MAKERERE UNIVERSITY

MAKERERE UNIVERSITY BUSINESS SCHOOL

AN ASSESSMENT OF LEGAL CHANGES ON REITS PERFORMANCE IN THE CANADIAN AND SOUTH AFRICAN MARKETS

BY

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A RESEARCH REPORT SUBMITTED TO MAKERERE UNIVERSITY BUSINESS SCHOOL (FACULTY OF GRADUATE STUDIES AND RESEARCH) IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION OF MAKERERE UNIVERSITY

PLAN B

November, 2023

DECLARATION

I **Ngomoloya Fiona** declare that this is my original proposal, and it has never been used by anyone else I know.

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DEDICATION

This research paper is dedicated to all individuals who have contributed to its realization, directly or indirectly, and to those who continue to inspire and support my academic pursuits.

To my family, my Israel the world is your oyster my precious!

To my mentors and educators, whose guidance, wisdom, and dedication have shaped my intellectual growth and fostered my passion for research and learning.

To the study participants who generously shared their time, knowledge, and experiences, contributing significantly to the depth and richness of this research.

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LIST OF ACRONYMS

REITs Real Estate Investment Trusts

NAREIT National Association for Real Estate Investment Trust

SA REIT South African Real Estate Invest Trust

C-REIT Canadian REIT

PUT Property Unit Trust

PLS Property Loan Stock

CGT Capital Gains Tax

STT Securities Transfer Tax

SEC Securities and Exchange Commission

MTF Mutual Trust Fund

EPRA European Public Real-estate Association

REALPAC Real Property Association of Canada

ABSTRACT

This research paper examines the relationship between legal factors and Real Estate Investment Trust (REIT) performance in the contexts of Canada and South Africa. Through an in-depth exploration of regulatory frameworks, tax implications, and governance requirements, this study aims to uncover how legal variables contribute to the operational dynamics and financial outcomes of REITs in these two distinct markets. Drawing on qualitative data collected from expert interviews, regulatory documents, and financial reports, the research employs thematic analysis to identify key legal factors that influence REIT performance and investor sentiments in each country. By contrasting the regulatory environments, tax structures, and market trends in Canada and South Africa, this study not only illuminates the multifaceted impact of legal factors but also provides insights into potential strategies for enhancing REIT performance and sustainability in diverse global contexts. The findings offer valuable insights for policymakers, investors, and industry stakeholders seeking to optimize legal frameworks for REITs and foster a conducive environment for real estate investment in Canada, South Africa, as well as new REIT markets in Africa.

CHAPTER ONE

INTRODUCTION

1.0 Introduction

This section contains the background, problem statement, the purpose of the study, research objectives, research questions, scope of the study, and significance of the study.

1.1 Background of the study

Investing directly in the real estate market can be costly in terms of resources Lausberg & Lee (2019) and information. It is, therefore, justifiable to approach the real estate market through investment in Real Estate Investment Trusts (REITs). REITs provide an avenue for real estate securitization Sari, Utomo, & Rahmawati (2020). The REIT is a shell with a portfolio consisting of real estate equity interests, mortgages, or a combination and has been widely used in financing various types of facilities in developed economies, including hospitals, apartments shopping malls, and more.

Globally, the number of listed REITs stands at about 865, operating in 41 countries. Equity market capitalization of listed REITs globally went up from about $10 billion in 1990 to over $2.5 trillion today. North America accounts for 57% of global market capitalization, followed by Asia Pacific at 25%, and Europe, the Middle East, and Africa at 18% Mattson-Teig (2022).

