limited, CIC Asset Management Limited, Centum Asset Managers Limited and UAP Investments Limited.

Furthermore, for a company to operate as an authorised REIT, it must apply to the CMA as either a close-ended or open-ended REIT. A close-ended REIT issues a specific number of shares through an initial public offering and does not issue new shares as investor demand grows. Prices, in this context, are driven by investor demand. An open-ended REIT, on the other hand, can issue an unlimited amount of shares. As more investors buy into the fund, more shares are issued; hence purchases and sales of fund shares take place directly between investors and the REIT. This requires a daily valuation process, which adjusts the REIT's per share price to reflect changes in portfolio (asset) value.²¹⁶

²¹⁴ Any realized capital gains may be retained and invested in income producing real estate.

²¹⁵ While, a restricted offer is made to professional investors only, an unrestricted offer can be made to any investor.

²¹⁶ Ebrahim, M. (2014). An Introduction to REIT's in Kenya. Available at:
<https://www.linkedin.com/pulse/20140909163459-24063084-an-introduction-to-reit-s-inkenya>

Importantly, corporate tax exemption plays a critical role in incentivising investment into the REIT industry in Kenya.²¹⁷

In recent years, the REIT market has performed relatively poorly in Kenya. In 2016, Kenya's only listed I-REIT, Fahari I – REIT, shed 45% of its value.²¹⁸ Furthermore, Fusion Capital's attempt to list a D-REIT (FRED – Commercial), failed due to the REIT being undersubscribed.²¹⁹

According to Cytonn Investments (2016),²²⁰ the Kenyan REIT market's poor performance during 2016 can be attributed to (i) poor returns from the underlying assets (ii) opacity of the exact returns from the underlying assets, (iii) inadequate investor knowledge and lack of institutional support for REITS, and (iv) the negative sentiment currently engulfing the sector given the poor performance of Fahari and failure of FRED.

3.6 Rwanda

Rwanda's REIT guidelines (Regulation No. 14 on Real Estate Investment Trusts) were established in 2013, with the objective of providing "better access to stable, global and more competitively priced capital, as well as stronger and more professional property businesses."²²¹

According to the guidelines, every REIT is required to be managed by a real estate investment management company that has obtained a certificate of registration from the Capital Markets Authority of Rwanda. The REIT and its management company are required to be independent of each other, and both must have a net worth of at least 25 million. Trustees of a REIT are to be appointed by the establishers of the REIT, and must be either a scheduled bank, a trust company that is a subsidiary of a bank, a public financial institution, an insurance company, or a corporate body.

In Rwanda, REITs are required to hold 100% of their assets in real estate. Generally, this real estate is required to be income generating. Nevertheless, a REIT may acquire uncompleted units in a building which is unoccupied and non-income producing, or in the course of substantial development, redevelopment or refurbishment, provided that the aggregate contract value of such real estate does not exceed 20% of the total net asset value of the scheme. At the same time, however, a REIT is prohibited from investing in vacant land or participating in property development activities.²²² Aggregate borrowings of a REIT may not exceed one fifth of the value of total gross assets of the scheme.

Unit certificates issued under a REIT scheme are required to be listed immediately after the date of allotment in recognized stock exchanges, and are freely transferable. REITs are required to distribute at least 90% of their annual net income after tax to unit holders as dividends each year.

To date, no REITs have been established in Rwanda.

²¹⁷ Anyanzwa, J. (2015). Regulators to Develop Legal Regime for Real Estate Trusts. The East African. Available at: <http://www.theeastafrican.co.ke/business/Regulators-to-develop-legalregime-for-real-estate-trusts/-/2560/2697216/-/jowrsyl/-/index.html>

²¹⁸ Cytonn Investments (2016). Cytonn Annual Markets Review. Available at: https://cytonn.com/download/Cytonn_Annual_Markets_Review_2016.pdf

²¹⁹ The D-REIT succeeded in raising only 37.8% from four investors out of the minimum requisite of 50% from at least seven investors. Cytonn Investments (2016). Cytonn Annual Markets Review. Available at: https://cytonn.com/download/Cytonn_Annual_Markets_Review_2016.pdf

²²⁰ Cytonn Investments (2016). Cytonn Annual Markets Review. Available at: https://cytonn.com/download/Cytonn_Annual_Markets_Review_2016.pdf

²²¹ Regulation No. 14 on Real Estate Investment Trusts (2013) Official Gazette n° 34

²²² For the purpose of the regulation, property development activities do not include refurbishment, retrofitting and renovations.

3.7 Morocco

In 2015, Morocco passed legislation allowing for the creation of REITs. Under this law, REITs are required to invest at least 70% of their assets in real estate, while the remainder can be invested in other assets to help diversify their investment portfolio.²²³ Moroccan REIT legislation further requires an external asset manager to undertake the management of any REIT operating in the country.²²⁴

However, the legislation does not include changes to the fiscal framework. Consequently, at present, companies acting as REITs are taxed in line with limited liability companies. An upcoming financial bill is expected to include a tax package which would complete the REIT legislation.

Real estate has traditionally been an attractive asset class in Morocco, particularly in recent years. The sector accounts for the largest share of foreign direct investment (FDI) inflows, at 38.6% of the total. While return on investment (ROI) on real estate averages around 9% in Casablanca – double the 4.5% average in Paris – investors have been slow to invest in Morocco’s commercial capital, as the high level of taxation on investment effectively eliminates the difference in ROI.

Consequently, once the REIT fiscal framework is in place, international investors are expected to start entering the sector. This in turn is expected to launch REITs in Morocco, with as many as five or six new REITs expected in the coming years.

