

Understanding real estate development for Real Estate
Investment Trust (REIT) Policy in South Africa: A case study
of the eThekweni Metropolitan area and the KwaDukuza
municipal area

by

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DECLARATION

Submitted in partial fulfilment of the requirements for the masters degree of Development Studies, in the Graduate Programme in Faculty of Humanities, Development and Social Science, University of KwaZulu-Natal,
Durban, South Africa.

I declare that this dissertation is my own unaided work. All citations, references and borrowed ideas have been duly acknowledged. It is being submitted for the degree of Development Studies in the Faculty of Humanities, Development and Social Science, University of KwaZulu-Natal, Durban, South Africa. None of the present work has been submitted previously for any degree or examination in any other University.

Student signature

Abstract

This study explores the policy implications of Real estate Investment Trusts on urban restructuring and attempts to uncover if monitoring and evaluating mechanisms are needed. This issue is relevant to South Africa for competing globally and domestically for real estate investment. Furthermore it is relevant to South Africa given the potential impact of unregulated property development and the implications for the poor. The study also investigates the implications of REIT investing over all types of property types and implications for spatial policy proposals

Acknowledgements

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List of Acronyms

BBBEE	Broad Based Black Economic Empowerment
BEE	Black Economic Empowerment
BRIC	Brazil, Russia, India, China
CISP	Collective Investment Scheme in Property
FDI	Foreign Direct Investment
FSB	Financial Services Board
GDP	Gross Domestic Product
IDP	Integrated Development Plan
IMF	International Monetary Fund
JSE	Johannesburg Stock Exchange
REIT	Real Estate Investment Trust
RSA	Republic of South Africa
KZN	KwaZulu Natal
PGDS	Provincial Growth and Development Strategy
PSEDS	Provincial Spatial Economic Development Strategy
MSA	Municipal Systems Act
OECD	Organisation for Economic Co-operation and Development
PGDS	Provincial Growth and Development Strategy
SDF	Spatial Development Framework
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
USD	United States Dollar

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Chapter 1: Introduction

Property investment in South Africa is mostly carried out through Collective Investment Schemes and Property Loan Stock (PLS) companies. A Collective Investment Scheme in Property (CISP) is administered through the Collective Investment Schemes Act No. 45 of 2002 and a Property Loan Stock is administered through the Companies Act No. 71 of 2008. Tax benefits for property investment companies are incurred through these relevant legislative frameworks. Under a new proposal Property Loan Stock companies and Collective Schemes in Property are to be converted to Real Estate Investment Trusts. Transition rules will allow Property Loan Stock Companies and other property companies to convert to Real Estate Investment Trusts provided they meet the relevant Real Estate Investment Trust qualifying criteria (RSA National Treasury of SA, 2008:5).

The South African National Treasury is reviewing the real estate investment structure within the country for two reasons. Firstly, the Treasury is of the opinion that the current property investment landscape is fragmented, partly regulated and not internationally competitive. The second reason is that there is an inconsistent tax treatment of the two different types of property investment vehicles (Collective Investment Schemes and Property Loan Stock companies) due to differences in their legal forms and governing regulatory legislation (RSA National Treasury, 2007:2). As of September 2009 the National Treasury of South Africa was still working on REIT policy for South Africa (Email communication with a Senior Economist Petrus Johannes Cillie Swart from the Financial Sector Policy Unit at the National Treasury of South Africa).

A further factor behind the Treasury's proposal is that REIT is an internationally form of property investment and it is expected to enhance integration of a more liberalised financial system of property investment for South Africa. The Real Estate Investment Trust regulatory amendments are to be housed under the Collective Investment Schemes Control Act No. 45 of 2002.

1.1 General problem area and theoretical framework

A policy proposal put forward in the discussion document 'Reforming the listed property investment sector in South Africa' under income and asset rules, is that 'there will be no restrictions on the types of properties (i.e. open land, residential, commercial or industrial) allowed for Real Estate Investments Trusts' (RSA National Treasury, 2007:13). One of the issues considered for tax dispensation in real estate investment trusts is that policy makers need to understand the development stage (market) of the commercial real estate market of a country before considering or following any international Real Estate Investment Trust (REIT) design (RSA National Treasury, 2007:25-26). The question arises, how should the National Treasury of South Africa understand the development stage (market) of the real estate sector and should Real Estate Investment Trusts be permitted over all types

of property? The concept of the development stage of the real estate sector refers to the market of the real estate sector. In an economic sense, market refers to 'any arrangement that enables buyers and sellers to get information and to do business with each other' (Parkin, 2003:44). In this case the market focused on is the development sector for REITs (ie. development of tangible buildings and structures on the built environment).

The research postulates that monitoring and evaluating mechanisms are needed to understand the development stage (market) of real estate sector to determine the viability of permitting Real Estate Investments Trusts over all types of properties.

The World Bank's *Global Development Finance Report* (2007:64) has argued that 'a more modern monitoring framework is required to enable lenders, borrowers, and policy makers to access underlying risks on an ongoing basis so that preventative measures may be considered'. The report adds that 'assessing risks entailed by foreign participation in domestic debt markets is complicated by the lack of monitoring systems for tracking cross-border portfolio investment flows' (World Bank, 2007:64). Furthermore the 'inability to properly compare one country's REIT performance to others when using audited financial statements will remain a problem for analysis and investors' (Ernst and Young, 2007:29). Proper monitoring of the market is necessary to protect the interests not only of business but the broader societies in which they operate. Bhattacharya and Stiglitz (1999: 131) caution that 'developing countries need to create regulatory structures that encourage safe and sound financial institutions while at the same time calling for increased transparency and accountability of decision makers in the private and public sector to avoid crisis within an economy'.

This research is framed within the broader debate between those who sought greater deregulation and those that who have cautioned against an entirely deregulated environment. The South African Government's proposal to reform the listed property sector is evidence that policy makers want to integrate further into global financial markets to encourage investment in South African real estate. Stiglitz (2002: 14) cautioned that 'the liberalization of financial markets has encouraged capital inflows to developing countries however developing countries have been urged to be cautious on the behaviour and impact of capital inflows on their economies. Capital market liberalisation has played an increasing role in economic crises of countries'. The World Bank's *Global Development Finance report* (2007: 1) shows that 'most developing countries have taken advantage of favourable external conditions to implement domestic policies designed to reduce their vulnerability to financial turmoil and reversals in capital flows'. As the events of the financial crises unravelled over the last two years it has become evident that the conditions to implement domestic policies to reduce financial turmoil are now less attainable and insulation from these conditions have proved to be difficult. The broader

issue to be investigated is the liberalization of real estate markets and its impact on urban form in relation to the case study of KwaZulu Natal.

This research is also framed within the theoretical framework reflecting a 'crises in the space economy of capitalism' (Harvey, 1982: 413-429). Harvey (1982:415-417) argues that the circulation process of capitalism contributes to a process of uneven geographical development within the built environment. The capitalism process also results in a business cycle consisting of different phases ie. Stagnation, recovery, credit based expansion, speculative fever and a crash (Harvey, 1982:300-305).

1.2 Aim of study and research questions

A weakness of urban spatial policy in post apartheid South Africa is that it did not address economic drivers of spatial form or take into account the way politics and the range of social needs for space (Todes, 2006:67). The aim of this research is to contribute to policy making in the real estate investment sector by understanding the development stage (market) of the real estate sector and its implications on urban spatial policy in South Africa. A case study of the Ethekwini Metropolitan and Kwadukuza Municipal areas is used to identify major real estate investment trends and implications on spatial policy. The key questions asked to achieve the aim of the study are

- According to stakeholders how should National Treasury understand the development stage (market) of the real estate sector?
- What is the significance of the development stage (market) of the real estate?
- Should REITs be permitted over all types of property?
- What methods currently exist to monitor and evaluate the real estate sector in the case study area?
- What implications will REIT have on spatial policy?

1.3 Limitations and key assumptions

The South African National Treasury proposes various reforms for the listed Property Investment Sector in South Africa. The research investigates one out of the seven reform categories ie. income and asset rules and one of the proposals under it namely, 'There are no restrictions on the types of properties allowed i.e. open land, residential, commercial or industrial' (RSA National Treasury, 2007:13). The introduction of a proposed REIT framework took place in what we now know to be the build up to a global economic crises resulting from the bursting of the property bubble. This study concentrates on the conditions prior to the crises itself. While it incorporates some reflections on the implications of the crises, some interviews were conducted before the crises happened. While this is in some ways a limitation, it does offer an insight into prevailing thinking prior to the crises. To the extent that Treasury is proceeding with its plans, it is doing so with a combination of pre-crisis assumptions and revisions flowing from the crises itself. This dissertation will be less able to comment on the latter. Furthermore, another major limitation of the study was the inability to get

developers themselves to contribute to the research. During email communication to source data in September 2009 a Senior Economist at the National Treasury (Petrus Johannes Cillie Swart) advised that ‘some of the information’ pertaining to reforming the listed property sector in South Africa is still confidential. The reluctance of developers to contribute to the research can be attributed sensitive or confidential data within the real estate industry.

1.4. Description of research methodology

The research follows a qualitative analysis and the intention of the researcher was to review relevant literature, interact with key respondents through telephonic, email and face to face interviews. Interviews were transcribed and arranged according to particular themes for analysis.

In order to identify real estate development trends, a study of the major development application trends in the eThekweni Metropolitan and KwaDukuza Municipal areas was undertaken. This was achieved by data sourced from the development application register at the Department of Local Government and Traditional Affairs. The objective of this exercise was to investigate the spatial trends in real estate markets and its impact on urban form in relation to the case study of the eThekweni and KwaDukuza Municipal areas. Furthermore the objective was to determine what methods are used to monitor and evaluate real estate at a local government level. The eThekweni Metropolitan Municipality and KwaDukuza Municipality are two Local Government structures form part of what the provincial Department of Economic Development define as a the bigger primary corridor from the Ethekeeni to the Umhlatuze Municipal areas (DED, KZN, 2006:19-22). A primary corridor is ‘a corridor with very high economic growth potential within all sectors that serve areas of high poverty densities’ (DED, PSEDS, 2006:21). According to the KwaZulu Natal Provincial Spatial Economic Development Strategy (2006:28) the objective of the [eThekweni] Durban – [KwaDukuza] Stanger corridor is ‘the sustainable management of industrial and residential land development.’ Therefore the study area is an area identified as significant by the provincial government.

1.5 Data collection techniques

The research entailed collecting data through the following techniques:-

The first was a desktop study. A main source of information for this research has been from secondary material. A review of relevant publications was undertaken in order to build up and analyse an archive of relevant material. The review of secondary material such as articles, government reports and discussion papers, reports Human Sciences Research Council and reports from international organisations such as the World Bank, International Monetary Fund and United Nations Conference for Trade and Development proved to be an important source of information for a desktop study and has assisted when interviews were not secured.

Interviews with national government officials were not secured, however a relevant discussion document 'Reforming the Listed Property Sector in South Africa, Response document (2008)' was emailed to the researcher from an official (Katherine Gibson, Director Financial Policy) at the National Treasury of South Africa. Interviews with private sector property companies did not materialise however this was partially overcome with a review of relevant secondary material for a desktop study.

The second source of data collection has also been through primary interviews with relevant role players at the local and provincial government level. A total of three interviews at a local government level (eThekweni City Treasurer Krish Kumar, Manager Real Estate Keith Maithus and Manager Land Use Management Lekha Alopi) and two provincial government level planners (Ashena Ramloutan and Julian Kiepal) were done.

1.6 Managing and recording data

Data that was collected has been arranged into themes. The questions above guided the organisation of the material. This type of thematic analysis is an acceptable theory driven approach and involves sorting of information into themes and is then followed by an analysis of data (Haynes, 2000). During data collection 28 themes were identified and slotted under 2 major themes ie. Global real estate trends and debates, and summary of property investment in South Africa.

1.7 Ethical Considerations

The study involved the participation of professional human subjects in relevant fields of occupation and did deal with sensitive matters pertaining to government policy formulation for the listed property sector. To ensure that participation is subject to informed consent, an informed consent form outlining the purpose of the study and informing respondents about their rights has been prepared. The research done has followed ethical norms for research as dictated by the University of KwaZulu-Natal ethics committee.

Chapter 2: Global real estate trends and debates

The following chapter consists of a literature review for REITs and unpacks investment trends and debates in the real estate investment sector. The chapter explores the types of land uses that global REIT investment in and the international policy reforms that countries are engaging in to accommodate REIT. REITs have been both a key reason for and outcome of the liberalisation of property investment. This liberalisation was initially prominent in the US although this format has now spread globally. In essence it allows many more investors, to participate in the financing of property development.

2.1 Definition and history of Real Estate Investment Trust

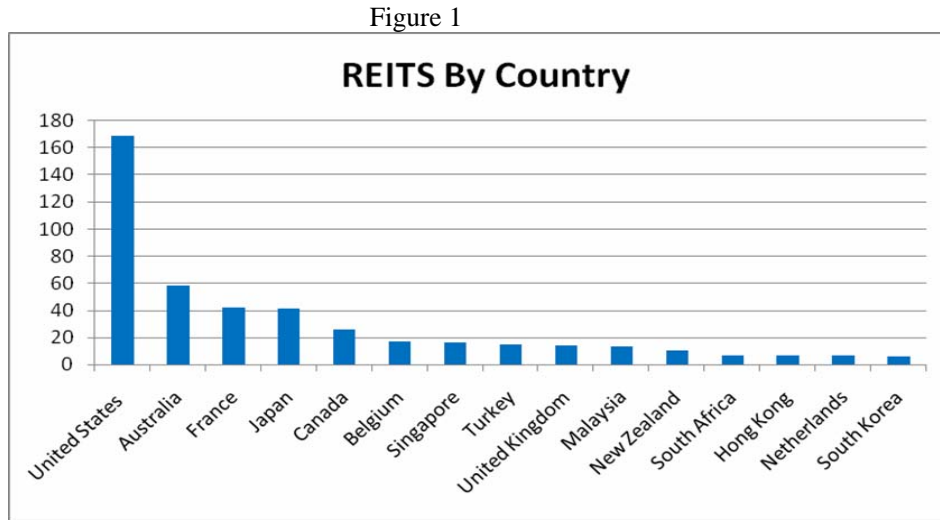
According to NAREIT (2009:2) a REIT is a ‘company that mainly owns, and in most cases, operates income-producing real estate such as apartments, shopping centers, offices, hotels and warehouses. Some REITs also engage in financing real estate. The shares of many REITs are traded on major stock exchanges.’

A Real Estate Investment Trust is an investment vehicle that enables investors with relatively limited means to pool their funds and invest in real estate projects that require substantial sums of money (Larson, 2003:70). According to Campbell and Simrans (2002:388) ‘Real Estate Investment Trusts are a special form of corporation created by the United States of America in 1960 to encourage liquidity and to improve efficiency of capital allocation in the real estate sector’. Real Estate Investment Trusts provide an opportunity for small scale investors to indirectly invest large scale real estate projects (Larson, 2003:70). The growth of Real Estate Investment Trusts in the US set the stage for the adoption of the REIT approach to securitized real estate investment across the globe (NAREIT, 2006:np). Packaged into real estate mutual funds, REITs are said to help investors combat inflation in the long run by providing some defence against the erosion of purchasing power without hampering overall returns (Benjamin and Zweig, 2006:63).

2.2 Global context of property investment and development

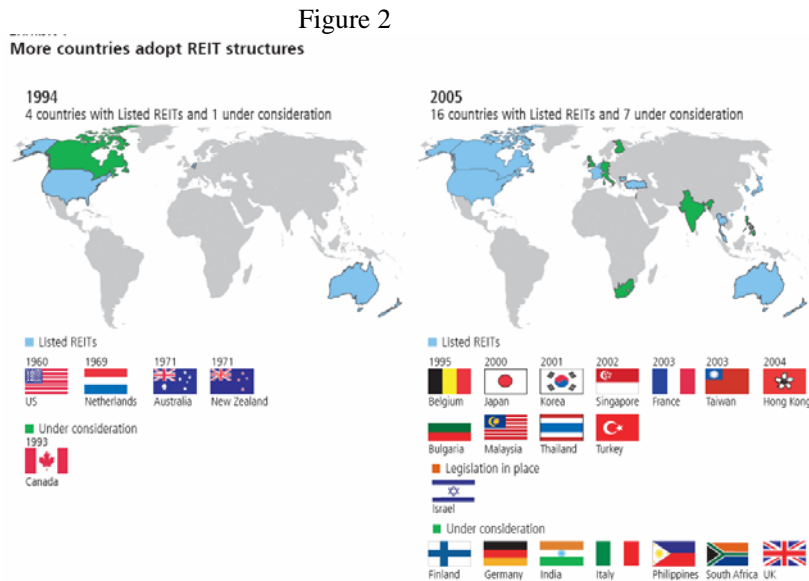
In order to understand the development stage (market) of the commercial real estate sector an understanding of real estate trends and debates at a global, country level, provincial or regional and local level needs to be understood. International investors, global economic financial consultancies and property service providers in property are increasingly gaining access to global property benchmarking information thereby building up intellectual capital. Furthermore Real Estate Investment Trusts are becoming the standard vehicle for property investment. The United States of America has the largest number of Real Estate Investment Trusts followed by Australia, France, Japan

and Canada (Ernst and Young, 2007:11). Figure 1 shows the number of Real Estate Investment type vehicles by country.