The first modern Canadian public REIT was formed in 1993 (PWC, 2019). There are currently about 50 operational C-REITS, 38 of these listed on the TSX Ogeturk et al (2022). C-REIT industry's total market capitalization rose, from about C$16 billion ($12.5 billion) in 2005 to almost C$60 billion ($46.8 billion) in four years, according to statistics from S&P Dow Jones Indices LLC that were released in March 2018. The 2015-2017 period saw a 48% rise in Market capitalization to $78.5 billion Yeates, Kakuk, & Hernandez (2019). As of October 2021, market

capitalization stood at about $99 billion McLean (2021). In Africa, the REITs market is at about $29 billion Onyema (2017), operational mostly in Nigeria, Kenya, Ghana, and South Africa. South Africa represents the largest part of the African REIT market valued at a market capitalization of 2019 De Klerk (2019) and about $8.4 billion as of 2020.

The legal framework plays a crucial role in the performance of all, including financial, markets, and affects the birth, governance, and performance outcomes of the REIT industry. Legislation such as in terms of property rights may favor or disfavor REIT properties, directly affecting their overall performance. For example, legislative amendments have been a major driving force in the growth of REITs into a multi-billion-dollar industry in Canada Pachai (2016). While REITs must adhere to particular legal requirements, the different REIT markets have over the years experienced changes in legal regimes. For example, in 2007, the UK introduced a brand-new REIT regime that saw many listed properties convert from Property Loan Stocks (PLS) and Property Unit Trusts (PLS) to the UK-REIT Nabarro LLP (2015). This was a scenario later mirrored in South Africa in 2013. Similarly, Canada had a legal regime change in 1993 PWC (2019) that birthed the modern REIT and more recently the SIFT laws, enacted in 2007, have taken effect since 2013. Thus, it is worth investigating the extent to which legal changes affect REIT performance.

1.2 Statement of the problem

A legal framework is postulated to affect financial markets as well as firms' financial and economic performance La Porta (2000;2012). The differences in legal frameworks partially explain the financial performance differences between Canadian REITs and South African REITs. Pachai (2016) attributes the prosperity of Canadian REITS to legal changes, particularly the 2007 SIFT Laws (Income tax act amendment). The South African REIT legal structure’s

introduction in 2013 registered outstanding first year results, outperforming even UK, European and Asian REITs Ntuli & Akinsomi (2017) and soon after a decline is attributed to the same. Despite the tax exemptions in the REIT regime, SA REIT performance declines notably after 2017, with some REITs seeking consolidation to survive. South Africa's R236bn sector is struggling to finance developments, and Simply Wall Street (2022) reported a decline of 11% in South African REITs in 2021, and down to a negative performance de Goede (2022) by the end of Q1 2022. By Q2 South Africa's Al Property Index was down 10% Motara (2022). There is no comparative study on differences in REITS performance between Canadian and South African markets based on the legal changes, and thus the need to conduct a comparative study on the two markets. This comparative work can assist in formulating a set of legal points to guide better economic efficiency. They should be of importance and interest to other countries with a plan to build their own REIT markets.

1.3 Purpose of the study

This study seeks to investigate to what extent performance disparities between Canada and South Africa can be attributed to legal changes.

1.4 Research objectives

i. To explore the legal structure surrounding REITs in Canada and South Africa.

ii. To investigate the causes of REIT performance differences in Canada and South Africa.

iii. To suggest strategies for improving REITs' performance in Canada and South Africa.

1.5 Research questions

i. What is the legal structure surrounding REITs in Canada and South Africa?

ii. What causes REIT performance differences in Canada and South Africa?

iii. What strategies can be employed to improve REITS performance in Canada and South Africa?

1.6 Scope of the study

This study looks into changes in REIT legal regimes and REIT performance in Canada and South Africa. This is because South Africa is one of the most developed economies in Africa, ranks among the highest in terms of Real-estate, and has been most successful with REITs to date Ijasan & Adam (2021). Canada is a proxy for the best practice to emulate since it is considered by Institutional Investors in Canada and Europe as a haven for investment with globally acknowledged political and economic stability Steve (2022).

1.6.1 Geographical scope

The study will be carried out in Canada and South Africa.

1.6.2 Content scope

The scope of content will cover how legal changes affect REIT performance in Canada and South Africa.