In early 2016, the government restructured Vecteur LV (VLV), a subsidiary of Moroccan retail distributor Label Vie Group, into the country’s inaugural REIT. Going forward, MARA Delta is also set to convert its Moroccan subsidiary into a REIT, in order to gain from tax savings created by the dispensation. To address the REIT legislation’s requirement for an external asset manager, Mara Delta has formed an asset manager, Morocco REIT Management SA, as part of its conversion of the Moroccan Fund into a Moroccan REIT. Mara Delta will hold a 20% stake in the asset manager.²²⁵

3.8 Summary

Below, the key characteristics of the REIT frameworks found in various African countries is summarized.

Table 9: REIT structure comparison across African countries²²⁶

Country	Management Style	Minimum Investment in Real Estate	Development	Gearing Limit	Minimum Dividend Pay-out	Corporate Income Tax Exemption
Ghana	Internal	n/a	Allowed	None	None	No

²²³ Morocco World News (2016) REITs to Drive Commercial Real Estate Growth in Morocco, Says OBG. Available at: <http://www.morocroworldnews.com/2016/06/188081/reits-to-drive-commercial-real-estate-growth-in-morocco-says-obg/>

²²⁴ Anderson. A. (2016) Mara Delta to create Morocco Reit. Available at: <http://www.businesslive.co.za/bd/companies/property/2016-09-06-mara-delta-to-create-morocco-reit/>

²²⁵ Anderson. A. (2016) Mara Delta to create Morocco Reit. Available at: <http://www.businesslive.co.za/bd/companies/property/2016-09-06-mara-delta-to-create-morocco-reit/>

²²⁶ Source: author’s own compilation

Country	Management Style	Minimum Investment in Real Estate	Development	Gearing Limit	Minimum Dividend Pay-out	Corporate Income Tax Exemption
Nigeria	Internal	75% ²²⁷	Allowed	15%	90%	No ²²⁸
Tanzania	External	50%	Maximum 10% of total assets	None	90%	No
South Africa	Internal / external	75%	Allowed	60%	75%	Yes
Kenya	External	IREIT: 75% DREIT: 35%	Allowed	IREIT: 35% DREIT: 60%	IREIT: 80% DREIT: Optional	Yes
Rwanda	External	100%	Not allowed ²²⁹	20%	90%	No
Morocco	External	70%	n/a	n/a	n/a	Not yet

²²⁷ Includes government securities

²²⁸ However, company income derived from investments in government securities and corporate bonds is deducted before arriving at the taxable incomes for CIT purposes. Furthermore, the dividends of publicly traded REITs are exempt from withholding taxes (WHT) in the hands of the investors.

²²⁹ However, 20% of total assets can be undergoing refurbishment, retrofitting and renovations

4. Analysis

4.1 REITs in Africa

To date, REITs have been only marginally successful within many of the African countries that have established REIT frameworks. In part, this can be attributed to their early stage of development. However, as explored below, there are a number of other critical enabling conditions not yet in place. This suggests that in addition to exploring the potential for affordable housing REITs in Africa, it is essential to understand the contextual factors that support or undermine REITs more generally. Interviews with a variety of real estate and housing finance experts across the various jurisdictions indicated that a number of pre-conditions need to be in place before REITs can thrive in any given context.

Many of these conditions relate to the institutional strength of the country and property markets in question. For example, robust **property rights** and accurate records of **title deeds** were highlighted as key elements underlying the type of institutional structure required for REITs to emerge.²³⁰ Furthermore accurate and reliable **property valuations** as well as **property market transparency** were identified as essential.²³¹ In other words, a certain level of market development and maturity is required for the REIT structure to work.

The **legislative and regulatory context** was also highlighted as being key. For example, appropriate **rental market legislation** (i.e. legislation that appropriately protects both tenants and landlords) was presented as a pre-condition.²³² Such legislation is particularly relevant in the context of residential REITs. All interviewees emphasized that the tax legislation and financial regulations that define the **REIT framework** need to be drafted appropriately.²³³

Economic conditions were also identified as significant. This is because REITs need economic growth and income to maintain demand. In this context, buyers and a vibrant market (preferably with mortgages in play) are essential.²³⁴ Interest rates constitute another economic factor at play. A high interest rate environment discourages investments in REITs because the opportunity costs increase substantially – especially if investors can invest in high yielding government securities.²³⁵

Interviewees further agreed that REITs require critical mass to attract investor interest, and therefore the emergence of REITs in Africa first requires the existing **property markets to reach a certain scale and maturity**.

Critical mass is important because a REIT needs to be liquid and tradable in order to be attractive to investors. In other words, shareholders need to be able to buy and sell their shares in the REIT relatively quickly and easily. This in turn is only possible in a context in which many different shareholders each hold relatively small percentages of the total shareholdings of a given REIT. Since shareholders – and institutional shareholders in particular – also often seek to make large investments, liquidity and tradability are only achievable in the context of a REIT with a large asset portfolio.²³⁶

²³⁰ Interview with Francois Viruly. Professor of Economics at UCT and Interview with Keith Engel. Deputy CEO of SAIT.

²³¹ Interview with Francois Viruly. Professor of Economics at UCT.

²³² Interview with Francois Viruly. Professor of Economics at UCT.

²³³ What constitutes an appropriate REIT framework in the African context will be further explored in the sections that follow.

²³⁴ Interview with Carel de Wit and Terry Kaplan. CEO and Financial Director of Indluplace and Interview with Heri Bomani. Managing Director of Pangani Group.

²³⁵ Interview with Evans Osano, FSD Africa.

²³⁶ Interview with Brian Azizhaloff. CEO of Capstone Properties.

This concept can be illustrated with an example. Assume that a REIT holds property to the value of US\$100 million, 40% of which is financed through debt and 60% of which is financed through equity (i.e. shares). In this case, only US\$60 million of shares would be in trading. Institutional investors, however, would be looking to invest US\$10 million plus. This would mean that a given institutional investor could come to own one sixth of the total REIT. This would significantly limit the liquidity and tradability of the REIT's shares.