Source: Ernst and Young (2007:11)

The international market for tax-privileged publicly listed real estate companies started to explode since 2000 with more and more countries having introduced vehicles which orientate on the US-model (Unger, 2006:np). REITs are expanding their real estate investments across borders resulting in more real estate assets becoming globally securitized. Real Estate Investment Trust opportunities are therefore increasingly being designed with a global scope (Chen and Mills, 2006: i-ii).



Source: Chen and Mills (2006: 8)

Figure 2 depicts the various countries have and are proposing REIT regimes. Germany introduced REIT structures in 2007, whilst Italy was planning to adopt REIT structures in 2008. Germany, Italy and the United Kingdom are significant world economies and their presence in the listed REIT market is set to transform the European region into a world force in REITs rivalling North America in scale and activity. In August 2007, the Philippines released Senate Bill 93 titled 'The Real Estate Investment Trust Act of 2007' (Ernst and Young, 2007:6). The United Kingdom REIT regime is set out in Part 4 of the Finance Act of 2006 and came operational on the 1st of January 2007 (London Stock Exchange, 2006: 22).

When China implements its REIT regime, it will have major implications on the global REIT market. China has began work on a pilot REIT project to test the proposed legal framework. In China, before a new law is established, the Government selects a pilot project so regulators can determine conflicts or potential problems (Ernst and Young, 2008:16). The initial REIT project was expected to start during early 2009 with industrial assets in Tianjin, China. Many prominent Chinese investment companies are vying for the right to sponsor the first pilot project. The Chinese REIT structure is expected to be fundamentally different from its international counterparts and tailored to fit the Chinese environment (Ernst and Young, 2008:16).

Mohammadi and Payne (2004) identify three categories of REITs i.e. 'equity, mortgage and hybrid'. They define equity REITs as those which hold at least 75% of their assets in income generating real estate. This contrasts with mortgage REITs which 'hold at least 75% of their assets in residential and commercial mortgages as well as short and long term construction loans, acquisition of loans or indirect lending through mortgage backed securities'. Hybrid REITs share the properties of equity and mortgage REITs by both owning properties and lending to owners and operators (Mohammadi and Payne, 2004:1211-1212). Currently, more than '90 percent of the nearly 200 publicly traded U.S. REITs are equity REITs that own and most often manage commercial real estate and derive most of their revenue and income from rents' (NAREIT, 2006). Governments and markets favour REITs because they 'enable industrial and service companies to sell off their corporate real estate, leaving in the hands of property professionals and freeing up capital for core business and they enable small investors to safely invest in property, enjoying the diversification benefits of this asset class and its qualities as protection against inflation' (Eichholtz and Kok, 2007:1).

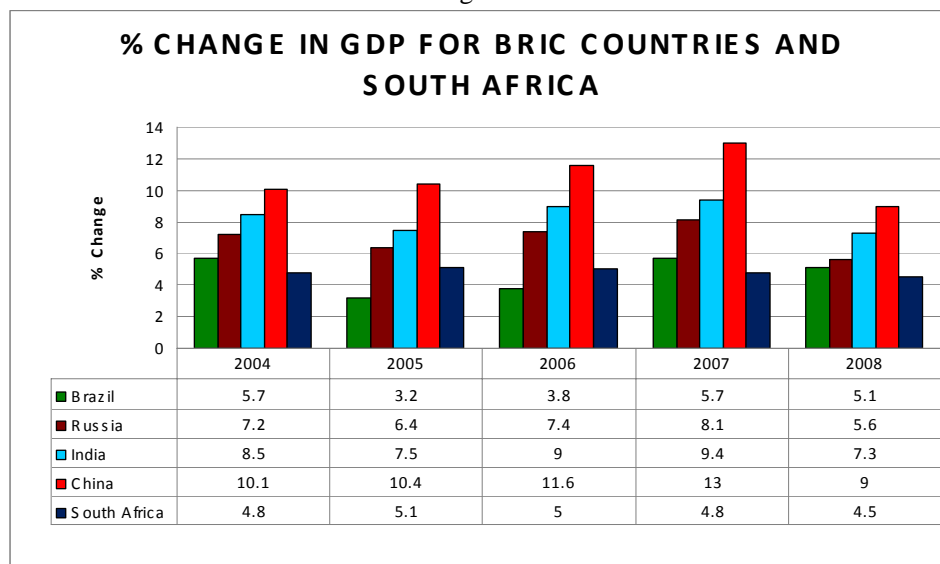
2.3 Foreign direct investment in real estate

According to Chang and Grabel (2004:107) the 'cross border purchase of real estate is classified as foreign direct investment'. Foreign direct investment refers to the 'purchase of controlling interest in a business of a country other than one in which the investor resides' (Chang and Grabel, 2004:107).

According to Chang and Grabel (2004:107) FDI can take one the two forms ie: greenfield and brownfield investment. Greenfield investment involves the construction of a factory by a foreign investor and brownfield investment refers to mergers and acquisitions of companies and also includes the purchase of assets of existing domestic firms (Chang and Grabel, 2004: 107).

REITs are increasingly packaged into stock exchanges of the world. REIT investors are showing interest in Brazil, Russia, India and China (BRIC). A number of analyses forecast that South Africa is to join the BRIC group (FM, 2008:11). Figure 4 identifies the percentage change in GDP for Brazil, Russia, India, China and South Africa. The BRIC countries with 40 percent of the world’s population spread out over three continents, already account for 25 percent of global GDP (IMF, 2009:np)¹.

Figure 4



Source: IMF Article IV Consultation papers for BRIC countries and South Africa (2004-2008)

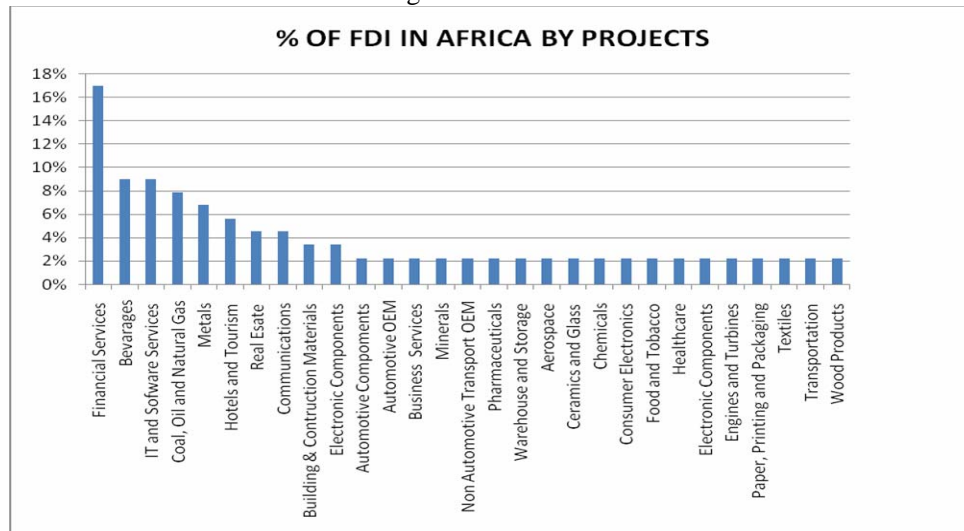
According to property investment specialists, property funds have shifted from developed to emerging markets with BRIC countries presenting opportunities for REIT investments (FM, 2008:11). The International Monetary Fund (2009) predicts that BRIC countries are going to be driving the global economic recovery. In addition to China’s introduction of REIT structure (mentioned above), India too is planning a framework to accommodate REITs (Ernst and Young, 2008: 7; SEBI, 2008). Brazil accommodates a REIT investment structure under Fundo de Investimento Imobil Āirio – FII (Da Rocha, No Date). Russia has a Russian real estate fund which was established in 2003 (Unger, 2006: no page).

¹ Gross Domestic Product (GDP) refers to the ‘total final output of goods and services produced by the country’s economy, within the country’s territory, by residents and nonresidents, regardless of its allocation between domestic and foreign claims’ (Todaro, 1997: 696).

2.4 Foreign direct investment in real estate for Africa

A number of policy measures adopted by several African countries continued to make the business environment more conducive to FDI. However the sharp decline in commodity prices and the slowdown in global economic growth in the second half of 2008 may signal a possible reversal of the trend towards rising FDI in 2009 (UNCTAD WIR,2009:42). According to Africa Investor (2008:116) FDI in the real estate sector for Africa accounts for just over 4% of the number of projects by sector. Figure 5 identifies the % of FDI projects in Africa.

Figure 5



Source: Oyando (2008:116)

A number of countries have been establishing or strengthening food security measures through investment in agriculture abroad. This trend that is due to increase over the long term (UNCTAD WIR, 2009:xxvii). According to UNCTAD WIR,

Food security has also become a major driver for new investors who include companies and funds (some State-owned or backed) from a variety of countries, especially the Republic of Korea and Gulf Cooperation Council countries. Investors in developing countries have become major sources of cross border takeovers in 2008 (2009:xxvii)

Real Estate Investment Trusts can also provide a financial investment vehicle for investment in agricultural sector if the REIT policy within the host country permits investment in the agricultural sector. A key debate for FDI in the agricultural sector is that 'host nations need to consider the possible implications of such investment for their own food security, land distribution and economic development objectives' (UNCTAD WIR, 2009:167). World bodies such as UNCTAD (2009) have argued that 'developing countries need to maintain a favorable business and investment climate and refrain from protectionist policies'. According to the United Nations, investment in agriculture with developing countries is expected to increase however many countries will not secure investment in

agriculture (UNCTAD, WIR, 2009:93). Governments will be seeking assistance from the domestic private sector and foreign investors to help with investment in agriculture (UNCTAD, WIR, 2009:93). In countries where governments permit REIT investment in the agriculture, policy formulation needs to factor in the long term development gains as opposed to short term gain for investment in agriculture through REITs.

2.5 Who is interested in REITs?

Financial investors, institutional investors, large property companies and governments have interests in REITs. Financial Investors are interested in REITs because they offer high annual yields with limited risks. According to Unger (2006: np) ‘from 1971 to 2003, the average Equity REITs annual yield in the USA was approximately 13 per cent. The Dow Jones Industrials increased by approximately eight per cent per year over the same period’.

Institutional investors (pension funds, banks, insurance companies) have collected huge amounts of capital and seek for profitable financial investments worldwide. REITs are welcomed as an option in their portfolio strategy. Unger argues that ‘for the financiers of REITs (persons, banks, funds etc) they are an attractive option to build a profitable business platform. For Private Equity Funds in the field of real estates, REITs are mechanisms to exit their short term engagement’ (Unger, 2006:np).

For owners of large real estate portfolios, companies or the public sector, REITs are a very attractive option to sell real estate (housing and other), especially if these sales get privileged by the taxation systems created by the government (Unger, 2006:np). Competing governments see REIT as an opportunity to encourage free market economics through strengthening of financial businesses and stock exchanges within their economies (Unger, 2006:np). Governments who seek to improve their budgets in the short term see REITs as an option to privatise public real estate (privatization of housing, land and infrastructure) and earn taxes paid on the sale (Unger, 2006:np).

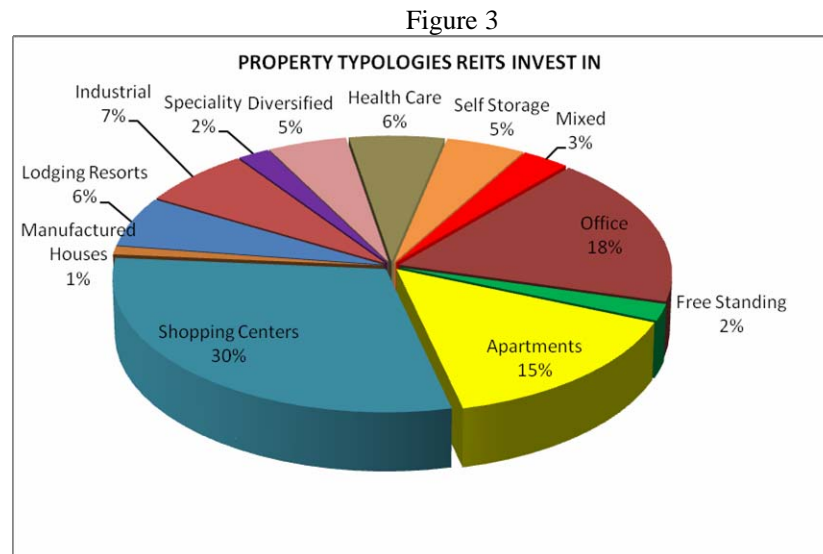
In the global context, REITs appeal to individual retirees and pension funds due to more stable income streams in the form of cash flow property operations or dividends from listed real estate securities (Chen and Mills, 2006:i). Furthermore, significant diversification potential exists, given the low correlation of both private and listed real estate with other asset classes, such as equities and bonds’ (Chen and Mills, 2006:i-ii). ‘By expanding the investment universe to cover a much wider spectrum of investment strategies and broader selection of real estate investment, opportunities in real estate offer attractive investment for high and stable income returns’ (Chen and Mills, 2006:i). Real Estate Investment Trusts have advantages over traditional forms of real estate investments in the form

of liquidity, daily pricing, tax transparency, constant analysis by experts and greater diversity of investment at a lower transaction cost (Financial Mail, 2008:10).

Both private and public real estate investments have experienced substantial increases in value. The core private real estate investable universe increased from USD 6.2 trillion in 2003 to USD 6.6 trillion in 2004. The global public market also grew by increasing more than 27% in 2005 to USD 644 billion (Chen and Mills, 2006: i).

2.6 Property typologies that REITs invest in

According to data from NAREIT (2006) and Ernst and Young (2007) the main sectors that REITs invest in are shopping centres, offices, apartments and industrial diversified, specialised and industrial land uses. Policy makers need to be aware that REIT investment target particular sectors therefore the implications of investment on the domestic economy need to be taken into account during policy design stage.



Source: Researchers own calculation from NAREIT (2006) Ernst and Young (2007) data

Internationally, REITs are now seeking to maximize returns on property through non-core activities such as car parking, gym facilities and cafes. A key international REIT issue is whether such activities are permitted through country specific REIT policy design (Ernst and Young, 2008:50).

The Chinese Government believes that a residential REIT structure may be the solution to its pressing need for affordable housing and retirement homes (Ernst and Young, 2008:16). In the United Kingdom the REIT market is dominated by office, retail and industrial property. Restrictive policy changes to favour investment in residential property will encourage investors into this sector (Ernst and Young, 2008: 23).

2.7 REIT as a favoured investment model

The Global REIT Report (Ernst and Young, 2007: 5-6) argues that REITs continue to be the property investment vehicle of choice that offers 'attractive opportunities' for investors. International investors have realised that that developing countries account for a large share the world growth output and trade (World Bank, 2007:2-5). REIT investments have performed well in South Korea and Singapore (Ernst and Young, 2008:4-5).

The London Stock Exchange guide to United Kingdom REITs (2006) provides information on these investment mechanisms in the United Kingdom. Investors have shifted from a domestic or regional focus to a broader, 'globally diversified approach to real estate investment' (London Stock Exchange, 2006:62). The changes in investor appetite increases allocations to the broad range of real estate products in particular to the REIT market will provide the capital base on which the market depends for expansion (London Stock Exchange, 2006:62).

According to the World Bank (2007:2) 'the globalization of corporate finance offers significant benefits for developing countries as more companies based in developing countries have entered world capital markets to broaden their funding sources, borrowing at longer maturities and improving risk management through the use of sophisticated financing instruments'. Growing numbers of firms are opting to cross-list their shares on major world stock exchanges as a way of facilitating trading by foreign investors and building channels for future capital needs (World Bank, 2007:2).

Frankel, Smit and Struznegger (2006:38-39) argue that 'US investors pour money into assets around the world (especially real estate, agricultural and mineral commodities) which seem to offer a higher rate of return than US Treasury bills (stocks and bonds generally) and then rush back when US interest rates rise'. Greenspan (2007) attempts to uncover the nature of the turbulent global economy and shows how the United States of America's economic policy adapts to the flexible, open, resilient, self directing and fast changing global economic environment over the years he presided as chair of the Council of Economic Advisers and Federal Reserve Board in the United States of America. He concluded that 'the decline in mortgage interest rates has resulted in a speculative real estate boom with the price of homes increasing to historic levels' (Greenspan, 2007:229-233). Furthermore Greenspan (2007:238-239) argues that the American economy uses property as an investment or wealth creation tool and then on the negative side, speculation in the real estate sector plunged the US economy into financial crises. Leaders of the US economy then put together tax cuts to pull the economy out of financial distress (Greenspan, 2007: 226-239). Greenspan (2007:251-256) and Mishkin (2006:19-25) argue that the importance of security for [immovable] property is an essential component for wealth creation in an economy.