1.7 Significance of the Study

Investors with an interest in international investment opportunities get a better understanding of REITs' performance drivers in different markets to help guide their decisions.

To the governments, this study may also contribute to knowledge relevant to policymakers in building international cooperation in the real estate and finance sectors. Furthermore, a study on different legal regimes may lead to the improvement of domestic laws.

The study will contribute to the existing academic literature on real estate financing, REITs particularly, and can be useful to other researchers with an interest in REITs by highlighting further areas of study.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This section reviews currently available literature about performance and legal framework.

2.1 Theoretical framework

For this study, we will review the performance improvement theory and the public interest theory of regulation.

2.1.1 Performance Improvement Theory:

According to this theory, performance improvement in manufacturing and servicing is the main objective of modern operations management approaches. ´Bench-marking, re-engineering. Fetais (2022), and Total Quality Management rely on the hypothesis that critical success factors may be improved, either through quantum leaps or continuous improvement of the underlying processes. This is relevant because the study aims to benchmark Canadian REIT practices to better REITS performance in South Africa. Benchmarking helps the management and decision-makers of a firm to improve performance and productivity. Benchmarking best practice involves identifying the best (performing) firms in an industry or a sector, and comparing specific performance metrics or indicators, to learn from peers how the business processes could be improved immediately, and over time Dai & Kuosmanen (2014). The most critical steps in benchmarking are; the selection of benchmark targets and the setting of goals to promote excellence regarding profit, and other key strategic dimensions Kwon, Marvel, & Roh (2017).

Business re-engineering tends to go hand in hand with benchmarking, as an approach to improving organizational performance. Re-engineering involves the radical redesigning of core business processes to achieve visible improvements in productivity, cycle times, and quality Bain

&Company (2018). It presents a major improvement in organizational design for business sustainability. Even as performance improves or REITS scales it has to be sustainable by adopting new means that ensure the organization's long-term survival by ensuring efficiency and maintaining competitive advantage Fetais (2022).

2.1.2 The Public Interest Theory of Regulation:

This theory first developed by George Stigler in 1971 and later by Robert Posner in 1974 generally holds that regulation seeks to protect and benefit the public at large. Regulations are a response to the public's need for the correction of unscrupulous operators and inequitable market practices, with emphasis on the maximization of social welfare having weighed the cost of regulations against the increased social welfare Ahiabenu (2022).

Regulatory frameworks are policies created by governments to impose controls and restrictions on certain specific activities or behavior Chu (2018). Regulation sees that REIT properties are well managed, ensures reporting and disclosures, as well as provides inbuilt safeguards for investors Hingorani (2015). REIT regulatory bodies vary from country to country as do the regulations. In the US REIT, regulatory controls fall under the Securities and Exchange Commission, in Canada REITS oversight is provided by Canadian Securities Regulators in each province as there is no regulator at the Federal government level. While in South Africa the Financial Sector Conduct Authority oversees all nonbanking financial services.

However, determining the optimal regulation that ensures the regulator is acting in the public's best interest can be a challenge Van Der Heijden (2022). Regulation can easily favor one stakeholder over another, for example, if for perhaps a justifiable reason a company is given a tax break, and their investors' dividends taxed. Regulatory compliance is crucial to ensure the

intended purpose is achieved. Regulations serve to protect investors by providing operational guidelines. The principal function of securities law is to reduce transaction costs and risk.

2.2 REITS Performance in Canada and South Africa.

REIT total return is the combination of income returns from dividends and capital gains from share price appreciation. Just like other assets REIT share prices are affected by market forces, but most especially the earnings from rental revenue and the price-earnings multiple assigned by the marketplace. Market capitalization measures the value of a REIT based on its stock price.