The implication is that REITs need to amass substantial portfolios before listing.²³⁷ Furthermore, in order to grow investor returns, REITs need to continue purchasing / developing properties once they are listed. This, in turn, can only take place in the context of a property market with substantial **existing housing stock** and the existence of **capable, well-governed developers**.²³⁸

4.2 Residential REITs in Africa

The concept of **critical mass** is particularly pertinent in the context of focused REITs, such as residential REITs. Since residential REITs invest only in residential property, the property market needs to be large enough to provide a potential REIT with the opportunity to build up its portfolio through the acquisition of existing residential properties.²³⁹

As demonstrated by the case studies in the previous section, REITs in countries with limited residential property markets have tried to get around this restriction by developing their own residential portfolios from scratch. However, the experiences of these REITs demonstrate that such REITs are not able to generate high and regular returns in the short-term – a key incentive for the REIT model in the first place.²⁴¹ The advantages and disadvantages of REIT engagement in development will be further explored in the sections below.

Another contextual factor impinging upon the feasibility of residential REITs in Africa include the **urban form** of African cities. Interviewees indicated that residential REITs rely upon economies of scale and thus seek to invest in high-density housing, single-ownership apartment buildings²⁴² and large mixed-use developments.²⁴³ Cities that lack such property assets and have limited land availability for this sort of development do not provide ideal environments for the emergence of residential REITs.

Other elements impacting the financial viability of residential REITs include:

- **The issue of VAT:** in certain jurisdictions, property owners can claim VAT on the price paid on the purchase of a commercial property, but cannot claim VAT on the purchase of a residential property.²⁴⁵
- **Land regularization and residential re-zoning:** in many African countries, the procedures required to prepare land for residential development, such as getting properties rezoned for residential use and securing title deeds, are slow and challenging. The inefficiency of such procedures negatively impacts the

²³⁷ In the South African context, for example, it is estimated that REITs need a market capitalisation rate of above R5 billion to be successful. Assuming 35% gearing, this means that REITs need to have property portfolios of above R7.69 billion.

²³⁸ Interview with Heri Bomani, Managing Director of Pangani Group.

²³⁹ Interviews with Renney Plit, CEO of AFHCO and Laurence Rapp, Chairman of the SA REIT Association.

²⁴¹ This is because properties under development are not income-producing (i.e. they are not yet occupied by rent-paying tenants). Therefore, portfolios consisting primarily of such properties cannot immediately provide returns to shareholders in the form of dividends.

²⁴² Residential REITs cannot invest in individual apartments within sectional title buildings, due to the fact that administration becomes too expensive and nobody invests in the overall building.

²⁴³ Interviews with Francois Viruly, Professor of Economics at UCT and Keith Engel, Deputy CEO of SAIT.

²⁴⁵ Hofmeyr, C. Value Added Tax: Residential Property. Available at: <https://www.saica.co.za/integritax/2016/2502-Residential-property.htm>

cash-flow of residential developments.²⁴⁶ A key consideration therefore, is where in the housing delivery value chain REITs can play the most effective role.

- **Higher management costs:** The management time and effort required in residential property is more significant than in other markets, due to the fact that the contracts are shorter and there are more tenants. Although risk is diversified (across tenants), there is more focus on systems and collection methodology than in the traditional market.²⁴⁷

The aforementioned issues differentiate the financial business case of a residential REIT from that of a commercial REIT, and have led investors to question whether or not residential REITs can give rise to high enough yields.

Evidence from the African residential REIT case studies is mixed. On the one hand, in Nigeria, the Union Homes Hybrid REIT failed to distribute dividends in 2014 due to the REIT's negative performance. On the other hand, HFC REIT managed to return a yield of 24.26% in 2015, which was significantly above the year end inflation rate (17.5%), and slightly above the one year Government of Ghana (GOG) note against which HFC REIT benchmarks itself (22.5%). However, none of HFC's yield was distributed to investors, due to fact that HFC REIT is a long-term investment vehicle that focuses on capital growth. In South Africa, Indluplace has on average distributed annual returns of 9.5% to investors. While this is substantially higher than South Africa's average rate of inflation and slightly higher than the average annual dividends delivered by commercial REITs (around 9%), it remains uncertain whether these returns are high enough to attract and maintain interest in the residential real estate sector in South Africa.

This issue, which takes on particular significance in the context of REITs investing in affordable housing, is further explored in the section that follows.

4.3 Affordable Housing REITs in Africa

In the context of this paper, affordable housing REITs simply refer to REITs that invest in residential property that is affordable for the majority of the population in African countries. Assuming that the conditions outlined in Section 4.1 are in place, the feasibility of such a REIT should purely be determined by the extent to which the fund is able to offer investors **returns that are appropriate given the level of risk** associated with the investment portfolio.²⁴⁸ As one interviewee stated: "Investors look only at risks and returns. If the returns outweigh the risks, they will be willing to invest".²⁴⁹

In order to attract private investment, affordable housing REITs would thus have to deliver yields comparable to those offered by other investment assets, such as commercial REITs. These yields would further have to be adjusted in order to take into account the relative level of risk associated with affordable housing as a property asset.

All of the interviewees indicated that **affordable housing as an asset class is perceived by the market to be substantially riskier than the more traditional asset classes**. This is primarily due to the management risks associated with affordable housing, which include:

- **Uncertain effective demand:**²⁵⁰ Effective demand is perceived as uncertain in the context of affordable housing due to the fact that tenants often have low, and potentially unreliable, incomes. This perception is based on the assumption

²⁴⁶ Interview with Keith Engel. Deputy CEO of SAIT.

²⁴⁷ Interview with Laurence Rapp. Chairman of the SA REIT Association

²⁴⁸ Interviews with Michael Bookstaber, Renney Plit, Brian Azizhaloff, Keith Engel, Carel de Wit and Terry Kaplan.

²⁴⁹ Interview with Renney Plit. CEO of AFHCO.

²⁵⁰ Effective demand refers to the level of demand that represents a real intention to purchase by people with *the means to pay*.

that lower income households tend to engage in more precarious employment and suffer more with economic downturns.