2.8 Disadvantages of REIT

The global introduction of the Real Estate Investment Trust (REIT) as an investment vehicle has come with problems. Unger (2006: no page) identifies the following problems:

loss of tax receipts; encourage the irreversible replacement of long-term social investment at low rates of profit by short-term financial investment at very high rates of profit; stimulate public municipal, industrial and other such owners to sell off and privatise their properties, because of REIT share holder value orientation on high returns lead to higher rents; disinvestment and demolition of rented housing into individual leaseholds and freeholds; the replacement of social housing by expensive condominiums which can be followed by forced evictions; loss of social accountability and participation; loss of local jobs; municipalities and other public institutions lose strategic instruments with which to promote affordable housing and socially inclusive cities; REITs lead to a massive concentration of financial power and anti- democratic political influence; REITs make housing markets dependent on international speculation bubbles; REITs even increase the economical pressure on other public real estates

According to Unger (2006: no page) Real Estate Investment Trusts have been linked to the following problems for social housing:

Personnel reduction of employees, buying out of social, public and low-cost housing, violent rent increase and increase of heating costs, service charges etc, massive condo-conversions, demolishing of affordable complexes and replacement by more profitable buildings, disinvestments, neglect of/worse maintenance of the housing stock, applying pressure on financially disfavoured tenants to leave, replacements by wealthy residents, stop of social neighbourhoods programmes, participation process etc, construction on public spaces, privatisation of public spaces, lobbying governments for weakening legal standards eg. weakening tenant protection laws

Some German municipalities and other public property owners have been bankrupted and as a result of the change in the structure of ownership and management of rental social housing. International Real Estate Investment Trust companies have been purchasing social housing stock leaving tenants to face escalating rents. In America REITs have been linked to forced evictions of tenants. Tenants of rental REIT developments are served with court orders to vacate premises (Unger, 2006: no page). It is clear that appropriate policy needs to in place for REIT investment in residential sector to prevent exploitation of the residential sector for excessive commercial gain.

For investors, investing in foreign REIT markets can offer diversification benefits and lower debt funding costs however it can also increase risk due to lack of knowledge of foreign markets, language barriers, foreign exchange risks and different legal and government systems (Ernst and Young, 2008: 48).

2.9 Cautions about investment environments

Capital account liberalization was one of the single most important factors that led to crises over the last quarter century (Chang and Grabel, 2004:123-125). In order for developing countries and their

corporations to benefit from globalization, appropriate macroeconomic regulatory policies by government need to be formulated. According to the World Bank (2007:2-3) firms in developing countries were inevitably becoming more orientated to a globalised world economy, it was necessary to 'manage short term fluctuation and risks.' In order to prevent mitigate against excessive corporate foreign borrowing and financial distress, market determined exchange rates, greater corporate transparency and government regulation of foreign borrowing by banks is needed (The World Bank, 2007:3).

Powerful business interests in developed economies such as the US lobbied governments to pass legislation that permitted savings and loans industry to engage in risky business investments in commercial real estate, purchasing junk bonds and common stocks (Mishkin, 2006:55). Stiglitz (2003:35-39) argues that the 'pursuit of self interest by Chief Executive Officers (CEOs), accountants, and investment banks did not led to economic efficiency but rather to a bubble accompanied by massive allocations of investment that eventually led to a recession of the American economy'. In America during the early 1980s, 'tax reforms and rapid depreciation allowances in the real estate industry allowed real estate investors to take full advantage of the policy environment by developing useless office space in cities which contributed to macro-economic instability of the American economy' (Stiglitz, 2003:36-39). Fitch (2008:68-70) argues that 'pension fund investment in real estate is risky. Private equity operators and pension fund managers do not disclose information as they sign confidentially agreements that prohibit them from disclosing the basic facts. Investors who refuse to enter these confidentially agreements risk losing may of their best investment opportunities'. Many private equity groups insist on confidentially agreements, claiming that 'all information is proprietary or, at least, easily misinterpreted by the public' (Fitch, 2008: 68-70).

In developing countries such as Mexico in 1994-95, Malaysia and Thailand in 1997, the collapse of speculative bubbles and high volumes of unregulated portfolio activity in the stock market contributed significantly to financial crises (Chang and Grabel, 2004:125). According to Chang and Grabel (2004: 125) the Malaysian Government was concerned that 'increased private capital inflows were feeding an unsustainable speculative real estate and stock prices were creating pressure on the domestic currency'. In Thailand excessive exuberance in the real estate sector was created when 'hot' speculative money flowed into the country and abruptly flowed out creating excessive volatility in exchange rates and financial crises (Stiglitz, 2002:197-198). In an effort to ensure that economic policies make a difference to peoples lives the state and the market has an economic role (Stiglitz, 2003:1). Bhattacharya and Stiglitz (1999) argue that developing countries need to create regulatory structures that encourage safe and sound financial institutions while at the same time calling for increased transparency and accountability of decision makers in the private and public sector to avoid crisis within an economy.

2.10 Risks to global financial stability

The Ernst and Young (2007 and 2008) Global REIT Reports argue that the turmoil in debt markets resulting from the significant issues in the US sub-prime mortgage market have been felt around the globe and have implication on global REITs. 'Credit margins on corporate debt have increased and new financings are likely to be subjected tighter covenants and increased financing costs with implications for real estate values and REIT returns. Historically low interest rate environments have led to increased debt levels in the global REIT market. REITs seeking to refinance will be disadvantaged by these market conditions' (Ernst and Young, 2007:6). The demand for commercial building related to residential construction (e.g. shopping centres) is likely to fall. Such dynamics are also likely to affect the commercial real estate sector in countries (Bank for International Settlements, 78th Annual Report, 2008:27).

According to the IMF, 'Loans and securities issued in the United States related to commercial real estate, the consumer credit market and the corporations increase aggregate potential loses to about \$945 billion' (IMF, 2008:5-8). There have been many defaults on loans for prime real estate and commercial real estate properties. 'Loses amount to \$565 billion to residential and \$240 billion to commercial real estate \$120 billion on co operate debt and \$20 billion on consumer credit' (IMF, 2008:5-9). The turmoil in the global economy has done little to slow down the globalisation of property investment. 'Property funds are still are still growing in Singapore, Hong Kong and China as western property buckles under the credit crisis' (Financial Mail, 2008:10).

The global credit crisis has taken a few casualties. For example Centro Properties, once Australia's second largest publicly traded owner of shopping centres, now technically insolvent and trying desperately to refinance acquisitions it made in the United States in 2007. At the same time higher interest rates to combat rising inflation are slowing economic growth worldwide (FM, 2008:71). Credit to the private sector for real estate projects has been increasing in the Middle East and Central Asia (IMF, 2007:29). Some institutions may be vulnerable to a correction in the real estate sector and a slow down in construction, especially in locations that have seen a boom in the construction of office space.

The 1989-92 US credit crunch was seen to have aggravated the recession in 1990. That credit crisis occurred in the aftermath of the savings and loans crisis in the 1980s, a period when banks increased their exposure to the commercial real estate sector (Bank for International Settlements, 78th Annual Report, 2008:27). Tighter credit conditions are more likely to be binding for commercial real estate firms than for others. According to the Bank for International Settlements (2008:27) 'compared with other kinds of commercial lending, leverage against collateral is generally higher for this type of borrower and lending conditions had eased much more than for other firms. The tightening in credit

conditions reported by US Banks has been particularly sharp in this sector and growth in business mortgage debt is already slowing’.

2.11 Tax implications for Real Estate Investment Trusts

An attraction to invest in REITs for domestic and international investors is the tax benefits REITs offered through their design by countries. There may be significant differences between countries as regards to the structure and how the tax exemption of income is provided. In some countries, REITs are developed using the tax rules generally applicable to trusts and companies and in others specific REIT regime has been developed (OECD, 2007:3-4).

Foreign investors seek tax relief through double taxation agreements with countries. According to the OECD (2008:7) international juridical double taxation can be defined as

the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods

Double taxation agreements are needed for ‘the development of economic relations between countries and the mitigation against the harmful effects on the exchange of goods, services, movements of capital, technology and persons’ (OECD, 2008:7). The importance and globalisation of investments in and through REITs have led the OECD Committee on Fiscal Affairs to examine the tax treaty issues that arise from such investments. Article 10 of the OECD Model Tax Convention on Income and On Capital (2008) provides the model on which countries may choose to design their tax treaties with other countries in regard to REIT.

2.12 Impact of real estate investment on cities

Speculative free market policies such Real Estate Investment Trusts are rapidly becoming reviewed and introduced around the world. Harvey argues that:

Capitalism does not develop upon a plain surface endowed with ubiquitous raw materials and homogenous labour supply with equal transport facility in all directions. The mobility of credit money and tendency to eliminate spatial barriers become the key to understanding the rapid dispersal of the circulation of capital across the face of the earth. The prospects of high profits lure capitalists to search and explore all directions across the world (1982:415-419).

Urban environments such in cities are exposed to REIT investments. McNamara and Pivo (2005:1) argue for ‘responsible property investing to maximise the positive and minimise the negative and social and environmental effects of property investing consistent with fiduciary responsibilities’. They argue that property markets are ‘inextricably linked to urban problems therefore better management of both new and existing properties are needed to resolve them’.

Shopping centres are a major form of REIT investments (see figure 3 above) and occur in urban environments. In countries such as Japan, authorities introduced a 'large store law' which discouraged the emergence of large shopping centres in an effort to curb the emergence of large shopping centres in Japan. This protected smaller shops from competition with larger shopping centres and is an example of targeted protection in the retail sector (Chang cited in Turok, 2008:10). Flath, (2002) and Chai and Rietmuller (1999) argue that geographical factors such as the scarcity of living space, low car ownership, highly developed transport system and 'willingness to pay for the convenience of next door shopping' has resulted in the proliferation of small stores in Japan. Flath (2002) also argues that the large store law in Japan has had limited economic distortions and impose 'deadweight losses' for a nation.

The Large Store Retail Law in Japan has been criticised by US officials who argue that the law is a structural barrier for US investment in Japan and contributes to the US trade deficit with Japan. In one case, a US toy company (Toys R Us) lobbied the Japanese government to open a store in the country to the disbelief and opposition to local shopkeepers who have to wait up to 10 years for permission to set up large stores (LA Times, 1990:no page). Recently, the Japanese Government has been encouraged by the OECD to reform the large store retail law and city planning laws to ensure that they do not act as barriers to larger store developments (OECD Observer, 2008:10).

In Brazil, authorities enacted the 'Federal City Statute in 2001'. This empowers city authorities to develop a concept of the city through a local Master Plan, and to intervene in local land markets to address social exclusion and spatial segregation. The Netherlands has a Major Town Policy which lays emphasis on economic and infrastructural potential, integrated with social renewal. It is applied in rundown city areas and urban districts with special needs (SACN, 2006:2-28).

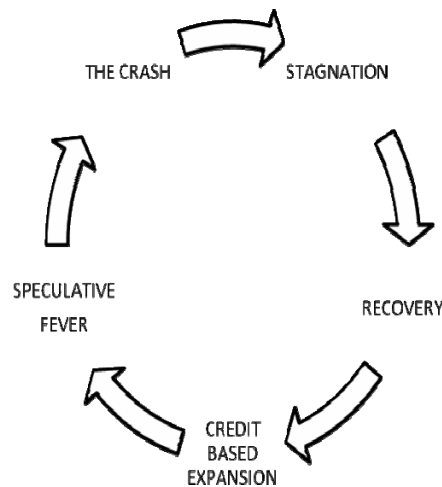
2.13 Business cycles

Harvey (2000:78-79) argues that economic power has shifted around from one part of the capitalist world to another. Speculators that are backed by international financing are seeking to maximise gains from land rent and changing metropolitan regions. A key aspect of REIT is the profit it makes from rent producing real estate. The more generalised search for rent creates geographical differences in the intensity of capital investment. A direct consequence is dualism of the economy whereby the capital region grows richer while the capital poor region gets poorer (Harvey, 2000:78).

Developing countries need to worry about asset bubbles. For example, the price of real estate in Mumbai is reported to as high or higher than that of New York or London. House prices in many parts of the world have been detached from rents. When asset bubbles burst, they have the potential to produce rapid slowdowns in the non-financial economy as well. It becomes important for coordinating influential country policies (IBRD, 2008:103). The cyclic nature of the real estate

investment exposes REITs to a business cycle. The business cycle goes through phases of stagnation, recovery, credit-based expansion, speculative fever and for companies that have not been responsible in managing finances result in a crash (Harvey, 1982:300-305). Figure 9 identifies a business cycle.

Figure 9: The Business Cycle



Source: Harvey, 1982:300-305

2.13.1 Stagnation

The phase of stagnation is characterized by a severe limitation of production and rates of profit. Prices are forced downwards as producers dispose of the surplus inventories at less than their prices of production (Harvey, 1982:300-305). The stagnation phase is characterised by widespread unemployment and low wages. Confidence in the credit system has been severely shaken, while demand for loan capital is much reduced because of negative expectations as to future revenues (Harvey, 1982:300-305).

2.13.2 Recovery

During this phase 'devalued capital (commodities, fixed capital, buildings etc) can be picked up for a song, so reducing outlays and constant capital and lowering the value composition of capital' (Harvey, 1982:300-305). He goes on to explain that 'producers who have weathered the storm are usually blessed with a strong liquidity position and pay their bill with hard cash. Low interest rates and surplus of labour power make conditions optimal for financing long term fixed capital formation' (Harvey, 1982:300-305). Harvey (1982:300-305) argues that most of the expansion begins once most

of the surplus inventories have been disposed of. This permits prices to rise and wages remain low with the larger share of surplus value going to profit of enterprise. The profit rate sparks the return of business confidence. According to Harvey (1982:300-305) ‘the quantity of fictitious capital increases but new promotions are usually associated at this stage, with direct investment in the means of production and the commercial credit extended is tied to actual commodities in circulation’. This kind of fictitious capital creation that is both necessary and unproblematic because it is usually followed by an ensuing expansion in accumulation. It therefore poses no threat to the preservation of sound monetary basis (Harvey, 1982:300-305).

2.13.3 Credit based expansion

During this phase faith in the economic system has recovered. The increased circulation of revenues creates positive expectations with respect to future revenues of all types of all types (land rents, taxes, mortgages, etc as well as profit enterprise). The gradual expansion of the preceding phase now reveals a whole host of imbalances in the productive capacity and consequent bottlenecks in inputs and outputs of the productive apparatus as a whole. The REIT industry is dependent on the credit from the banking sector. According to FM (2008:17) ‘you need large sums of capital to buy a single property and borrowing from the bank is inevitable. It is also desirable as long as it is prudently done.’ Industrialists capitalists extend credit to each other and is finally exhausted as they reach their limits. They are forced to turn to banks and financiers who strengthen their power. The quantity of fictitious capital moves steadily ahead of accumulation and the gap between monetary basis as real measure of values and the various forms of paper moneys in the circulation begins to widen. Industrialists compete for funds against land speculators, stock –jobbers, dealers in government debt etc (Harvey, 1982:300-305).

2.13.5 Speculative Fever

During the speculative fever phase industrialists look desperately for ways to innovate their way out of difficulties. They aided by the by a credit system that is by now fuelling both production and realization which eventually creates huge quantities of fictitious capital making room for the ‘most colossal form of gambling and swindling’ (Harvey, 1982:300-305).The recent financial crises that affected global economies had been growing through risky speculative financial behaviour of capitalists. According to the United Nations

Increasing financial deregulation, along with a flurry of new financial instruments and risk-management techniques (mortgage-backed securities, collateralized debt obligations, credit default swaps, and so forth), encouraged a massive accumulation of financial assets supported by growing levels of debt in the household, corporate and public sectors. In some countries, both developed and developing, domestic financial debt has risen four- or fivefold as a share of national income

since the early 1980s. This rapid explosion in debt was made possible by the shift from a traditional “buy-and- hold” banking model to a “dynamic-originate-to-sell” trading model (or “securitization”). (2009:v)

It is clear that regulation of the international financial sector was not possible to stop the rampant speculation for capital gain. In the real estate state sector, intense speculation gives rise to real estate bubble. A real-estate bubble arises ‘when real-estate prices are not justified by underlying forces and/or fundamentals. As the market continues to boom everyone is uniformly optimistic about the economic outlook, based on the rationale that high real-estate values will continue on the upward trend. If the increase in property values is not in line with responsible market fundamentals, the boom may actually result in a bubble, which will eventually burst’ (SARB Financial Stability Review, 2004:30).