The modern REIT structure began to take off in Canada in 1993, market capitalization from then to 1995 was between $175million and $300million, continuing a steady rise to about $ 1 billion in 1996 from 5 REITS, almost $ 3 billion in the next year and a halfway through 1998 the 14 listed REITS registered a market capitalization of more than $3.8 billion. Although not immune to the global financial crisis either, by 2005 market capitalization had risen to about $12.5 billion as the Canadian REIT marked 25 years Chandler (2018). By 2015 the number of REITs operating in Canada had grown to 48 with a market capitalization of over CAD 50 billion (Pachai, 2016) and more recently estimated at $80 billion. As of October 2021, market capitalization stood at about $99 billion McLean (2021). South African REITs grew from a US$18.7 billion market capitalization in April 2013 to a record high of US$30 Billion in September 2018, more recently stood at US$8.4 billion in September 2020, a notable decline Akinsomi (2020). South African REITs once featured on prominent global indices like the S&P Global Index and FTSE EPRA/NAREIT representing the second-largest REIT market based on market capitalization in 2015 Akinsomi (2016). The South African REIT still ranks as number 1 in Africa and ranked number 21 globally based on EPRA FTSE NAREIT indices in 2020.

Before the establishment of the REIT regime though, the listed property sector became active in South Africa in 2002, with the introduction of Property Unit Trusts and Property Loan Stocks. The South African National Treasury in 2008 acknowledged the regulation governing these as too restrictive to compete internationally, somewhat hindering their performance. PLS were treated as companies, and PUTS as trusts and so accordingly taxed.

PUTS were only taxed once in the hands of the investor, but were exempt from capital gains tax (CGT), as it only applies to the beneficiaries upon the disposal of units held by beneficiaries Carstens (2018). PLS was subject to income tax at the 28% company tax rate, but in the hands of the investor, dividends were exempt from income tax but still subject to a 15% withholding tax for distributions to non-residents.

Between 2005 and 2015, the distributions of PUTS and PLS averaged 8% and 9% respectively. These listed properties registered some negative capital returns in the periods of 2008-2009, 2011, and 2013-2014. Cumulative capital returns from 2009-2013 were at 2,3% for PUTS and 14,55% for PLS. 2008 registered the worst performance due to the global financial crisis Erasmus (2015). Returns were mostly positive in the 10 years leading up to 2013 when the modern REIT structure took effect. Before 1993, Canadian listed property was characterized mostly by taxable corporations which are a bit similar to South Africa's PLS. The early 1900s was a difficult time for the real estate industry in North America overall, Canada not exempt also suffered. The Commercial Real Estate crisis of the 1990s saw both financiers and developers filing for bankruptcy Martin (2017).

2.3 Legal structure surrounding REITS in Canada and South Africa

Legal foundation is of utmost importance in finance and economics because it brings about transparency, creating a safe environment for capital inflow and outflow. The laws behind credit systems protecting shareholders' and creditors' interests are a major determinant in capital financing, channeling capital towards more efficient use. A strong legal system results in a more active and vibrant capital market. A study on corporate banking in India suggested that stricter regulation and the use of regulation technology (Reg Tech) reduce information asymmetry, consequently promoting data-driven finance while managing credit risk Dashottar & Srivastava (2020).In a paper assessing the impact of legal reforms on pension fund management in Poland, multi-factor market models to assess the impact of regulatory changes on the construction of investment portfolios by fund managers was found that highly regulated funds slightly outperform their unregulated competitors Dopierała & Mosionek-Schweda (2021). A pattern is apparent where law and finance are an inseparable influence on each other as discussed in a recent review of the works of La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1997, 1998, 1999) who contend that countries with the strongest laws tend to have the most developed capital markets Shilon, (2021).

$$Value(t=0) \equiv \frac{\sum_{t=1}^{\infty} E[NA(t)]}{(1+r^t)}$$

The present value (V(t=0) of an asset depends on the Expected future value (A(t)), the legal systems(N), and the interest rates(r) at a future time (t). The legal structure of an economy affects the overall probability distribution of cash at any given time in an economy. It creates a more stable business environment for example where there's political stability, less corruption, and people have more trust in the system therefore there will be more cashflows because of more certainty of receiving the value therein, as well as attracting more foreign direct investments. The

averages of the two distributions may be similar but in the standard deviation lies the difference. Where the standard deviation is smaller it's more favorable. Given this, we look further into how the different legal systems in Canada and South Africa affect the REIT market specifically. It would be remiss to discuss REITs and not include the United States which is the oldest and biggest REIT market in the world today.