- The **inability to evict non-paying tenants** due to legal or reputational considerations: Reputational risks, in particular, become a factor for rental providers in affordable housing, due to the fact that society often perceives it as cruel or unjust to evict lower-income tenants who are unable to pay their rent.
- **Urban decay.**

Affordable housing REITs would thus have to **compensate for this risk by offering yields higher than those provided by the more traditional investment assets**. In the South African context, for example, it is estimated that an affordable housing REIT would need to deliver returns at least two to three percentage points higher than those typically delivered by commercial REITs in order to attract investment from the market.²⁵¹

Whether or not this is possible in practice is a matter of debate, and very much dependent on the particular context. As highlighted in the previous section, residential REITs are already faced with challenges that impinge on their ability to deliver high returns. The sections that follow therefore explore various factors that influence the risk – return profile of affordable housing REITs, with the view of understanding the conditions under which this asset class could constitute a feasible form of market investment in the context of the REIT structure.

Affordable Housing Market Segment

A key determinant of the risk-reward profile of a given affordable housing REIT is the precise segment of the affordable housing market being targeted. Indeed, interviewees indicated that there is a **floor to the income levels of tenants** below which a REIT cannot feasibly go.

This is because, on the one hand, the **risks associated with affordable housing** (outlined above) are perceived to **become more pronounced** the further down the affordable housing market that rental providers go. Indeed, households with a monthly income of US\$1 100 are generally assumed to have a more stable and reliable source of income (i.e. form of employment) than households with a monthly income of US\$330 per month. Similarly, the reputational damage to a rental provider forced to evict a household with a monthly income of US\$330 is likely be worse than the reputational damage that would be suffered if the evicted household had a monthly income US\$1 100.

At the same time, **returns on affordable housing investment tend to decrease** as the income levels of the target market decreases. This is because rental affordability, and therefore household income, determines the levels of rent that a housing provider can charge. For example, assuming that households can put 25% of their income towards rent, a rental provider can charge a monthly rent of US\$275 if its target market is households with an monthly income of US\$1 100. However, the same rental provider can only charge a monthly rent of US\$82 if its target market is households with a monthly income of US\$330. Consequently, REITs targeting the lower end of the rental market (i.e. households with lower levels of income) need to accept **lower levels of rental revenue**,²⁵³ relative to REITs targeting middle-income households.

Operating expenses, however, are more or less fixed, irrespective of the income levels of the target tenants. Certainly, there is a floor operating cost that rental providers cannot go

²⁵¹ Given that commercial REITs are on average delivering around nine percent annual returns, an affordable housing REIT would need to deliver around 11% annual returns in South Africa.

²⁵³ Rental revenue refers to the total amount of money that a housing provider receives from the rent paid by its tenants.

below.²⁵⁴ The **operating profit** (i.e. rental revenue less operating expenses) earned by housing providers targeting lower-income households **is thus necessarily lower** than the operating profit earned by housing providers targeting relatively higher-income households. (Indeed, operating profit becomes negative if the level of rent that the target market can afford is lower than the floor operating costs.)

Operating profit in turn directly influences the net profit that a housing provider makes. Net profit is what remains of the operating profit once the REIT's financing costs have been paid. Consequently, **given financing costs, lower operating profit results in lower net profits.**

It follows that **the only way for a low-income residential REIT to generate profits equivalent to those generated by higher income residential REITs is to reduce its financing costs.**²⁵⁵ In theory this should be possible, as the cost of acquiring / developing²⁵⁶ a building consisting of housing units appropriate for low-income earners is expected to be lower than the cost of acquiring / developing a building consisting of housing units attractive to middle-income earners. However, in practise, **rental providers have struggled** (or have been reluctant to try) **to get the financial model for lower-income housing to work.**

Indeed, to date, very few property investors / developers have succeeded in developing a financial model for low- end affordable housing that yields returns equivalent to those generated by middle-income residential property and commercial property. In the South African context, for example, property investors are generating relatively high returns through the provision of rental housing targeting households that earn between R6 000 (US\$445) and R15 000(US\$1 113) per month. However, these same property investors have largely not been able to arrive at a model that allows for the same returns to be generated in the context of households earning below R6 000 (US\$445) per month.

Nevertheless, more interest is being shown in trying innovative approaches to making the financial model work for lower-income rental housing. For example, with the assistance of concessional financing from the French Development Agency (AFD), AFHCO (Affordable Housing Company) recently re-developed two buildings in the Johannesburg inner-city in an attempt to cater for households earning between R4 500 (US\$334) and R6 000 (US\$445) per month. A communal ablutions model was implemented in order to reduce capital expenditure. The project demonstrated that, **in certain circumstances and with the assistance of certain financial instruments, affordable rental housing can be provided for low-income earners at reasonable rates of return.**

Innovative approaches, such as the one taken by AFHCO and AFD, are key to increasing returns in the context of investing in lower-income housing. Further work in this area could contribute towards making low-income housing REITs feasible from a risk-reward perspective.²⁵⁷

Another approach certain REITs are taking, in an attempt to deliver low-income housing without negatively impacting their risk-return profiles, involves **nesting housing assets catering towards the bottom end of the market within a larger residential or diversified portfolio.**

For example, as outlined in the South African case study, Indluplace rents out a number of small rooms with shared bathrooms and kitchens for R 800 a month. Since these rooms are

²⁵⁴ For example, the floor operating cost is estimated at around R1000 (US\$73) per month in the Johannesburg inner-city.

²⁵⁵ Financing costs refer to the monthly amount paid by the REIT to service its debt. This amount consists in part of the instalment amount and in part of the interest cost.

²⁵⁶ The implications of developing as opposed to acquiring property in this context are explored in the section below.