2.13.6 The crash

The recent financial crisis is evidence that unregulated forms of credit based expansion can lead to a crisis which intern affects world economies. According to Harvey (1982:300-305)

The onset of crises is usually triggered by a spectacular failure which shakes the confidence in fictitious forms of capital. The ensuing panic immediately focuses attention upon the quality of various credit moneys. A chronic shortage of money of the right sort closely tied to the money commodity emerges at the very moment when producers and merchants are scrambling to meet their obligations. The rate of interest climbs to a point of extreme usury. The extended chain of payments is broken and the circulation of capital lies momentarily broken into a thousand disconnected pieces. Masses of labourers are thrown out of work, the wage rate drops precipitously and circulations of revenues suffer chronic disruption in reaction to the breakdowns in the circulation of capital. The devaluation of capital and the labourer proceed apace. Capitalists seek to stay alive by cannibalizing upon each other.

Real estate booms and bursts are recurring events. Careless lending by financial institutions has played a role in creating unsustainable property bubbles (Renaud, 1995:1-2).

2.14 Conclusion

REITs are globally becoming the premium investment vehicle through which property is invested in. They signal the increasing liberalization of the investment environment, making it ever easier for more kinds of investors to seek returns on real estate, often across great distances. In order to maintain economic and social stability in the investment environment for property, countries developing REIT policies need to factor in the consequences of REIT investments on the domestic economy and more broadly consequences for vulnerable groups such as the poor.

Countries need to determine the feasibility of permitting REIT over all types of land use (residential, industrial, commercial and agricultural land use) and consider if appropriate restrictions need to be imposed. International evidence suggests that REIT investments have negative impacts on the rental market, buying of social housing schemes by corporate REIT organisations, privatization of public properties, tax reduction on national revenue and canvassing support for weaker tenant protection

laws. REIT investments if not properly managed through a vigilant financial supervision, promoting tight lending standards and strong risk management will ultimately have impacts on the macro economy of countries.

Chapter 3: Summary of the Property Investment Sector in South Africa

The following chapter looks at the property investment sector in South Africa and unpacks the changes in policy for investment in property. South Africa's new government in 1994 had the challenge of orientating the economy for global competition and therefore had to restructure its domestic economic policies to compete in the global trading and investment regime (Hirsch, 2005:109-116). The introduction of the Collective Investments Schemes Act in 2002 with property investment as a component and the further reform of the Collective Investment Schemes Act in 2007 are signals that Government and private sector embraced liberalization of its domestic policies to promote property investment that is more conducive to international investment.

3.1 South Africa's listed property investment sector

Investment in property was historically carried out through Property Unit Trusts in South Africa. The Property Unit Trust industry dates back to 1969 when two property trusts were listed on the Johannesburg Stock Exchange (Invesco, 2008:43). The purpose of the sector was to encourage investment in property by 'individuals and small pension funds lacking the inclination or expertise to manage freehold property investments themselves' (Invesco, 2008:43). In South Africa, about 85% of property unit trusts are held by institutional investors. In Australia by comparison, private investors dominate the property unit trust sector to the tune of about 60%. It has been estimated that about 45% of institutional property investment is through property unit trusts and this percentage is expected to increase (Invesco, 2008:126). Property Unit Trusts (PUT) invests in fixed commercial and industrial property, such as factories, office blocks and shopping centres (Invesco, 2008:43).

The public comment and discussion paper on 'Reforming the listed property investment sector in South Africa' provides the details on the proposed reform of the regulatory environment for the listed property investment sector and the introduction of Real Estate Investment Trust (REIT) as a property investment vehicle in South Africa (SA National Treasury, 2007). The South African Government's proposal to reform the listed property sector is evidence that policy makers want to integrate further into global financial markets to encourage investment in South African real estate. The change in policy for the listed property sector has been spearheaded by the Property Loan Stock and Collective Investment Scheme Property companies who argue that 'the current property investment landscape is fragmented, only partly regulated and not internationally competitive; secondly, there is inconsistent tax treatment between fund vehicles in the collective investment schemes in property and those not regulated under the [Collective Investment Schemes] Act' (FSB, 2006:4).

A Real Estate Investment Trust can be an investment vehicle for capital inflow in the real estate sector of South Africa. South Africa's proposal to reform the listed property sector suggests that policy

makers see the need to conform to a globally accepted form of property investment (i.e. Real Estate Investment Trusts) to promote investment in SA real estate. The Real Estate Investment Trust regulatory amendments are to be housed under the Collective Investment Schemes Control Act No. 45 of 2002.

The purpose of the Collective Investment Schemes Control Act No. 45 of 2002 is

To regulate and control the establishment and administration of collective investment schemes; to repeal or repeal certain laws and to provide incidental matters

The Collective Investment Schemes Act No. 45 of 2002 defines a collective investment scheme as a scheme, in whatever form, including an open ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which-

- (a) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through scheme through shares, units or any other form of participatory interest; and
- (b) the investor shares the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or any other basis determined in the deed but not a collective investment scheme authorised by any other Act

The Collective Investment Schemes Act replaced the Unit Trusts Control Act No 54 of 1981 and the Participation of Bonds Act 55 of 1981. The Collective Investments Schemes Act provided a legislative framework to supervise the collective investment industry based on internationally accepted principles and best practice (National Treasury, 2002:50).

Collective Investment Schemes can be classified according to the type of structure of underlying assets. Most Collective Investment Schemes in South Africa are unit trusts meaning that the portfolio is held in trust by a trustee (Invesco, 2008:41). The different types of collective investment schemes include unit trusts, open ended investment schemes, participatory bonds, declared collective investments and collective investment schemes in property (CISP) (Invesco, 2008:41).

A CISP is a portfolio of investment grade properties that is typically held in the form of a trust even though CISCA does not prescribe the legal form. Each portfolio's participatory interests are listed on the Johannesburg Stock Exchange in the real estate sector and is administered by a manager responsible both for day to day operation of the properties and leases and for the investment strategy of the company (RSA, National Treasury, 2007:3).

At a Property Loan Stock Association conference on Real Estate Investments Trusts in 2006, a number of international speakers and investors were in attendance. According to Azizollahoff, Brooking and Hallows (2006:np) these foreign experts agreed that 'the South African investment property sector has delivered attractive returns but does not offer the international investors the uniformity and simplicity which to facilitate international investment'.

Reforming economic policy for the financial sector is high on the South African Government's agenda. The South African Government's macroeconomic strategy, 'The Accelerated Shared Growth

Initiative of South Africa' (2006), has identified that removing obstacles to investment as part of its macroeconomic strategy. Reforming the Collective Investment Schemes in Property to accommodate Real Estate Investment Trust is an example of how the Government plans to remove obstacles for domestic and foreign investment in real estate.

The Johannesburg Stock exchange previously grouped property shares into three different property sectors ie: property companies, property unit trusts and property loan stock companies (also known as variable loan stock companies). The three types of companies still exist and are now grouped into one sector known as Real Estate (Invesco, 2008:128). According to Invesco (2008:128) the characteristics of the companies are as follows:

Property Companies

These are not collective investment schemes, but ordinary companies involved in the property business, such as letting agencies, property brokers, property owners or property developers. Investors in these shares have to take a view on the profitability or desirability of property trading and development.

Property Unit Trusts

Property Unit Trusts are collective investment schemes governed by the Collective Investment Schemes Act. They have to have a financial institution as a trustee, and must be listed on the stock exchange. They are obliged to pay out all income earned during each reporting period. Property Unit Trusts can borrow up to 30% of the value of the assets under management subject to the trust deed. Property Unit Trusts do not pay out Capital Gain Tax on disposal of properties they hold directly.

Property Loan Stock Companies

These companies are not collective investment schemes but companies that use special linked units (debentures linked to ordinary shares) to finance the purchase of property portfolios. Debenture trustees of property loan stocks do not have to have financial institutions. Accountants or attorneys can serve as trustees. Property loan stocks can elect to hold back income if they choose, although in practise the debenture deed usually requires all income to be paid to unit holders. Property unit trusts are obliged to pay out all income earned during a particular year. There is no regulated cap on the level of borrowing in property loan stock companies. This increases the element of risk, especially in a high interest rate environment. Property loan stock companies pay capital gains on the disposal of properties.

The following are some of the differences and similarities between a Property Loan Stock Company and a Collective Investment Scheme in Property.

	Property Loan Stock Company	Collective Investment Scheme in Property
1	Derives income from a portfolio of investment grade properties that is typically held in the form of a trust	Derives its income from holding a property portfolio
2	Governed by the Companies Act (No. 61 of 1973)	Governed by the Collective Investment Schemes Act No. 45 of 2002
3	Regulatory requirements imposed by the Johannesburg Stock Exchange	Regulatory requirements imposed by the Johannesburg Stock Exchange
4	Management Activities performed internally	Management Activities performed by an external entity
5	A listed PLS company on the Johannesburg Stock Exchange pays out all of its annual income	Retains up to 80% of income
6	An investor receives one part equity ² and one part debenture ³	An investor receives value through rental income from the property portfolio and appreciation in the values of these properties over time

Source: RSA National Treasury (2007:2-5)

Another type of investment option in property is Property Equity Funds which invests in shares on the stock exchange. A key difference is that a Property Unit Trust buys actual buildings and office blocks whilst a property equity fund buys shares like any equity Collective Investment Scheme on the stock exchange. Property Unit Trusts differ from equity funds in that they are closed ended. This means that the number of units remains constant, and investors can only buy if there is a seller (Invesco, 2008:126- 129).

3.2 Property development and investment dynamics in South Africa

The Property Sector Charter On Black Economic Empowerment (DTI, 2007:3) argues that direct commercial property ownership is ‘dominated by institutional investors, large private owners, collective investment schemes, property loan stocks and listed property entities with the Government being the largest commercial player’. The property sector charter (DTI, 2007) provides the framework for establishing the principles upon which Broad Based Black Economic Empowerment will be implemented in the property development sector. Broad Based Black Economic Empowerment is an initiative implemented by the government to address past economic inequality practices of the previous government regime in South Africa⁴. In terms of Real Estate Investment Trusts policy, the National Treasury of South Africa seeks to align and support Broad Based Black Economic Empowerment targets for the Property Investment sector (National Treasury of SA, 2008:17-18).

²Equity refers to ‘an ownership interest in a corporation in the form of shares. It also refers to total assets minus total liabilities in which case it also referred to as shareholder’s equity or net worth or book value. In real estate, it is the difference between what a property is worth and what the owner owes against that property’ (RSA, National Treasury, 2007:31)

³Debenture is defined as ‘an unsecured debt backed only by the integrity of the borrower, not by collateral, and documented by an agreement called indenture. One example is an unsecured bond. The debenture portion of a linked unit in a PLS generates interest at a variable rate for the linked unit holder. The interest is paid out of the profits’ (RSA, National Treasury, 2007:31)

⁴The Broad Based Black Empowerment Act No 53 of 2003 establishes the legislative framework for the promotion of black economic empowerment in South Africa

The main South African property investment vehicles are Property Loan Stock companies and Collective Investment Schemes in Properties. The discussion paper indicated that there were 'five CISPs and nineteen PLS companies listed on the main board of the Johannesburg Stock Exchange and at least one other CISP listed on the Alt-X exchange of the Johannesburg Stock Exchange. In addition, there are a number of unlisted PLS companies of which two are registered with the Property Loan Stock Association (PLSA)' (RSA, National Treasury, 2007:3).

The property development sector is also characterised by various land reform programmes being driven by the government (DOL, 2006/2007 and KZN PSEDS, 2006). This is needed to reform apartheid land and settlement policies of the previous government. The Minister for Agriculture and Land Affairs appointed a panel of experts on the development of policy for land ownership by foreigners in South Africa in 2007. The main reasons for the investigation was for land reform purposes and to determine ownership patterns of property to inform policy making around this issue in South Africa. In terms of REIT investments, immovable property rights form an important component therefore the land reform process will be carefully monitored by investors.

Over the last decade or so, the real estate sector has boomed, especially for commercial developments and upmarket lifestyle estates. An artificial consumer spending boom 'fuelled by the credit recklessly lent by the banks, raised expectations that property investment would keep yielding big returns' (Noseweek, 2009:7-14). The recent credit crisis has resulted in many shopping malls closing after defaulting on their loans to commercial banks. Valuations and formulas used to predict rental incomes have become more and more complicated. These valuations and projections are used to persuade banks, pension funds and individual pensioners to invest in commercial property. The monitoring role of the Financial Services Board, a law enforcement body for collective investment schemes in property has also grown weaker according to some commentators (Noseweek, 2009:7-14).

3.3 Macro Economic Challenges faced by South Africa

Real Estate Investment Trusts are linked to capital flows in financial markets. Frankel, Smit and Strurznegger (2006:2-3) argue that 'capital inflows with a strong rand, healthy budget and inflation rates and low interest rates has lead the South African economy to perform well'. The authors question South Africa's macro economic strategy (the Accelerated Shared Growth Initiative) on how challenges and risks are to be identified and dealt with. Frankel, Smit and Strurznegger (2006:2-3) suggest that that ASGI-SA macroeconomic strategy 'relies too heavily on capital accumulation in a way that other growth accelerations have not'. The authors also advise that 'the avoidance of pro-cyclical fiscal policy and active intervention by the monetary authorities to build up reserves and dampen real exchange rate appreciations will offer some proposals to reduce vulnerability in the South African economy' (Frankel, Smit and Strurznegger, 2006:2).

Asset prices continued to rise in 2006 and 2007 driven by strong commodity prices, favourable growth prospects and a positive assessment by rating companies (IMF Staff Report, 2007:7). Property prices rose by approximately 35% between January 2003 and June 2004. This increase hides substantial regional disparities. Stress tests conducted by the SARB between 2003 and 2004 suggested that the banks were resilient to potentially adverse developments in the real estate market. SARB officials noted that mortgage debt had fallen relative to the value of collateral. Vulnerability would, however, rise if increases in interest rates were to accompany a fall in property prices (IMF Staff Report, 2004:13). Real estate prices have increased since 1997 and the IMF has requested close monitoring of real estate prices and household sector (IMF Staff Report selected issues, 2005:46-48).

The South African government's proposal to review Real Estate Investment Trust policy for the purpose of enhancing global competitiveness in the real estate sector is an example of capital market liberalization in the real estate sector. A key debate within the capital market liberalization process is the introduction of capital controls for developing countries to prevent financial crises within an economy. Economists such as Chang and Grabel (2004:112-133) argue for capital controls in developing countries. According to Chang and Grabel (2004:113) capital controls refer to 'measures that manage the volume, composition or allocation of capital flows and/or maintenance of restrictions on investor entrance or exit opportunities.' South Africa's financial markets and exchange controls have gradually liberalized since 1996. The plan is to move towards a more prudential system for the management of financial markets. Mishkin (2006:53) argues that 'a solution to a lending boom and bust is prudential regulation and supervision of the banking system to prevent banks from taking on excessive risk.'

In order to have more flexibility with the REIT environment a new distinction is being considered for REITs in South Africa ie. prudential REITs and non prudential REITs. According to the National Treasury of South Africa (2008:21) 'prudential guidelines may include the following risk diversification categories ie. number of properties, geographical location of properties (domestic and foreign) and types of properties (retail, manufacturing, office, residential)'.

REITs will not be limited to specific number of properties although a number of risk diversification categories are being considered. It is unlikely that REITs will be allowed to invest in more than one sector. Prudential guidelines will be based on weighting of risk across the different categories or for example, a fund with only a limited number of properties in a specific geographical area but with proper spreading with respects to the type of properties (eg. office, residential and retail) will be a prudential fund (RSA, National Treasury, 2008:21).

Non prudential REITs may not be offered as a retail product directly but may be offered via another vehicle with a proper risk diversification strategy or with limited exposure to one non prudential REIT

or to the non prudential REIT sector as a whole. According to the National Treasury of South Africa (2008:21) ‘investment REITs may be limited to a certain percentage of total investment in the non prudential sector’. Non prudential REIT requirements may result in limitations on who may invest in these non-prudential REITs and how much these investors may invest in non prudential REITs individually and in aggregate (SA National Treasury, 2008:21)⁵.

3.4 The South African Property Industry

As of the 2007 year the South African property sector that is listed on the Johannesburg Stock exchange was made up of 35 companies. Each company consist of different shareholders who form partnerships with other property or private companies. Shareholders include banks, the Public Investment Corporation, other listed property companies, insurance companies or private companies. Table 1 shows the property companies that are listed on the Johannesburg Stock exchange.