Market Entry and Exit. Various factors in an economy may be considered responsible for the ease of new entrants on the market, as well as winding down or change of structure to let go of the REIT structure.

REIT structure. The type of REIT operating in different countries vary, and similarly the legal aspects regarding them. South Africa has two types of REITS, Company and Trust REITs Company REITS are fully registered limited companies whose shareholders; are fully protected by the Companies Act and Takeovers Regulations Panel; can vote on specific issues in general meetings and vote for the company to qualify as a REIT. The company has the REIT structure recorded in its memorandum of incorporation PWC (2019). With Trust REITS investors' interests are protected by a trust deed and the trustee, whose role it is to ensure compliance with the Collective Investment Schemes Control Act and to safeguard investors' assets. This is much like the Canadian structure all REITs (open or closed-ended) are a type of Mutual Trust Fund Yeates & Hernandez (2017). Closed-ended REITS raise money by selling stock to the public through an initial public offer. Closed-end funds must be listed on a designated stock exchange. Open-end funds are generally listed but there is no requirement to do so. One can therefore say that if an entity prefers the Company REIT structure as opposed MTFs then the Canadian market would be harder to enter. A large majority of REITS in the US operate as corporations. The US is such a pro-business environment that offers so many different ways to do business such as

corporations, limited liability companies, S corporations, and partnerships IRS (2022) each with specific deliberately crafted legislation. The REIT legal structure was also very specifically created to be enabling for the REIT industry.

REIT Capital Requirements. In South Africa, a REIT must have at least ZAR 300m of gross assets as reflected in its financial statements and debt of less than 60% of its total asset value SAIT (2019). While by comparison to Canada's capital requirements that of South Africa is lower, it should be remembered that not only are REITS in South Africa in their infancy PWC (2019) but also Canada is a more economically stable economy which further highlights differences in risk factors as a cause in the REIT performance differences. This reality reflects in ease of entry and exit, where in the case of South Africa more REITS took advantage of the option provided for in the REIT law, allowing for easy conversion of PUTS and PLSs into REITS Akinsomi (2020) as the regular entry requirements are quite steep for local new entrants.

National Policies. The difference in policies Howlett & Cashore (2014) for example regarding REIT income-generating activities including limitations to what kind of investments are allowed. In Canada, a REIT must be primarily engaged, directly or indirectly in property activities including the holding of properties and development of properties for letting and retention as investments, the purchase of land for development of properties for retention as investments, and must derive 75% of its revenue of comprehensive income from rental or dividends from other REITs PWC (2019). South African REITs generally generate their income from leasing and renting out space, although equity REITs are also publicly traded. Other policies could be concerning operational licenses and subscriptions among others.

Company dissolution policies. There is no REIT-specific dissolution legal requirement Coleman & Huang(2022) recommends putting in place a plan as dissolution is no small undertaking. It is a lengthy process and a lack of preparation may be a point of concern to investors.

The Canadian Income tax amendment that birthed the SIFT laws also disqualified some MTFs from REIT status. SIFT (specified investment flow-through) laws were to eliminate income trusts, a legal loophole many businesses were using to avoid paying taxes and also to eliminate active business elements in REITS. The Income Tax Act 122.1 highlights the rules that apply in taxing SIFT trusts and defines SIFT as a trust which at any one time in the year is both resident in Canada and listed on the stock exchange. (CRA, GOVERNMENT OF CANADA, 2021) (JusticeLaws, 2022). By this law, REITs that involve active day-to-day business aspects such as hotels and seniors' homes lost the REIT status in Canada and although they still keep the REIT name, they are MTFS that do not have the special flow-through element. This also created an entry barrier for some REITS while eliminating others.