²⁵⁷ Section 5 further considers the need for innovative approaches to the financing and delivery of low-income housing.

a small portion of Indluplace’s portfolio, they do not significantly influence Indluplace’s overall risk-return profile.²⁶⁰ Similarly, the communal housing units developed by AFHCO (described above) are nested within SACorp’s larger property portfolio.²⁶¹ Large residential and diversified REITs thus potentially have an important role to play in the delivery and management of affordable housing catering for lower-income earners.

Development versus Acquisition of Property

The potential role of REITs in property development takes on renewed significance in the context of affordable housing in Africa.

In addition to contributing towards the fulfilment of a social need (i.e. the provision of additional stock of much-needed affordable housing) and addressing the issue of critical mass (discussed above), it has been suggested that **new development has the potential to enable REITs to achieve higher returns** in the context of affordable housing, thus making the model financially viable.²⁶²

When evaluating the potential role of development in the context of residential REITs, it is necessary to differentiate between property investors that **develop to rent** and those that **develop to sell**.

Developing to Rent

According to various REIT experts, the **development of residential property for the purpose of ultimately renting it out can be made to work in the context of the REIT structure**. The primary source of the REIT’s revenue in such a context would be rental income, which would eventually flow into the REIT in a predictable and relatively regular manner. Consequently, after an initial period of development, the REIT would come to be in a position to distribute regular profits to its shareholders (generated from the inflow of rental income) – dividends that would be relatively high, due to the fact that the REIT’s net profit would not be taxed at the corporate level. In this context, the REIT structure (i.e. the REIT tax arrangements and the associated regulations) would work effectively to incentivise investment in the residential property sector.

Engaging in this sort of development activity in the context of residential property – and affordable housing in particular – **can result in higher returns than simply acquiring property for rental purposes**. This is because new developments allow for the intended affordable nature of the property to be factored into account during the construction process. Thus, like in the AFHCO example above, a residential property could be constructed with relatively small rooms and communal bathrooms – thereby lowering capital expenses (as less bathrooms need to be constructed) and increasing rental revenue (as more tenants can be housed). Higher revenue streams and lower capital expenses (and therefore lower financing costs) ultimately translate into higher returns.

However, it is important to highlight that a REIT of this design would only be able to distribute regular, high dividends once its portfolio of developed properties reaches a certain size. The process of building its property portfolio to a scale at which the portfolio would effectively and consistently generates returns would require significant incubation and investment of capital upfront. **This introduces a higher level of risk into a REIT that**

²⁶⁰ Carel de Wit and Terry Kaplan. CEO and Financial Director of Indluplace.

²⁶¹ In April 2014, SA Corporate Real Estate Limited (SA Corp) concluded a R953 million transaction to acquire the entire issued share capital of AFHCO and its portfolio of 27 Johannesburg inner city properties. According to the CEO of SA Corp, in the context of a scarcity of assets in the traditional spaces, the company was seeking to gain exposure to non-traditional areas with robust investment cases. SA Corp had decided to gain exposure to the affordable housing component of the residential property sector due to the strong fundamentals underlying the sector, and the manner in which it allows property developers to diversify over thousands of leases and to buy into an economic environment.

²⁶² Interview with Renney Plit. CEO of AFHCO.

is seeking to develop, as opposed to acquire, its portfolio – and has the potential to result in the dilution of investor returns in the short-term.

The question thus becomes whether the increased returns resulting from development activity in this context outweigh the higher risks. Interviewees indicated that this approach to property investment does have the **potential to positively impact the risk-return profile of a REIT investing in affordable housing**. However, most interviewees qualified this assertion by stating that such development should only be undertaken in the context of a larger income-producing portfolio.²⁶³ It was suggested that having between 10% and 30% of a REIT's portfolio in affordable housing development could increase the overall returns of the REIT, without noticeably diluting short-run returns or significantly raising the REIT's risk-profile.²⁶⁴

One interviewee nevertheless suggested that, in the context of affordable housing, having a larger proportion of a REIT's portfolio in development could be beneficial.²⁶⁵ According to this argument, although the development stage would slow down the dividend stream initially, the REIT would make up for it from future growth. This approach, however, would only be viable in the context of rental apartments (i.e. not in the context of houses to rent).

Developing to Sell

In the context of the REIT framework, the concept of developing residential property for the purpose of subsequently selling it is significantly more controversial.

The primary source of a REIT's revenue, in this context, would be proceeds from the sale of properties, which would likely flow into the REIT at irregular, non-frequent intervals. Such a REIT would thus **not be in a position to distribute regular, consistent profits to its shareholders**. Rather, its purpose would be to generate long term capital growth.

Such an investment vehicle would therefore not exhibit many of the distinguishing characteristics of the traditional REIT structure, and would carry a lot more risk.²⁶⁶

Critics argue that the "patient capital" required in the context of this sort of REIT is an internal contradiction in the context of REITs, which are synonymous with safe, consistent and predictable cash-flows. According to this argument, classifying such an investment vehicle as a REIT introduces "hidden" risk into a traditionally safe investment asset and therefore has the potential to damage the reputation of the entire REIT industry in emerging markets.²⁶⁷ It is for this reason that the concept of Development REITs (D-REITs) has come under fire from many housing finance experts, who argue that D-REITs ultimately require a different type of investor from that associated with traditional REITs.

At the same time, however, it has been argued that a REIT developing and selling multiple, small units – such as those developed in the affordable housing sector – would be less exposed to risk than a REIT developing and selling a few, large developments (which are typical of the commercial and high-end residential sectors).²⁶⁸ According, to this line of thinking, **the sale of multiple affordable housing units on the market could be viable from a risk perspective**. Nevertheless, even in this context, development would need to

²⁶³ Interviews with Michael Bookstaber, Renney Plit, Laurence Rapp, Brian Azizhaloff, Keith Engel, Carel de Wit and Terry Kaplan.

²⁶⁴ SACorp, for example, has been successfully engaging in residential development in the context of their larger property portfolio and a strong balance sheet. Presently, they are seeking to roll-out about 60 residential units per month.