Table1 Property Companies listed on the Johannesburg Stock Exchange

No	Company Name	% Owned	Major Ordinary Shareholders	% share of Major Shareholder
1	Acucap Properties Ltd	79.30%	Thesele Group (Pty) Ltd	8.30%
			Resilient Property Income Fund Ltd	7.00%
			Nedbank Ltd	5.40%
2	Ambit Properties	39.40%	Absa Bank Ltd	34%
			Redefine Income Fund Ltd	20.30%
			Broker Proprietary	6.30%
3	Apex Hi Properties	74.50%	Redfine Income Fund Ltd	9.90%
			Clearwater Capital	7.90%
			Investec	7.70%
4	Capital Property Fund	60.10%	Old Mutual	22.20%
			Resilient Property Income Fund Ltd	17.70%
5	City Lodge Hotels	81.20%	Enderle SA (Pty) Ltd	12.50%
			Old Mutual High Yield Fund	3.20%
			PIC Int Equity	3.10%
6	Diversified Property Fund Ltd	64.80%	Resilient Property Income Fund Ltd	19.10%
			De Beer, Des	8.60%
			Stuhler, Barry	7.50%
7	Emira Property Fund	54.70%	Momentum Group Ltd	36.70%
			Tiso Group	8.60%
8	Fairvest Property Holdings Ltd	67.70%	Wynbury Ltd	15.80%
			Time and Tide CC	9.40%

⁵Attempts have been made to secure telephonic interviews with officials of National Treasury however this did not materialize. A copy of the policy document entitled ‘Reforming the Listed Property Sector in South Africa, Response Document (2008)’ was emailed back to the researcher from Katherine Gibson, the Director Financial Sector Policy at the National Treasury of South Africa. This document proved to be useful in this research.

			TP Botsis	7.10%
9	Fountainhead Property Trust	100%	-	-
10	Growthpoint Properties	68.90%	Old Mutual Group	11.90%
			Investec	11.70%
			Stanlib Funds	7.50%
11	Hospitality Property Fund	64.80%	Nobuntu Investments II (Pty) Ltd	15.50%
			Old Mutual Asset Management	11.40%
			Sanlam	8.30%
12	Hyprop Investments Ltd	52.90%	Redefine Income Fund Ltd	28.60%
			Stanlib Funds	10.60%
			Coronation Group Funds	7.90%
13	IFA Hotels and Resorts Ltd	5.50%	IFA Hotels and Resorts K.S C.C Ltd	85.00%
			International Investments Projects Co KSCC	9.50%
14	iFour Properties Ltd	34.80%	Pangbourne Properties Ltd	41.50%
			Rand Merchant Bank	18.20%
			Absa Commercial Property Finance	5.50%
15	Johnnic Holdings Ltd	25.80%	Hosken Consolidated Investments Ltd	51.30%
			Old Mutual Group	11.60%
			Coronation Group	11.30%
16	Liberty International PLC	71.20%	Gordan Family Interests	20.40%
			Liberty Group Ltd	4.40%
			Legal and General Investment Management Ltd	4.00%
17	Madison Property Fund Managers Holdings Ltd	61.30%	Broker Proprietary	14.70%
			Cesman WE	12.00%
			Wainer M	12.00%
18	Merchant & Industrial Properties Ltd	30.30%	Marshall Monteagle Holdings Societe Anonyme	69.70%
19	Monyetla Property Fund	16.30%	Pangbourne	62.20%
			Micawber 398 (Pty) Ltd	17.60%
			Standard Bank of SA Ltd	3.90%
20	Oasis Crescent Property Fund		Oasis Crescent Bal Prog Fund of Funds	22.40%
			Crescent Global Equity Fund	7.90%
			Crescent Preservation Pension Fund	7.70%
21	Octodec Investments Ltd	52%	Directors and Families	26.10%
			Stanlib	12.50%
			Liberty Group	9.40%
22	Orion	15.80%	Franz Gmeiner Property Trust	84.20%
23	Pangbourne Properties Ltd	58.22%	Stanlib	14.68%
			Resilent Group	11.06%
			SBSA	8.05%
			Panya Investments (Pty) Ltd	7.99%
24	Premium Properties Ltd	52.60%	Directors and families	24.90%
			Stanlib	14.60%
			Octodec Investments Ltd	7.90%

25	Putprop Ltd	47%	Carleo Enterprises	53%
26	Queensgate Hotel and Leisure Ltd	68.30%	Exteq Realtime Systems (Pty) Ltd	12.70%
			Watermark Securities	11.10%
			Cyberhost Trust	7.90%
27	Redefine Income Fund Ltd	57.20%	Old Mutual	15.40%
			Investec	15.30%
			Stanlib	12.10%
28	Resilient Property Income Fund Ltd	62.70%	Stanlib	18.60%
			Old Mutual	12.40%
			Eagle Eye Investments	6.30%
29	Sable Holdings Ltd	14.20%	Isdale Holdings BV	71.90%
			Sable Group Holdings (Pty) Ltd	9.70%
			Enterprise Risk Management Ltd	4.20%
30	SA Corporate Real Estate Fund	39.70%	Public Investment Cooperation	31.60%
			Old Mutual Group	19.30%
			The Wipken Trust	9.40%
31	SA Reit Ltd	24.20%	Trematon Capital Investments	75.80%
32	Siyathenga Property Fund	33%	Pangbourne Properties Ltd	35%
			Broker Proprietary (Pty) Ltd	25%
			Siyam Investments (Pty) Ltd	7.00%
33	Sycom Propert Fund	43.70%	Hyprop Investments Ltd	35.80%
			Attfund Ltd	20.50%
34	Vukile Property Fund	47.50%	Sanlam Group	27.50%
			Clidet 598 (Pty) Ltd	25.00%

Source: Profile (2008)

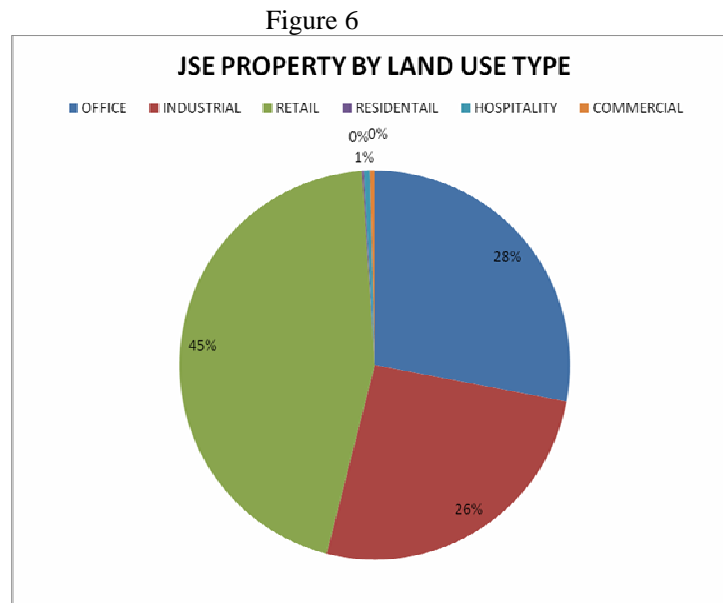
3.5 Trends and problems the property industry is facing

The South African listed Property Index returned about 23% between June 2003 and June 2008. According to Investec Property Equity Fund, the 2006 and 2007 years have been characterised by volatility. 'After good returns during the four months of 2007, share price volatility increased on the back of higher interest rates, inflation and other economic challenges' (FM, 2008:5-7). According to the Financial Mail (2008: 5-7) 'rents and property payouts continue to rise. Listed property fund data shows an average rent rise of 9.5% and rises in costs of between 7% and 8% thus double digit profits and payouts'.

The fundamentals of the South African property market in 2008/2009 continue to be what they were in 2007/2008. Both commercial and residential property are still, according to some commentators, stunted by South Africa's pre 1994 history, with a lot of catching up to do. 'It remains largely dislocated from the global property market and is unlikely to suffer the long burst bubble slump western Europe, America and partially Australia experienced' (FM, 2008:6-7).

Between November 2007 and 2008 the SA Listed property index lost 36.4% of its value and investors lost R32,3 billion. A direct consequence of the global financial crises was that that demand for property has fallen and the prices of listed properties continuing to rise after the first seven interest rate hikes but finally succumbed to a combination of higher interest rates, electricity shortages, slowing consumer spending, a weaker rand and negative sentiment towards emerging markets and emerging market property in particular (FM, 2008:70-71). A trend in South Africa was that the Public Investment Corporation acting on behalf of the Government Employees Pension Fund provided an ideal market to acquire assets due to falling prices and because it is a cash buyer (FM, 2008:70-71).

3.6 SA Property investment by land use type



Source: Researcher's own calculation from Financial Mail (2008) and Ernst and Young (2007)

Figure 6 shows the split for JSE property investment in South Africa by land use. Retail, office and industrial land uses are the main choices for investment in prime property and are in line with global REIT typology split from Ernst and Young data (2007). Supermarkets and retail centres have been rapidly growing in South Africa and the rest of Africa. Reardon and Weatherspoon (2003:333-355) argue that 'the rise of supermarkets have challenges on procurement and implications on the rural agricultural sector especially small farmers'.

Although shopping centre returns have slowed, the appetite of developers, investors and retailers to add to more shopping centre space has continued. There is concern that South Africa's retail landscape could be dotted with many mothballed shopping malls. Recent trading updates from a number of shopping centres suggest that some retail portfolios are heading for trouble, with smaller

centres in less than prime areas more vulnerable to financial difficulties (Fin Week, 2009:37-38). Several corporate property companies have reported an increase in vacancies and rent arrears in their portfolios in the retail sector and are concerned that the retail property market is heading for a fall out (Fin Week, 2009:37-38). Most of the shopping centres that have popped up in townships and rural areas appear to be less affected by the downturn than suburban centres due to those areas being under serviced by retail centres (Fin Week, 2009:37-38).

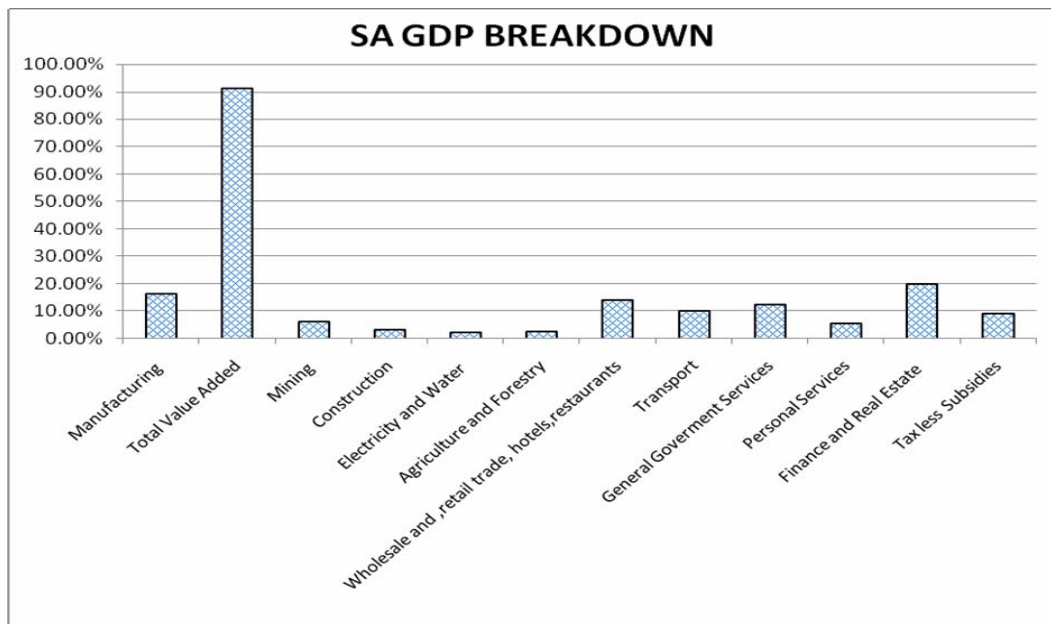
At a conference for shopping centres in Durban, Massmart, a huge conglomerate of retail centres in South Africa argued that retail has done well in South Africa but that rentals needed to come down by at least 20% (Massmart, 2008). High overhead costs for rent has been identified as a constraint that limits economic expansion for entrepreneurial activity in KwaZulu Natal (D.E.D, 2006:16).

3.7 Recent developments

The listed property sector is currently consolidating as large funds swallow the smaller ones after years of smaller listings. Sector heavy weight, Growthpoint bought Metboard Properties and Paramount Property Fund. Vukile acquired MICC Property Income fund; Emira swallowed Freestone Property Holdings; SA Corporate absorbed SA Retail; Redefine bought Spearhead; Acucap acquired Atlas Properties; Pangbourne took in iFour and Siyathenga. Resilient is in the process of acquiring Diversified (FM, 2008:71).

3.8 Economic Outlook for REITs

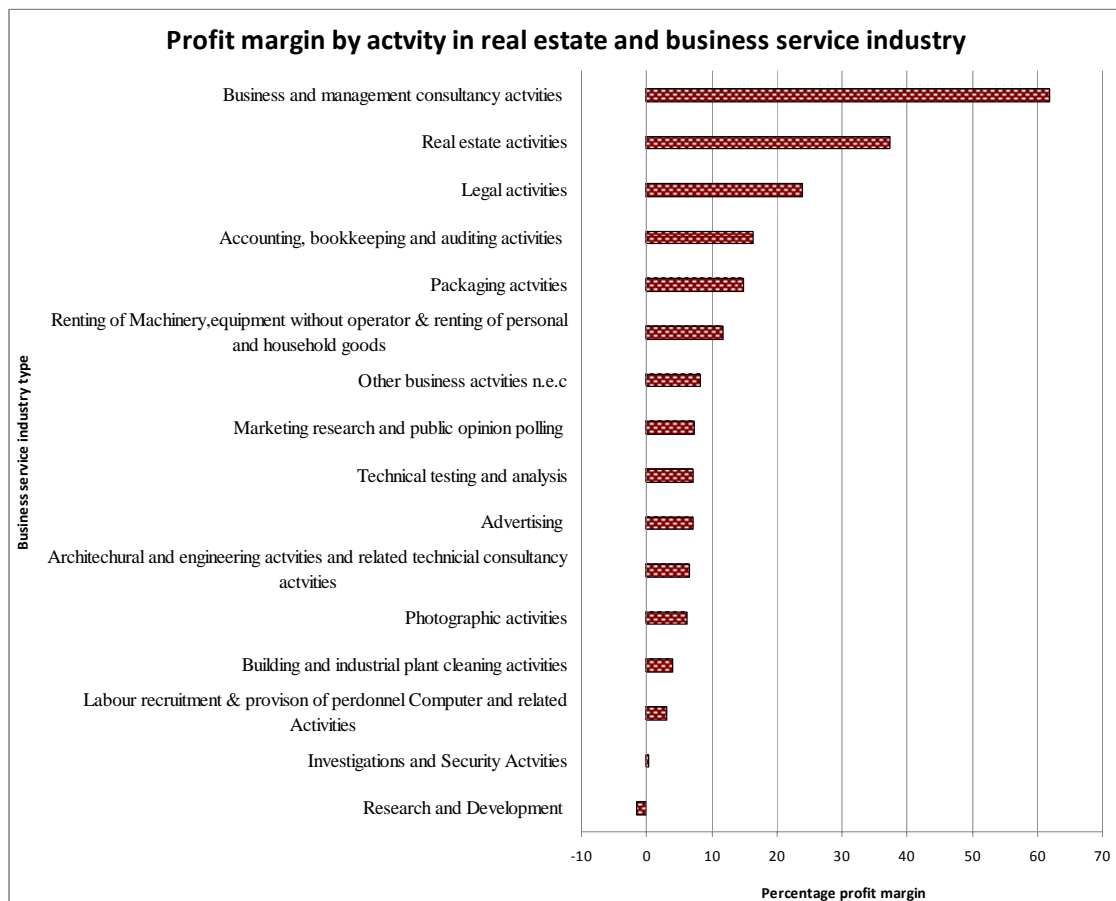
Figure 7



Source: Stats SA 2005

Figure 7 gives the GDP breakdown of South Africa. Real Estate and finance are grouped together in South Africa's GDP breakdown. Approximately 20% of GDP can be attributed to real estate and finance. According to Financial Mail (2008:32) 'the international financial crises was phase 1 of South Africa's troubles. Phase 2 will be the consequences that flow from the excessive consumption financed by increased debt and a radical slowdown in house building' (FM, 2008:32). Commercial and residential property will continue their emergence as a major investment asset classes however piercing the short term cycles and sentiment will prove a challenge. Population, economic and household growth will determine the health of the property market (FM, 2008:32-33). There is large exposure to retail properties in South African listed property sector. Office and industrial markets are expected to remain buoyant over the next 12 to 18 months though not the same degree as the past three years (2005 – 2007). Smaller retailers are likely to suffer as consumer spending slows (FM, 2008:70-71).

Figure: 8



Source: Stats SA (2006:9)

Figure 8 identifies the profit margin in the real estate and business service industry. 'Business and management consultancy activities' had the highest profit margin at 61,8%, followed by 'Real estate activities' at 37,4% and 'Legal activities' at 24,0%. For purposes of REIT investments, international and domestic economic growth will determine profitability in this sector.