²⁶⁵ Interview with Keith Engel, Deputy CEO of the SAIT.

²⁶⁶ Property investors that make money on sales, as opposed to rental, carry additional risk because there is no smoothing when the economy takes a hit. Interview with Keith Engel, Deputy CEO of the SAIT.

²⁶⁷ Interviews with Keith Engel, Deputy CEO of SAIT and Michael Bookstaber, Global Housing Strategies.

²⁶⁸ Interview with Keith Engel, Deputy CEO of the SAIT

be kept at **below 30% of the REIT's total portfolio**, in order to ensure the REIT's ability to pay regular dividends to its investors.²⁶⁹

The REIT structure, therefore, is not ideally suited for directly facilitating the development and sale of affordable housing units at scale. Nevertheless, affordable housing REITs have the potential to play an important role in **ensuring demand for affordable housing units, thereby freeing up capital for developers** active in the sector. Indeed, a thriving affordable housing REIT sector would enable developers to develop a pipeline of residential units targeting the affordable housing market segment, with the knowledge and security that they would be able to off-load the units to various REITs once the development stage was complete.

A key question that arises from this discussion, is whether a **modified, more appropriate version of the REIT structure could be developed to incentivise the development and subsequent sale of affordable housing**. In other words, although the REIT structure may not be appropriate for the direct channelling of "patient capital" into affordable housing development, perhaps there is a need for another mechanism that could serve this goal.

One approach could be to create an incentive mechanism, applicable in the context of affordable housing development, which **reduces the financial costs associated with the sale and transfer of property**. In contrast to the REIT structure, which focuses on the reduction / exemption of corporate tax on the condition that the majority of the REIT's profits are distributed, such a mechanism could exempt developers from capital gains tax, stamp duty and transaction tax on the transfer of property.

Such a mechanism would result in significant financial savings for developers selling newly developed property. Large property developers employing this mechanism could potentially attract large institutional investors (such as pension funds) seeking long-term capital growth. When applied in the context of affordable housing, it could thus incentivise the development and delivery of an under-supplied asset at scale.

Although REIT regulations in certain jurisdictions allow for exemptions on capital gains tax, stamp duty and transaction tax, it is proposed that **a separate and distinct mechanism** be applied in the context of affordable housing development and sales. This is because certain other features of the REIT framework, such as the requirement to distribute the majority of profits to shareholders each year, simply do not make sense in the context of an investment vehicle seeking to attain long-term capital growth. In addition, and perhaps even more importantly, creating a mechanism distinct from the REIT framework would avoid the problem of conferring the REIT "brand" on an investment vehicle that has significantly different risk-return characteristics from a REIT – thereby potentially misleading investors looking for safe and regular returns.

²⁶⁹ Interview with Keith Engel, Deputy CEO of the SAIT

5. Recommendations

The analysis of the potential for affordable housing REITs in Africa suggests that the success of such a concept will ultimately depend on two overarching factors:

- The presence of the critical enabling conditions that need to be in place *for REITs in general* to emerge and thrive;²⁷⁶ and
- The ability to increase the returns and decrease the risks associated with *affordable housing as a unique property type*.²⁷⁷

While interventions in less mature markets will typically begin by focusing on addressing the former, interventions in more mature markets will increasingly focus on engaging with the latter.

It is within this conceptual framework that this section explores potential interventions that could be undertaken by government and by CAHF, which would support the potential of residential REITS in the affordable housing market in Africa.

5.1 Potential Government Interventions

Government is the entity best placed to undertake the institutional work required for the property market itself to function effectively, and thus become a suitable context for the large-scale establishment of REITs within the African context. As outlined in Section 4.1., governments seeking to support the emergence of REITs within their countries should focus on entrenching the following enabling conditions:

- a strong, well-enforced system of **property rights**;
- **property market transparency** (e.g. quality property valuation and risk assessment systems);
- appropriate **rental market legislation** (which affords sufficient protection to landlords); and
- **economic stability and growth**.

Importantly, comprehensive and unambiguous **REIT legislation and regulations** should form the foundation of any REIT framework. If such a framework is to achieve the policy objectives behind the REIT structure effectively, at a minimum, it should provide for the following:

- the requirement for a minimum proportion of a REIT's annual income to be distributed to shareholders;²⁷⁸
- a corporate tax exemption on all distributable income; and
- restrictions on the extent and type of development activity that a REIT can engage in.²⁷⁹

Each of these factors need to be addressed in order to support the emergence of residential REITs across the continent. It is proposed that the establishment of residential REIT sectors should not be attempted in countries where the majority of these conditions are not being

²⁷⁶ This is explored in Section 4.1

²⁷⁷ This is explored in Sections 4.2 and 4.3

²⁷⁸ The minimum pay-out requirement should seek to achieve a balance between enforcing the REIT's commitment to providing high, regular dividends, and allowing for the REIT's capital investment and flexibility needs.

²⁷⁹ See Section 4.3 for a discussion around this issue. It is proposed that a mechanism distinct from the REIT framework, which allows for exemptions on capital gains tax, stamp duty and transaction tax, be introduced to incentivise the *development, sale and transfer* of affordable housing.

met. Attempting to do so, may harm the reputation of the REIT structure in the long-term.²⁸⁰

Other potential government interventions, outlined below, are based on the idea that government can play a role in **decreasing the costs and minimizing the risks associated with the development, acquisition and management of affordable housing** as an asset class. The purpose of such interventions would be to incentivise individuals and / or institutions considering various investment options to invest in affordable housing.

Allowing property owners to claim **VAT on the purchase and construction of residential property** is one intervention that interviewees indicated would go a long way towards decreasing the costs associated with affordable housing in the REIT context.²⁸¹

At the municipal level, additional **interventions aimed at reducing costs** could include:

- increasing the pace of **land regularization and preparation** (including infrastructure investment) **and residential re-zoning**;
- lowering **municipal levies** on affordable housing; and
- enforcing effective **urban management**.

If implemented effectively, such interventions would positively influence the returns that could be generated on a REIT's investment in affordable housing.

At the same time, the perceived **effective demand risk** faced by affordable housing REITs could potentially be mitigated through government intervention. For example, government could engage an affordable housing REIT in the process of housing government officials. In this context, government could deduct rent directly from officials' salaries, thereby providing a measure of insurance to the REIT that rentals will be paid.²⁸³

Taking this concept one step further, government could enter into head leases with REITs investing in affordable housing and targeting low-income earners. This would essentially amount to government underwriting the rentals paid by the affordable housing tenants, thereby eliminating the non-payment risk faced by affordable housing REITs.²⁸⁴

These approaches to minimizing the risk associated with investment in affordable housing could significantly contribute towards the stimulation of investor appetite for affordable housing REITs.

Finally, government could experiment with approaches to incentivising market investment in affordable housing through the application of **innovative financial instruments** that serve to increase returns on private investment in the sector.

For example, government could facilitate the replication of projects similar to the AFD / AFHCO communal housing project (discussed in section 4.3) through **the provision of grants in the form of concessionary financing** to REITs, on the condition that a set proportion of the housing units acquired and / or developed are allocated to beneficiaries that fall within a specific income target group.²⁸⁵

While such an approach would serve to stimulate investment by property developers and investors in affordable housing more generally, it would be particularly impactful in the

²⁸⁰ Interview with Francois Viruly. Professor of Economics at UCT

²⁸¹ Interviews with Keith Engel, Deputy CEO of SAIT and Renney Plit, CEO of AFHCO.

²⁸³ Interview with Keith Engel. Deputy CEO of SAIT

²⁸⁴ Interview with Brian Azizhaloff. CEO of Capstone Properties.

²⁸⁵ Despite the fact that such an approach would require government funding, the AFHCO example demonstrated that the approach would likely be more cost-efficient than the existing social housing programme.

context of the REIT market – due to the large amounts of capital it could potentially attract from existing REITs seeking to diversify into new, yield-producing sectors.

5.2 Catalytic Areas of Focus for CAHF

A key barrier to the establishment of affordable housing REITs within African countries is a lack of awareness and knowledge around this type of investment product. Interviewees indicated that in most African countries private investors, fund managers and property developers don't understand this type of product or its benefits, and are therefore not inclined to invest in it.

It is in overcoming this overwhelming market ignorance across Africa that CAHF has an important role to play. This objective could be achieved through a number of channels, including:

- The compilation and dissemination of **country-specific market studies**. Such studies would need to give an indication of the relative market readiness of countries across Africa with respect to supporting the emergence of affordable housing REITs. The reports would need to be comprehensive and be presented in a format familiar to property investors and developers.
- The **facilitation of workshops** with government officials, property investors, fund managers and developers in which the REIT structure and its benefits are explained, and approaches to implementing the structure in the context of affordable housing are discussed.
- The **development of online platforms** that provide information regarding the existence and performance of residential REITs across the continent, and provide an interface for informed online trading. Such a platform would open up the market beyond existing broker networks.²⁸⁶

In addition, given that the South African REIT market is significantly more advanced than REIT markets in other African countries, a **South African study tour** for representatives from diversified and residential REITs located in other parts of Africa could be arranged. For example, representatives from HFC REIT, Union Homes Hybrid REIT, and Watumishi Housing Company could be invited to meet with core players in the South African REIT industry and affordable housing sector (including Indluplace, AFHCO / SACorp and Transcend). In addition to learning about South Africa's REIT framework and the contextual factors that have facilitated the success of REITs in South Africa, the visiting stakeholders could gain further insight into how the REIT structure has been applied in the context of residential property and affordable housing in particular.

A final potential intervention for CAHF involves **engaging with investors, and impact investors in particular**, who have previously shown interest in investing in affordable housing REITs internationally.²⁸⁷ The purpose would be to enlist the assistance of impact investors in establishing a "demonstration" affordable housing REIT in Africa, which could yield interesting insights into how to get the financial model to work in the context of affordable housing. Although the ultimate aim would be to attract the capital of investors seeking financial returns (as opposed to social returns), enlisting the assistance of impact investors in establishing a "demonstration" REIT has the potential to prove to the market that an affordable housing REIT can yield competitive returns when done appropriately. This, in turn, could set the process in motion for establishing a profit-orientated affordable housing REIT sector in Africa.

²⁸⁶ Interview with Patrick Mususa, Projects and Business Development Manager at the Dar es Salaam Stock Exchange.

²⁸⁷ For example, see Case Study 1: Housing Partnership Equity Trust - United States.

6. Conclusion

Internationally, the REIT structure has proved to be an effective mechanism for attracting retail and institutional investment capital into global real estate markets. While the nascent REIT market in Africa has demonstrated the need for certain enabling conditions to be in place before REITs can thrive, it has also confirmed the huge potential that such a mechanism has for channelling investment into African real estate markets.

The application of the REIT structure in the context of residential property in Africa, and affordable housing in particular, introduces unique challenges. The fundamental question becomes whether or not REITs investing in affordable housing are able to generate competitive returns, given the specific costs and risks that exist in the affordable housing sector.

Addressing this question requires private sector experimentation as well as government and NGO support. The private sector needs to be incentivised and supported in experimenting with various segments of the affordable housing market, as well as with the appropriate role for property development in the context of affordable housing REITs. It is proposed that if, in addition, government and NGOs intervene to minimize the risks and costs associated with affordable housing, a viable affordable housing financial model can be developed. Such a financial model would have the impact of making the affordable housing segment an attractive target market for REITs, which in turn could potentially stimulate much-needed retail and institutional investment in affordable housing markets across Africa.