3.9 National issues

The introduction of Real Estate Investment Trust legislation for South Africa will make clear the tax exempt status of South African listed property funds and introduce measures to ensure unit holder protection (FM, 2008:7). Lack of suitable accommodation at a lower rent for industrial land is forcing occupants into new developments at a higher rental. Two factors that influence suitability are the availability of electricity and the zoning of land. Land that is zoned for industrial use and which has good power would be highly valued (FM, 2008:58). This has put considerable upward pressure on the value of such land. 'Rising building costs are also likely to put upward pressure on industrial rentals. Substantial assessment rate increases could also hit the rental market' (FM, 2008:58).

Political uncertainty due to policy changes at the African National Congress national congress in Polakwane influence the listed property sector. Further interest rates from April 2008 to June 2008 combined with high inflation, rising electricity and food costs have impacted on the listed property sector. Furthermore, Eskom announced it would be introducing load-shedding because the country's grid could not meet rising demand thereby impacting of listed property sector (FM, 2008:58).

3.10 Growth Opportunities

According to one report, 'World Bank economist Hans Timmer surprised delegates at the annual property fest in Cannes in March 2008 by declaring Africa [as] the next great property investment opportunity' (FM, 2008:8). This report said that SA property operators are already out building their contacts and knowledge. Ghana was his first choice but only marginally beyond a dozen other countries. 'SA investors are best equipped to take advantage of this' (FM, 2008:8). Opportunities become more plentiful in bad times as people get out of dangerous positions (FM, 2008:31). Predictable industrial nodes around the OR Tambo International and other international airports in South Africa remain consistently popular (FM, 2008:58).

3.11 The Real Estate Business Cycle

REIT based companies form part of the corporate business in South Africa. The drive to seek out profits in the real estate sector by capitalists result in a real estate cycle in an economy. It is helpful to examine the South African experience in relation to Harvey's cycle (see point 2.13 above).

3.12.1 Stagnation

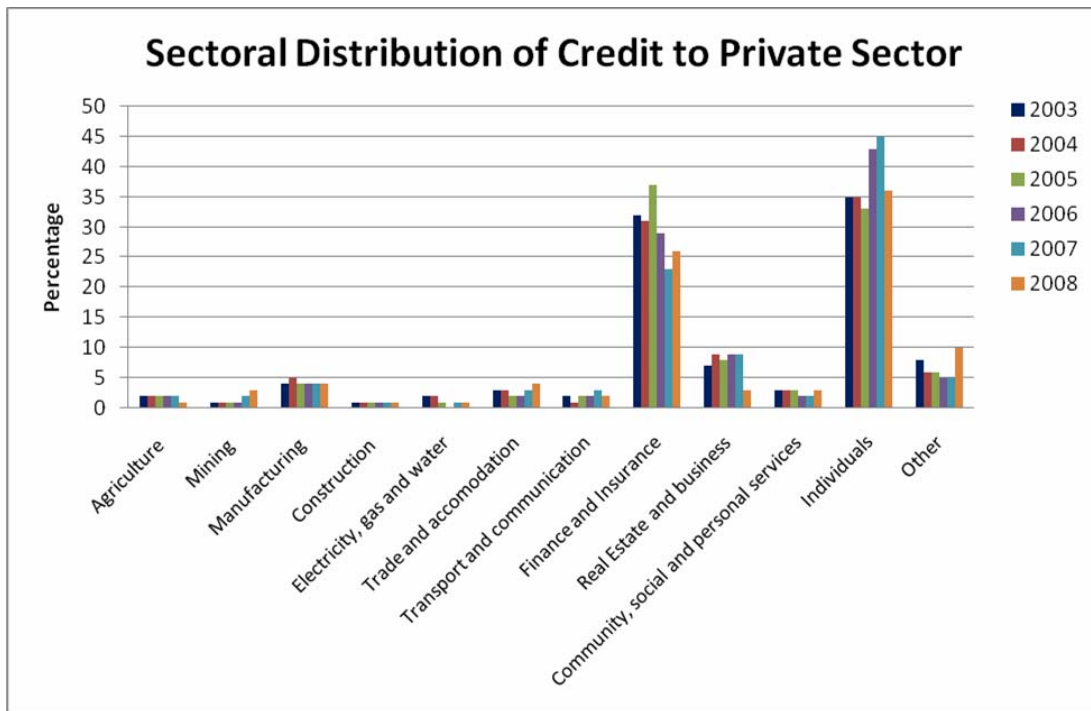
The real estate sector in South Africa has characterised by high interest rates and the reluctance of the banking sector to make credit available for property companies. Property industry role players who over geared themselves during the credit based expansion phase will be looking to offload their assets and this is going to provide bargain opportunities for other groups and individuals (FM, 2009:15).

The retail sector in South Africa has characterised by rising debt, increasing interest rates and high inflation. Industry experts in the retail property market agree that landlords will have no choice but to refocus, redevelop or sell shopping centres that have not lived up to expectations (FM, 2008:53). According to the financial mail 'the SA property market is under pressure mainly from high interest rates. Once interest rates start falling possibly in late 2009, property's long term recovery will resume as it catches up and re-connects with the rest of the world'(FM, 2008:53). It is possible that an oversupply of office and retail space will appear in places where speculative development had started in 2006/2007 and rents there could soften (FM, 2008:53).

3.12.2 Credit Based Expansion

Figure 10 identifies the distribution of credit to the various sectors of the economy and individuals. According to the South African Reserve Bank (2003 to 2008) most of the credit issued by the private sector over the period 2003 to 2008 was issued to individuals, finance and insurance companies, real estate and business sectors and other sectors. The South African Government introduced the National Credit Act No. 34 of 2005 for the purpose of providing general regulation of consumer credit and other relevant reasons.

Figure 10



Source: SARB, Financial Stability Review (2003 to 2008)

Although figure 10 identifies that individuals have obtained a higher percentage of credit from the private sector this does not provide the monetary value of the credit portfolios issued by the private sector. Companies have greater chances of securing higher credit loans from the private sector due to private sector banking institutions identifying companies as a juristic person (close cooperation, company or trust) and applying different lending criteria (Lee, 2009:161-164).

3.12.3 Speculation

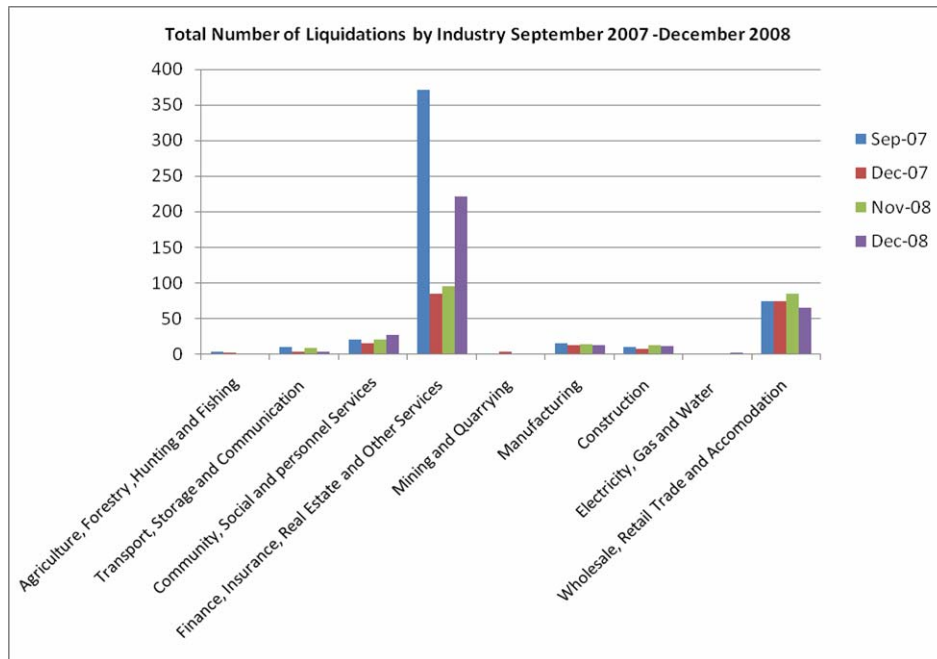
A trend amongst certain South African retailers has been to sign up with speculative retail developments in order to keep out competitors. However the result is that research to determine the longer term prospects of a retail centre is sacrificed (Prinsloo cited in Muller, 2009:20). The reason for certain retailers signing up with speculative retail developments is that 'they [retailers] don't carry the same financial risk as the developer and the banker and can easily walk away from underperforming centres' (Prinsloo cited in Muller, 2009:21). In some cases poor information and research is cited as a factor that lead to development of REIT investments such as shopping malls that are not viable. In one example, the developers of Maponya Mall in Soweto wanted to 'transplant Sandon City to Soweto' (Muller, 2009:21).

3.12.5 The Crash

South African retail centres which are prime REIT investments have suffered as a result of the financial crises. ‘Developers are also to blame for the cannibalisations of consumer spend because of overestimating the market and providing misleading information to retailers purely out of greed’ (Prinsloo cited in Muller, 2009:21). In addition to developers ‘retailers are partly to blame for the cannibalisation of consumer spend now evident in many popular shopping nodes country wide’ (Prinsloo cited in Muller, 2009:20). Retail cannibalisation occurs ‘when a retailer opens to many stores in the same area’ (Muller, 2009:20).

According to the Reserve Bank of South Africa (2008:26, 2009:21) the real estate industry together with finance, insurance and other services have had many liquidations of companies. 371 companies in the real estate industry, finance, insurance and other services were liquidated in September 2007 and number dropped to 222 by December 2008 (See figure 11 below for the number of liquidations by industry type).

Figure 11



Source: SARB, Financial Stability Review (2008:26) (2009:21)

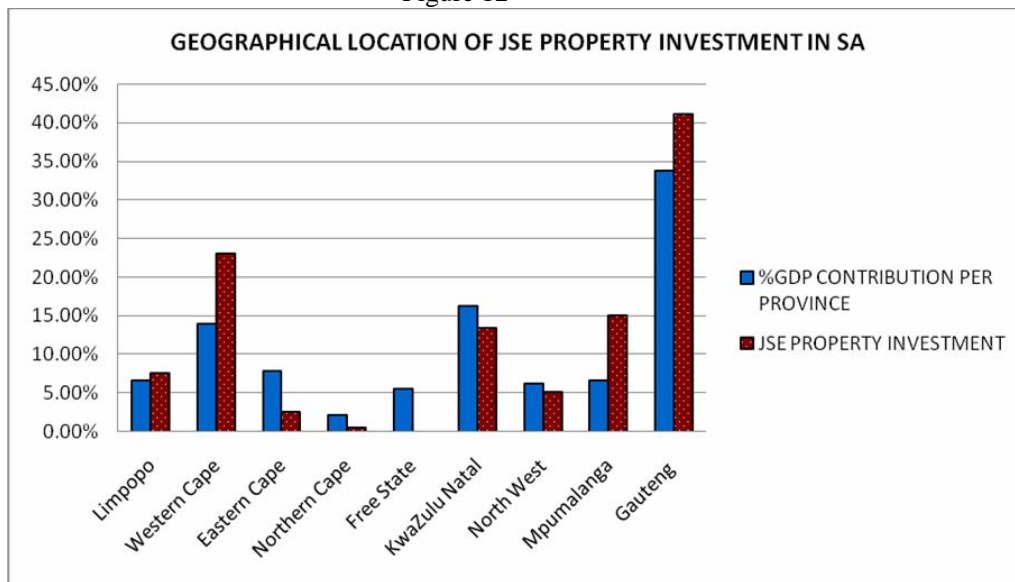
The finance and insurance industry are also shareholders or owners of REIT type investments vehicles as is identified in chapter 3 (Summary of property investment in SA) of this research. This implies

that the REIT industry is sensitive to global and local financial markets for real estate, finance and insurance industries. Furthermore if these industries are not managed well, they can become risks to the banking sector of an economy and can contribute to severe financial crises of an economy. Mishkin (2006:34-35) argues for regulation and the need for ‘prudential supervision’ to be by the government mitigate against risky portfolios.

3.13 Impact of real estate investment on cities in South Africa

In analysis of companies that appeared in the Financial Mail Property Handbook for 2008 more than 40% of properties listed on the Johannesburg Stock Exchange are to be found in the Gauteng region followed by the Western Cape (23%), Mpumalanga (15%), KwaZulu Natal (13%), Limpopo (7%), North West Province (5%), Northern Cape (2%) and Free State with less than 1%. Figure 12 illustrates the geographical spread of properties from property loan stock companies and collective investment schemes in properties that are listed on the Johannesburg Stock Exchange and the % GDP contribution of each Province to the country.

Figure 12

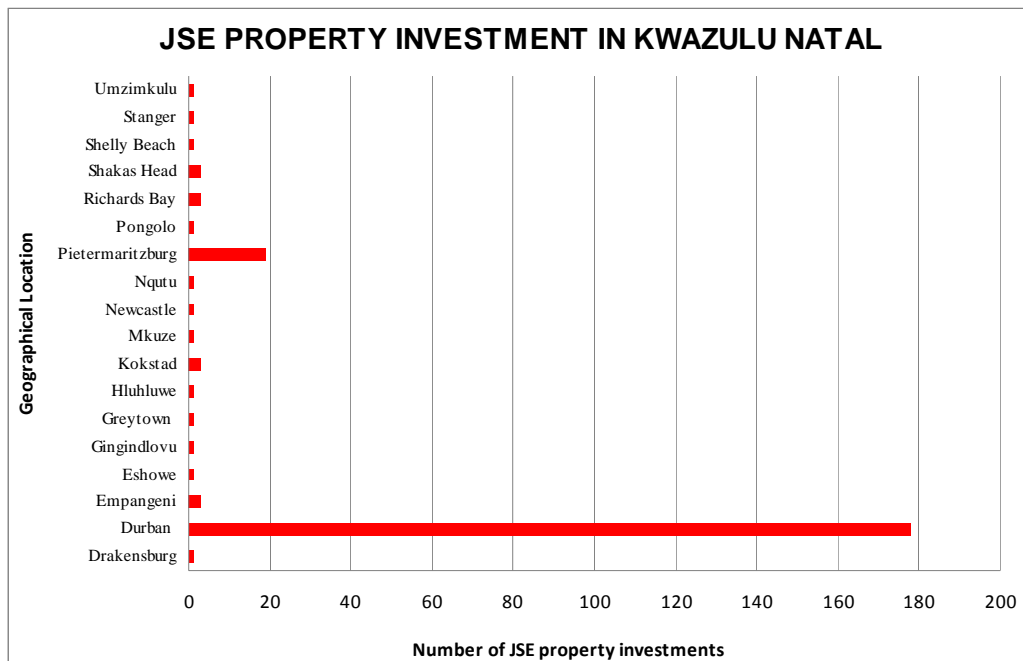


Source: Researchers own calculation from Financial Mail (2008:72-122)
Stats SA (2005)

The general trend has been that JSE investment occurs where there is economic concentration of activity in the country. Gauteng, Mpumalanga and Western Cape Provinces have more JSE investment than KwaZulu Natal. The relative advantage of [spatial] location is the driving force

behind real estate capitalism or profit seeking investment in the built environment (Murray, 2008:128). South African real estate investments involve complex relationships amongst stakeholders. On the production and purchasing side there are property developers, corporate lenders and equity lenders whilst borrowers and tenants form part of the consumption side (Murray, 2008:197). These stakeholders influence the spatial dynamics of real estate capitalism by choosing to invest in new locations and at the same time disinvestment in other regions of cities (Murray, 2008:128-129).

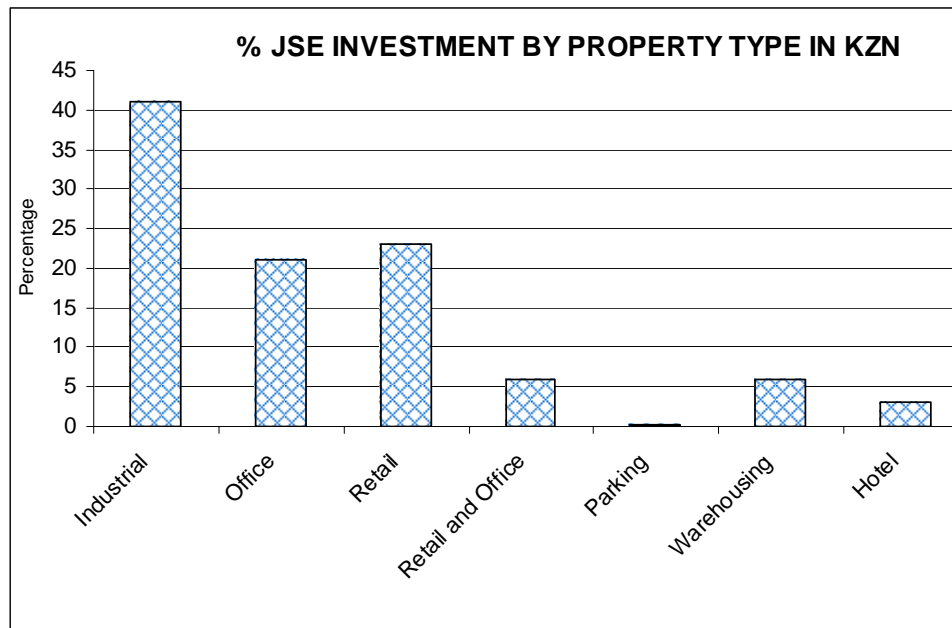
Figure 13



Source: Researchers own calculation from Financial Mail (2009:70-118) and Listed Property Company Annual Reports

Figure 13 identifies JSE investment within KwaZulu Natal. Durban has the most JSE investment (178 property investments) and is followed by Pietermaritzburg (19 property investments).

Figure 14



Source: Researchers own calculation from Financial Mail (2009:70-118) and Listed Property Company Annual Reports

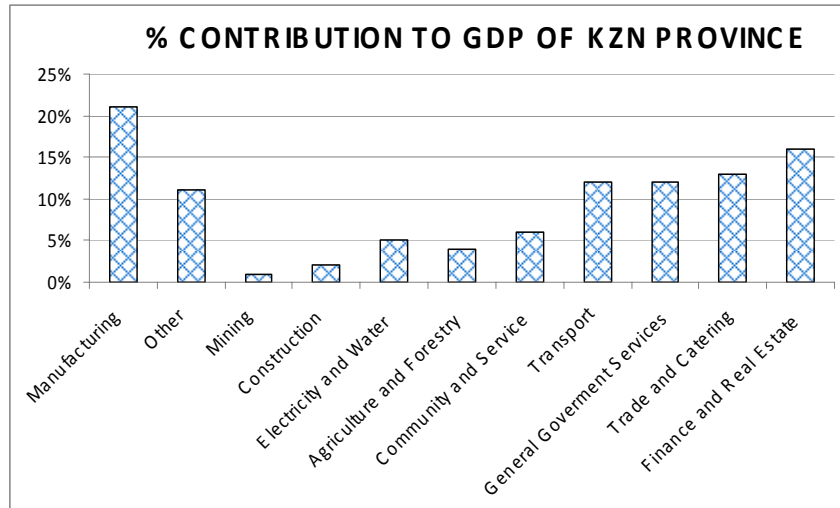
Figure 14 identifies JSE investment by property type in KwaZulu Natal. 41% of JSE investment is for industrial use and is followed by retail (23%), office (21%), and office (6%), warehousing (6%), hotel (3%) and parking (0.3%). The investment trends for JSE in KZN are different from the rest of South Africa (Figure 6). More JSE investment in the industrial sector occurs in KZN than the rest of South Africa.

3.15 REIT Opportunities in KwaZulu Natal

A particular focus in recent years has been on municipal infrastructure and property development particularly in the Umhlanga and the North Coast and increasing commercial development along key logistics routes such as the Riverhorse Valley, the N3 Corridor and in previously disadvantaged areas such as Umlazi. Much of these facilitated between the eThekweni Municipality and Moreland and Old Mutual Properties (KwaZulu Natal Business, 2007/2008:139). This area forms an ideal opportunity for REIT investments in the industrial and office sectors.

Some R4 billion will be spent on the construction of the new King Shaka International Airport and Dube Trade Port situated 30 km outside the Durban city centre. Construction of the airport is scheduled for completion in 2009. The Dube Trade port will be developed on a site of about 3000 hectares and will be connected to Durban and Richard Bay by the N2 freeway, the R102 and the dual line rail link (KwaZulu Natal Business, 2007/2008:139). Properties around the new airport in KwaZulu Natal can be potential REIT opportunities for investment.

Figure 15



Source: Stats SA 2005

Figure 15 identifies the GDP breakdown for KwaZulu Natal. REIT investments can occur over any of the sectors in GDP breakdown in KwaZulu Natal however have favoured sectors in the industrial, office and retail in KwaZulu Natal (See figure 14). The agricultural and forestry sectors contribute nearly 4% of the GDP for KwaZulu Natal.

Land use in KZN in 1994/1995 per 1000 hectares are as follows: Land use is predominantly in the form of natural vegetation (5, 7 million hectares or 62, 3% of total land area), followed by cultivated agricultural land (1, 6 million hectares or 17, 2%), nature reserve and conservation (0, 6 million hectares or 7%) and forest land (0, 6 million hectares or 7%). About 40% of South Africa's commercial forest plantation area is found in KwaZulu-Natal (KZN Draft PGDS, 2008:5).

A trend in the United States of America was the acquisition of forestland being used for timber production by REIT companies (Hickman, 2007:1). An unexplored sector is the agricultural sector for REIT investment in South Africa and KwaZulu Natal.

3.16 Conclusion

The South African property investment industry has made strides to become integrated with global property investment models and financial markets. The move towards a REIT structure is an example of capital market liberalization for the property industry in South Africa. The key land use types for REIT investments in South Africa have been in the retail, office and industry sectors. REIT investments occur in areas of economic activity. The residential and agricultural sector has not yet been fully targeted however opportunities do exist. The concentration of REIT investment has favoured urban over rural areas in KwaZulu Natal.

Chapter 4: Stakeholder perspective

The purpose of this chapter is draw on conclusions from the previous chapters and to contribute to policy making in the real estate investment sector and its implications on spatial policy in South Africa. REITs are economic drivers of spatial form and will have implications on urban as well as rural environments. This chapter reflects on interviews conducted and relates them REIT policy proposals as well as spatial policy proposals in South Africa.

4.1 Policy considerations for urban and rural restructuring

During interviews with key local government officials their opinion on understanding the development stage (market) of the real estate sector was as follows

There are two dimensions in understanding the development stage of the real estate sector. Firstly one needs to understand in the context of national revenue and for local governments⁶. Secondly one has to take the local context into account⁷

Officials were of the opinion that the development stage (market) of the real estate sector needed to be understood and was important for the following reasons

For a municipality it is based around service delivery and stock take. It also relates to guiding development through the long term development framework plan and the municipality should not be

⁶ Interview with Krish Kumar (eThekweni Metropolitan Municipality, City Treasurer)

⁷ Interview with Keith Maithius (eThekweni Municipality, Manager: Real Estates)

spending money where it should not resulting in fruitless expenditure and furthermore there is the concern around maintenance of services which the municipality is responsible for⁶. It is important to understand the development stage of the real estate sector in order to not comprise public funding for services and further compound unfunded mandates⁷

At the moment the Public Sector faces more challenges than the Private Sector therefore there needs to be a more flexible model to incorporate both sectors of society. There is a problem of power being shifted to a group of elite individuals for development purposes. One has to factor in the implications on the poor. A good monitoring and evaluating process is needed however the process is driven by a political process thereby intense speculation for development in the real estate sector is possible⁸.

It is important to determine the location of land for development and implications on urban sprawl. There is also the issue of segregation communities especially in light of the development of gated communities. It is important for municipalities to understand the development stage of the real sector for municipal services issues and rates collection⁸

Free market policies such as REITs have impacts on urban environments as they tend to utilise the most prime and strategically located properties. This comes at the cost of the poor who forced to utilise properties on the urban peripheries especially for residential purposes. Urban restructuring for the poor in post apartheid South Africa has been marginalised (Todes, 2006:67).

With this in mind the South African REIT policy design (National Treasury, 2008:9) proposes that

REITs have to generate 75 per cent of total income as rental income from immovable property

Income from these assets (cash, money markets and government securities) will be added to determine total income (ie. 100 %). 75 % of the total income has to be from immovable property ie. rental income. Rental income will be defined and should include all income earned for the physical use or occupation of the immovable property for a specified period. Included in rental income should be income earned from the direct utilisation of immovable property including space for promotional purposes such as parking (RSA National Treasury, 2008:9).

A further proposal by the National Treasury of South Africa (2008:9) for REIT is to

Permit development activities as long as the property is retained for letting purposes and retained for at least three years. Development activities should be encouraged but the government policy objectives regarding the types of developments preferred should determine the design. The development for sale in general should be limited. One option that could be explored is to include income earned from developmental for sale assets in the 25 per cent non rental income. A REIT breaching the 25 per cent limit due to development for sale profits should result in monetary penalties for the relevant decision maker. The development of low cost housing ie. residential properties sold for less than R500000 per unit, should be encouraged. Income earned from such development for sale assets should be allowed and should count towards the 75 per cent threshold. Full disclosure of these transactions or undertakings to investors will be required.

⁸ Interview Ashena Ramloutan (Planning Practitioner) Department of Local Government and Traditional Affairs

The South African REIT proposal to accommodate lower income housing for under R500000 is an attempt by the government to 'leverage' the market for residential accommodation between the poor and the rich. McCarthy (2006) identifies this process as 'making markets work for the poor'. According to McCarthy (2006:2)

The making markets work for the poor perspective is being widely perceived as amongst the most useful of new policy approaches in many parts of the world. This is particularly so when considering maximizing the effectiveness of public resource allocations designed enhance the economic circumstance of, and opportunities available to, the poor. Since the making markets work for the poor perspective is relatively new to South Africa, and since there is also a strong tradition of anti-market thinking in the country, the potential of making markets work for the poor perspective to shed light on issues like accelerated delivery of higher quality of land to the poor in SA is likely to be regarded by many as counter intuitive.

The success of the 'making markets work for the poor' strategy is undetermined at the moment however it can be a contribution for urban restructuring. McCarthy (2006:26) argues 'it seems more logical to use public funds to leverage influence on the operation of land and urban development markets, and (where this is not already done) to use progressive property taxes to enhance the scale of such funds'. REIT investments are going to form part of the developmental and growth path trajectories of the South Africa especially in areas such as housing for under R500000. This implies that the government is aware of the need for the housing market for under R500000 and will be encouraging REIT investment in this sector. For purposes of urban restructuring, REIT investments in residential development for under R500000 is an attempt by the government to leverage the REIT market to invest in the housing sector for under R500000.

Although sound policy and legislative mandates exist for the residential sector in South Africa, the government needs to be cautious about REIT investment in the residential sector for under R500000. In 1992, reforms in the housing sector lead the Russian Government to introduce the Federal Housing Privatisation Law which led to the privatisation of social housing stock. In Germany it is estimated that the mid-term potential for privatisations and other sales of real estate to REITs is about 100 billion dollars. The introduction of REITs in Hong Kong seems to have created new speculations with consequences on raising rents (Unger, 2005:no page).

4.2 Post apartheid real estate development trends

In order to identify real estate investment trends, a study of the major development applications in the EtheKwini Metropolitan and KwaDukuza Municipal areas was undertaken. The objective of this exercise was to determine the potential that the developments have for Real Estate Investment Trusts, determine what methods are used to monitor and evaluate real estate at a local government level and policy implications for urban restructuring. Figure 16 and 17 identifies private sector investment in the real estate sector.

Private sector real estate development has continued in healthy manner within the eThekweni Metropolitan areas (See figure 16 and 17). For purposes of REIT investments, shopping centres and gated residential estates can form investment opportunities for REIT investments (Campbell and Sirman, 2002). It is evident from the examination of the case study areas that substantial investment from the private sector in the form of shopping centres and gated residential estates has occurred.

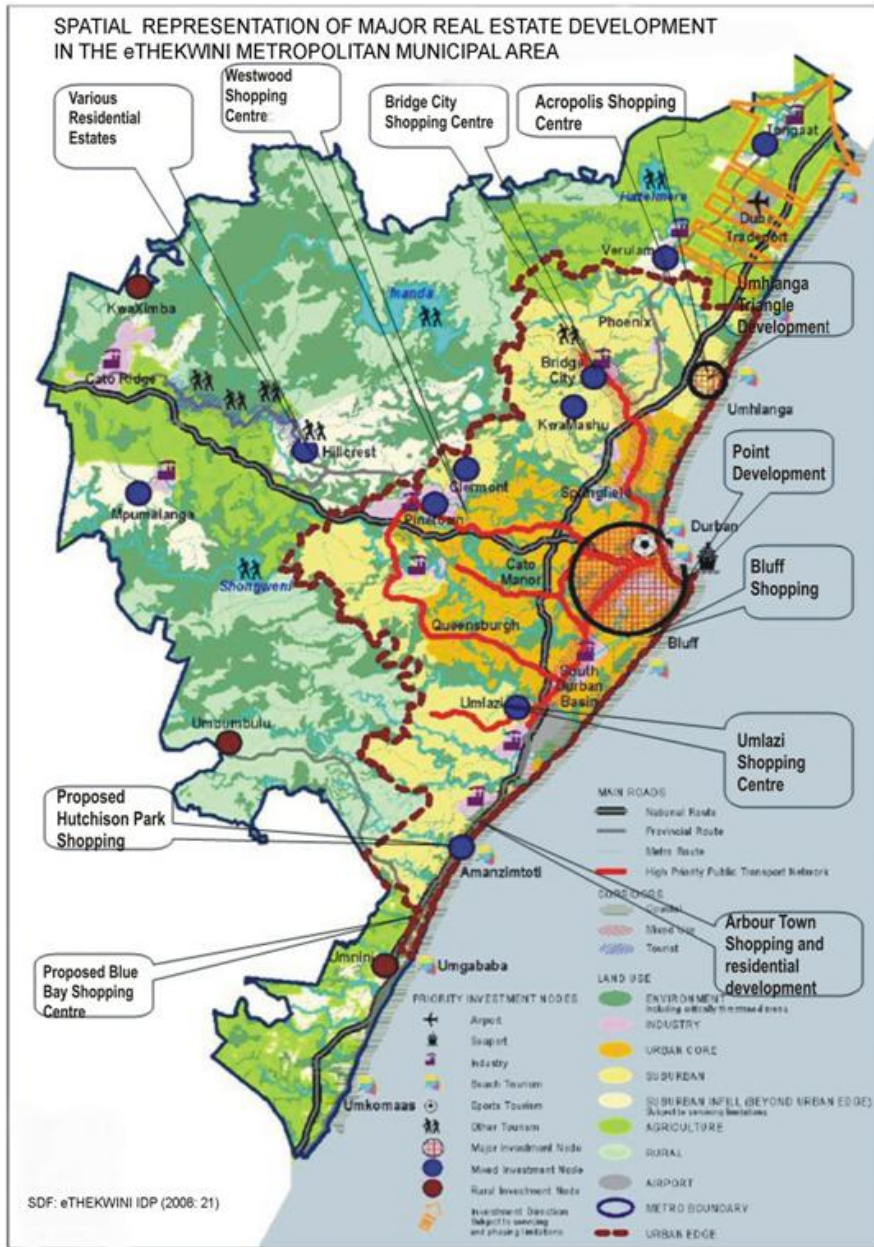
A suggestion by an interviewee to contribute to urban restructuring was introduce a lease tenure system linked to tax system.

In light of the value of land as a resource and its scarcity around the world our country we should have a tighter rein on ours. One way to encourage investment but still hold on to our land would be to lease it as opposed to just selling it outright and thereby losing all ownership rights. A tax incentive can be worked into an agreement by offering reductions for longer lease periods, the types of developments (those which benefit our country would get an incentive) and the environmental impacts (lower impact means a lower tax, higher impact = more penalties)⁹

At the moment, no South African law permits the government to do the above. The South African government would have to expropriate land and follow procedures in terms of expropriation in terms of the Constitution of South Africa.