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8. Appendix A: Alternative Funding Structures

The various types of funding structures competing with the REIT structure in the context of housing will vary depending on the features of the national housing market in question. A national housing market is classified in accordance with a list of variables, which may include:

- the transparency of the real estate market, which is reflected by various indicators such as data availability, regulatory and legal factors, and ethical standards among professionals;
- the level of involvement of the government in the development of an affordable housing market through housing finance schemes;
- the size of the banking industry (domestic credit), equity market and bond market;
- the ratio of mortgage loans to GDP, the maximum loan-to-value ratios, and the maximum mortgage terms available;
- real estate taxes and transaction costs;
- the scale of a Mortgage Backed Securities market; and
- the institutional framework for MBS issuance, including the effectiveness of the legal framework, the enforcement of ownership transfer, the enforcement of foreclosure, SPV arrangements, tax treatment and restrictions on multiple-tranche securitization.

A given housing market's state of maturity will determine which funding structures are relatively more or less accepted by both retail and institutional investors. Furthermore, this will be influenced by the specific local regulatory and institutional environment. For example, certain countries will have institutions mandated to actively support affordable housing by setting up special affordable housing funding and tax vehicles.

Below a number of affordable housing funding structures are listed.²⁸⁸

Conventional Loans

Conventional loans are mortgages that are not insured or guaranteed by the federal government. They are the most difficult to qualify for due to their requirements for down payments and qualifying criteria which may include a minimum credit score and income.

They also come with certain costs, such as private mortgage insurance. Conventional loans are generally more costly than forms of government guaranteed mortgages.

Fixed vs. Floating Rate Mortgages

When it comes to interest rates, there are effectively two types of mortgages: fixed-rate mortgages and floating-rate mortgages.

A fixed-rate mortgage is one where the rate does not change for the entire period of the loan. The benefit of getting a fixed-rate loan is that the borrower knows what the monthly loan costs will be for the entire loan period.

However, a floating-rate mortgage, such as an interest only mortgage or an adjustable rate mortgage can be structured to assist first-time home buyers or people who expect their

²⁸⁸ In order to compare these various funding structures to the REIT a comprehensive review of the context in which the structures exist would be required. In other words, in-country research exploring the regulatory and tax environment would need to be conducted.

incomes to rise substantially over the loan period. There are a large number of different rate structures that can be applied depending on the legal and tax regulatory context.

Mortgages and Grants

Depending on the policy and fiscal context, governments can potentially provide a diversity of funds and grants to assist with affordable housing.

Federal funds can be made available at the local and state level to the retail housing finance market, and / or through experienced organisations such as housing ministries.

Grants can take the form of:

- project-based rental assistance to low-income households, in the context of affordable, privately owned, multifamily projects;
- closing cost assistance (i.e. reduced cost of finance) to provide affordable housing opportunities for developers as well as low- and moderate-income first-time home buyers;
- community development grants for low- and moderate-income persons in both urban and rural areas; and
- construction cost supplementary finance, in the context of the development of affordable housing for low-income families through multiple partners.

Mortgage-Backed Security (MBS)

A MBS is an asset-backed security that is secured by a mortgage or a collection of mortgages. These securities are grouped to obtain a rating determined by an accredited credit rating agency, and usually pay periodic payments that are similar to coupon payments. Furthermore, the underlying mortgage must originate from a regulated and authorized financial institution.

Non-profit social housing organisations

Social housing organisations are non-profit sector associations that originated in the Netherlands. As social enterprises, these specially registered entities pursue social goals. They seek to ensure an adequate supply of affordable, good-quality homes for the less privileged, lower-earning individuals in society.

Social housing organisations are required to monitor their social performance, involve various interested parties in their policymaking and account for their policy decisions to public stakeholders and society.

New investments are primarily financed through bank loans, which are secured using their assets. This makes the sector highly capital intensive and dependent on the situation in the financial markets.

In this context, the sector is looking for new forms of funding. Bonds are becoming more popular instruments for financing such organisations. Social housing organisations have also begun looking at the possibility of reinvesting their incomes within closed systems that essentially act as revolving funds.

Shared Equity

In certain countries, shared equity schemes are an option for addressing the affordability concerns of young households seeking to become home owners. Shared equity schemes

have the potential to facilitate home ownership for those households who may have difficulty purchasing a home through the open market.

These schemes vary in detail but broadly allow the consumer to obtain part equity in a home by sharing the overall cost with an equity partner — either a financial institution or a government backed provider. The involvement of an equity partner helps to reduce the overall costs involved in a mortgage, and thus improves housing affordability.

Community Land Trusts (CLTs)

A CLT is a mechanism, originally developed in the USA, which is receiving increasing attention internationally.

According to this model, a not-for-profit CLT is established to acquire land to be held in perpetuity. Dwellings are then built on the land. A long term ground lease is created which allow for dwellings to be leased by low to moderate income households. The ground lease sets out legal obligations of the two parties i.e. occupier and CLT. The ground lease provides the occupier of the building exclusive use of the land on which the buildings sit. The long term ground lease will also have a value, which means that the ground lease with improvements can be bought and sold.

In effect the CLT model is a form of lease hold common in the business sector but adapted for residential purposes. Under a CLT the provisions of the ground lease needs to be such that any transactions of the ground lease require the approval from the CLT as landowner. Approval of the disposal and purchase of the ground lease by the CLT, as well as caveats contained within the ground lease, will ensure that the sale price is kept to a predetermined affordable level that also allows for some share of capital gain on the dwelling and improvements.

By controlling this aspect the CLT also ensures that the potential purchaser meets eligibility requirements. With these restrictions in place, affordability remains in perpetuity and the control of the land remains under the management of the CLT. The ground lease also provides the CLT with power if the owner of the building does not use the building responsibly. In other words, the CLT can force owners to make repairs as required.

The ground lease should also provide for first right of purchase to the CLT if an owner decides to sell. The CLT should therefore proactively manage the risk of inheriting a building requiring substantial renovations.