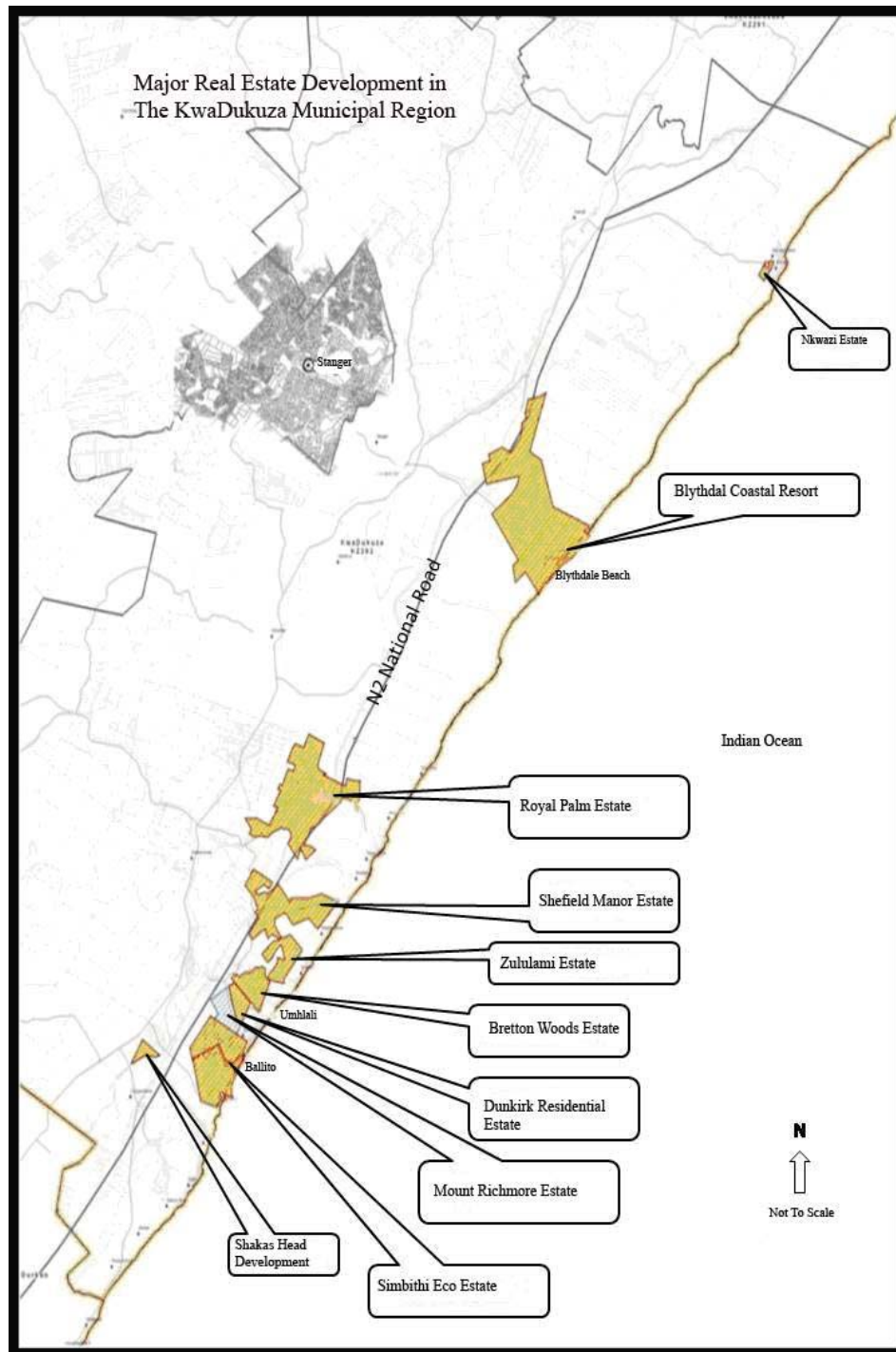
Figure 16

⁹ Interview with Ashena Ramloutan, Planning Practitioner : KZN Department of Local Government and Traditional Affairs , Municipal Strategic Planning Unit



Source: Application Register Department of Local Government and Traditional Affairs

Figure 17



Source: Application register Department of Local Government and Traditional Affairs

No South African law at a national or provincial level exists to regulate shopping centre in manner in which the Japanese regulate large retail centre developments (See section 2.10 above). In the absence of appropriate laws in the built environment for urban restructuring and economic regulation of land use types, REIT investments are expected to capture prime spatial locations and contribute to spatial

distortions that prevent urban restructuring for the poor. ‘One weakness of urban spatial policy [in South Africa] was that it was founded on a planning approach which did not address economic drivers of spatial form, or take into account the way politics shapes cities, or the diversity of social needs for space. Too little was done to investigate how the aims of urban restructuring could be realised or to explore the types of instruments which would be required to do so’ (Todes, 2006:67). All forms of property investment such as residential housing, office blocks and retail shops are commodities to be exploited for profit and contribute to the ‘creative destruction of the built environment’ whereby some groups profit at the expense of others (Murray, 2008:42). McCarthy (2006:25) argues that ‘punitive’ measures such as restrictive land use controls, denying rezoning and imposing high rates will likely lead to contrary outcomes that impact on the poor.

4.3 REIT restrictions on land use

South African REIT policy design intends to liberally permit REIT over all property types. Internationally, permitting Real Estate Investment Trusts over sectors such as residential properties has come with problems for social housing in countries such as United States of America, London, Canada and Germany (Unger 2006: no page). At the moment social housing is protected by housing policy and legislative objectives through the Constitution of South Africa.

Some interviewees for this research broadly accepted permitting REIT investments over all types of land uses and advised. There were two broad positions on the possibility of REIT investments. The first was broadly accepting.

What’s wrong with it? No problem, as the onus is on the developer to deliver infrastructure and Local Government to play a part in facilitating investment to transfer skill and intellectual capacity¹⁰

The second expressed some concern during the interview

One should be wary of allotting blanket approval for REITs over all property types. At the moment there exists a situation where the market is being controlled by an elite few and the types of developments that are needed are not being addressed as the world is governed by capitalism. There are benefits to be derived from allowing REITs over a larger property scope e.g. the foreign investment would more likely result in a completed development due to the availability of finance; housing developments with infrastructure would be more likely to occur once again due to available finance as opposed to municipality trying to source the budget for housing developments. However, one has to factor in the implications on the poor and their needs – In terms of housing would the REITs development be targeted at a middle to low income market (especially as this is where the demand is)? If REITs is to be applicable over all types of properties there needs to be a good monitoring and evaluating process in place to ensure that the needs of the South African people are

¹⁰ Interview with Lekha Alopi (Manager Land Use Management, eThekweni Metropolitan Municipality)

*considered. Currently development is driven by a political process thereby intense speculation for development in the real estate sector is possible.*¹¹

*There are concerns regarding the commercialization of residential properties and its impact on society. There are concerns around the extraction of capital for speculative gain*¹².

*There are concerns around the impact of investment from the corporate sector over different types of property land uses eg. agricultural properties and its impact on food production*¹³

In an effort to prevent negative externalities on land use, restrictions on land use for REIT could be considered by the National Treasury. Amendments to the Collective Investment Schemes Act No 45 of 2002 will need to be made. The amendment to the Collective Investment Schemes Act could state that all new REIT investment for agricultural, residential or any land use purpose must be authorised through a land use application authorised by the land use regulator or the Minister and Agriculture and Land Affairs in terms of the Land Use Bill of South Africa. The South African Government has released the National Land Use Management Bill (Government Gazette No. 30979) on 15 April 2008 within which certain sections advise that development applications that affect a ‘provincial’ or ‘national’ interest need to be considered by a land use regulator and the Minister for Agriculture and Land Affairs respectively. Section 37 of the National Land Use Management Bill proposes that

a land use application

- (a) affects a provincial interest if, amongst other things, such application materially impacts on
 - (i) a provincial growth and development strategy or similar instrument;
 - or
 - (ii) provincial policy objectives; and
- (b) affects a national interest if, amongst other things
 - (i) such application materially impacts on
 - (aa) national spatial development perspectives or similar instruments;
 - (bb) national policy objectives, principles or priorities; or
 - (cc) land use for the purpose which falls outside of the functional areas listed in Schedules 4 and 5 to the Constitution; or
 - (ii) the outcome of the application
 - (aa) may be prejudicial to the economic, health or security interests of one or more provinces or the country as a whole ;
 - or
 - (bb) may be prejudicial to or may impede the effective performance by one or more municipalities or provinces of its or their functions in respect of matters listed in schedules 4 and 5 to the Constitution

In considering an application, the land use regulator needs to take into account compulsory norms and standards, national spatial development perspectives, provincial and municipal frameworks for spatial

¹¹ Interview with Ashena Ramloutan, Planning Practitioner : KZN Department of Local Government and Traditional Affairs , Municipal Strategic Planning Unit

¹² Interview with Krish Kumar (City Treasurer, eThekweni Metropolitan Municipality) and Keith Maithius (Director: Real Estate eThekweni Metropolitan Municipality)

¹³ Telephonic interview with Julian Kiepal (Senior Planner Policy: Spatial Planning Business Unit) Department of Local Government and Traditional Affairs

development, taking into account public interest, constitutional imperatives and related duties of the state, the facts and circumstances relevant to the application, the respective rights and obligations of all those affected and time frames for making decisions (RSA National Land Use Bill, 2008:16). During interviews respondents did raise concern for government policy initiatives such spatial development initiatives and integrated development planning.

IDPs and SDF not incorporating Provincial and National Initiatives. Several requests for IDP and SDF from investors but they are unable to translate SDF and IDP

Local level working however not seen PSEDS[KZN Provincial Spatial Economic Development Strategy]. No integrated Development Spatial Plans. Development in the North and South a challenge. Challenge of incorporating Provincial input

In terms of the IDP there has been some success in its use to guide development but as stated previously this is only successful if there is a strong monitoring system and if the municipality is willing to take a stand on their issues.

The adoption of the National Land Use Bill into law can provide the legislative framework for future urban restructuring and will need the strengthening of IDPs and SDFs for effective monitoring and evaluating in the built environment.

The Provincial government of KwaZulu Natal has approved of the KZN Provincial Planning and Development Act No. 6 of 2008¹⁴. The purpose of the KZN Planning and Development Act is

To provide for the adoption, replacement and amendment of schemes, to provide for the subdivision and consolidation of land; to provide for the development of land outside schemes; to provide for the phasing or cancellation of approved layout plans for the subdivision or development of land; to provide for the alteration, suspension and deletion of restrictions relating to land; to establish general principles for the permanent closure of municipal roads or public places; to provide for the adoption and recognition of schemes, to provide for compensation in respect of matters regulated by the Act; to establish the KwaZulu-Natal Planning and Development Appeal Tribunal; to provide for provincial planning and development norms and standards; and to provide for matters connected therewith.

Chapter 11 of the KZN Planning and Development Act provides for Provincial Planning and Development Norms and Standards. Any targeted policy similar to the Japanese Large Store Law or restriction on land use for agricultural, residential or other purposes could be accommodated under Chapter 11 of this Act however the adoption of a Provincial Norm and Standard will require political will and government support for effective implementation. Economic matters relating to the urban and rural environments could be incorporated under KZN Provincial Planning and Development Norms and Standards however they needed to aligned the purpose of the Act¹⁵.

¹⁴ The KwaZulu Natal Planning and Development Act No. 6 of 2008 repealed the Town Planning Ordinance No. 27 of 1949

¹⁵ Telephonic interview with Julian Kiepal, Senior Planner, KZN Department of Local Government and Traditional Affairs: Spatial Planning Unit: Policy

In terms of monitoring and evaluating mechanisms for the real estate sector officials at the eThekweni Municipality interviewees advised that

a development control mechanism such as Town Planning Schemes, valuation rolls and open market system is currently being used to monitor the real estate sector. There appears to be a limited role in monitoring and there is concern from an income perspective in monitoring development. In some cases there is no relationship with the rate roll¹⁶

A response from a Provincial Planner was that

Town Planning Schemes are used to monitor the real estate sector however the monitoring of schemes is currently weak due to intense speculation on the built environment. The Spatial Development Framework should be guiding development however the private sector is driving the SDF process. There are few good quality SDFs from Local Authorities. Going hand in hand with the SDF is the IDP of the municipality which is used to identify the plans of the Municipality for the next 5 years¹⁷.

It is evident from a local government perspective there is some monitoring being carried for the real estate sector however the evaluation for effective policy implementation is deficient. The monitoring involves the considering the kinds of land uses and development that may be permitted within a municipality town planning scheme. Problems exist with speculation in the real estate sector and monitoring of Town Planning Schemes.

The World Bank's *Development Report* (2009:128) argues that

Policy makers have often misjudged the potency of market forces. Many policymakers perceive cities as constructs of the state [that is] to be managed and manipulated to serve some social objective. In reality, cities and towns, just like firms and farms, are creatures of the market. Just as firms and farms deliver final and intermediate goods and services, towns and cities deliver agglomeration economies to producers and workers. So city administrators are better advised to learn what their city does, and to help it do this well, rather than try to abruptly change the course of their city's destiny. Planners and policy makers should see their role as prudent managers of a portfolio of places, to get the most from agglomeration economies¹⁸.

South African policy makers have followed advice from the World Bank and is currently facilitating a more market oriented structure for REIT. Property investment through the collective investment schemes act and the proposed amendment to the act to accommodate REIT has not restricted investment over the different land use types. Furthermore the market for REIT investment has followed 'agglomeration' spatial locations within South Africa. Restrictions on land use for REIT investment can be considered anti market thinking however this can be an effort by authorities to

¹⁶ Interview with Krish Kumar (City Treasurer, eThekweni Metropolitan Municipality) and Keith Maithius (Director: Real Estate, eThekweni Metropolitan Municipality)

¹⁷ Interview with Ashena Ramloutan, Planning Practitioner : KZN Department of Local Government and Traditional Affairs , Municipal Strategic Planning Unit

¹⁸ According to the World Bank (2009:126) agglomeration economies refers to 'locating in areas densely populated by other producers and benefiting from economies of scale'

prevent negative externalities for the economy of South Africa (ie. prevent the exploitation of REIT investment in sectors such as residential, commercial or the agricultural sectors).

4.4 Summary of interviews

The eThekweni and Kwadukuza municipal region has been characterised by intense speculation for residential gated estate as well office and industrial developments (Figure 16 and 17 above). In the KwaDukuza region there is well over 36000 housing units for the high income bracket being proposed (Researcher's analysis from new township layouts and KwaDukuza IDP (2005/2006: 39-43). These developments can be considered for potential REIT investments. It is evident that real estate development is being driven by the market. Strategies like 'making markets work for the poor' (McCarthy, 2006) which postulates leveraging private and public funding for real estate developments need to be explored further given that 'urban restructuring' for the poor has been marginalised in post apartheid South Africa (Todes, 2006).

Chapter 5: Conclusion and main findings

This research attempted to understand the development stage (market) for the real estate sector and the significance of the development stage of the real estate sector, attempted to uncover if REIT investment ought to be permitted over all types of property land uses, determine monitoring and evaluating mechanisms for real estate and REIT implications on spatial policy in South Africa. The main findings of the data collected to address the research questions through the desktop study and interviews fall under the following themes: free market ideology, capital market liberalization and REIT implications on spatial policy in South Africa.

5.1 Free market ideology and capital market liberalization for real estate in South Africa

In understanding the development stage (market) for real estate it is important to understand that South Africa's economy has moved towards a more globally competitive free market economy. The role of the state for REITs is policy formulation. Some argue that this is needed to facilitate REIT markets and to grow this sector for the needs of a competitive capitalist sector. The information being communicated by the real estate industry in South Africa is that REIT legislation is needed to conform to global norms and standards to promote local and international investment in this sector. In determining the significance of the development stage (market) of the of the real estate sector authorities need to factor in the global context of real estate investment and for South Africa's long term developmental and growth needs for this sector. The South African financial system for Real Estate Investment Trust is becoming integrated with the global financial system for REIT.

The capital market liberalization process for REITs undertaken by the South African government can have implications for the economy. The business cycles endured by REIT companies if not managed well can contribute to financial crises and can harm the overall functioning of the economy. The unravelling of the global financial crises through the bursting of the property market bubble is evidence of the property industry not being managed well. The RSA National Treasury (2008) is currently proposing prudential monitoring and evaluating policies to reduce the effects of bad speculation in the real estate sector for REIT investments. The success of prudential regulation for REIT industry is undetermined at this stage. Understanding the development stage (market) of the real estate investment sector is unpredictable and complex. However prudent supervision is needed by regulatory authorities for macroeconomic stability of the country.

5.2 REIT implications on spatial policy in South Africa

A key assumption in this research was that understanding of the development stage (market) of the real estate sector is needed to determine the viability of Real Estate Investment Trusts over all types of

properties (ie. open land, residential, commercial or industrial). The research has revealed that REIT investments prefer to invest in retail, industrial and office land use types in South Africa. REIT investments in sectors such as agriculture remain undetermined at this stage. More research on the socio economic benefits of REIT in the agricultural sector needs to be investigated. REIT investments can have implications for rural restructuring.

Respondents from interviews at the local government level were of the opinion that real estate is an important resource for the country and understood the scarcity of prime land for social benefits. Proposals by the South African Government to introduce a law for land use management can provide the legislative framework for future urban and rural restructuring and will need the strengthening of IDPs and SDFs for effective monitoring and evaluating in the built environment. For purposes of REIT investments, a law for land use management can ensure that REIT developments are coordinated through the municipal IDP and the prevention of negative externalities such as the commercialization of residential properties for speculative gain, negative impact of REIT investment on agricultural and other property types.

Monitoring and evaluating the REIT industry is currently being done by the Financial Services Board. The FSB looks at the REIT industry from a financial perspective. In order to consider restrictions on land use for the REIT industry for purposes of urban and rural restructuring, amendments to the Collective Investment Schemes Act and further consultation with government departments that monitor land use and a Provincial and Local Government level could be explored. At the current moment, the South African Government has a liberal approach to investment in real estate and plans no restrictions on land use for REITs. A direct consequence will be that urban restructuring for the poor will continue to be marginalised as REIT investment and the rest of the real estate market will continue to utilise prime real estate. Attempts by the National Treasury to 'leverage' the REIT industry to invest in the housing market for under R500000 is one way in which urban restructuring for individuals earning under R500000 can be achieved.

Local government structures will need to have the necessary funding to ensure that REIT developments are serviced and maintained. This currently poses a challenge for big local government structures such as the eThekweni Metropolitan Municipality who large service delivery mandates. Furthermore there appears to be no monitoring and evaluating of the real estate sector across the three spheres of government. This can assist and strengthen reporting and statistical information for the real estate sector.

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