Taxation.

The 2012 Taxation Laws Amendment Bill took the form of a new section (section 25BB) in the Income Tax Act. Bringing South Africa’s publicly traded property sector in line with international standards.

REITs are taxpayers and submit tax returns. However, section 25BB allows South African REITs to deduct all distributions paid to shareholders as an expense, although the investors' income received from the REIT is taxed. The REIT itself still pays tax, but only on the taxable income at the standard corporate tax rate, such as dividends tax in the case of foreign income, transfer duty, and value-added tax (VAT) (SAIT, 2019).

Section 25BB also exempts the South Africa REIT from paying capital gains tax (CGT) from any profit from the sale of its properties. In the Income Tax Act, the rental definition is broadly applied to investments in property companies where the assets are at least 80% property investments. Any property-owning subsidiaries of a REIT, for example, a corporation-type subsidiary created for property development purposes will also benefit from section 25BB tax dispensation. Similarly, a REIT that is a South African resident for income tax purposes (even if it is a foreign REIT) also qualifies for the same tax dispensation.

When buying or selling shares, South African REIT holders(investors) are not charged securities transfer tax (STT) Reifarth, (2019), which is charged to the REIT (company). Foreign shareholders in South African REITs have to pay dividend withholding post-tax at the current rate of 20%, but the amount could be reduced in terms of the rates set by the applicable double tax agreement (PWC, 2022), also known as DTA Bantseke, (2018) between South Africa and the country in which the investor lives, for example, Netherlands (5%), Germany (15%), UK (15%), USA (15%).

For tax purposes in South Africa, both Company and Trust REITS are treated identically, as companies (PWC, 2019). In their legal form, Canadian REITs are mutual fund trusts (MFTs) and are since 2007 subject to a specific set of rules that apply to listed REITs called the REIT Rules.

The original REIT law in Canada has not evolved much since however a very detailed CRA (2008) additional set of rules was added to the Income Tax Act, the SIFT (specified investment flow-through) laws were to eliminate income trusts, a legal loophole some businesses were using to avoid paying taxes and also to eliminate active business Goodmans LLP (2017) element in REITS. The Income Tax Act 122.1 highlights the rules that apply in taxing SIFT trusts and defines SIFT as a trust which at any one time in the year is both resident in Canada and listed on

the stock exchange. CRA (2021) JusticeLaws (2022). By this law, REITs that involve active day-to-day business aspects such as hotels and seniors' homes lost the REIT status in Canada and although they still keep the REIT name, they are MTFS that do not have the special flow-through element, although in the US REITS continue to run with an active business element. Some MTFS that run active businesses in Canada includes Chartwell and American Hotel REITs.

The SIFT law also increased restrictions on what kind of assets a REIT can hold or what kind of income they are allowed to receive. These conditions were tested every tax year and had to be met for the REIT to maintain REIT status GoodmansLLP (2017) and failure to do so was met with a penalty of 33% federal tax, the highest tax rate. The South African REIT must be a company, likening it more to the US REIT. The South African legal system is based on both British common law and Roman-Dutch civilian law. Although Canada and South Africa are both former British colonies the differences in the legal structure arise firstly from the Roman-Dutch influences in the law, aside from the difference in the motivation for creating the REIT structure in the first place. Although the Canadian REIT was first created out of the need for liquidity GoodmansLLP (2017) in the real estate market, for South Africa the motivation being REIT was to create a more unified tax treatment for listed properties Naidoo (2016) and lift the South African real estate market to a more internationally competitive level.

REIT Consolidation. Evidence shows that acquirers in a merger enjoy positive and significant gains, just as much as the acquired REIT gains wealth. The acquirers even enjoy improved abnormal returns when the target is privately listed Ratcliffe & Dimovski (2012). In the 1990s several US REITS scaled up through mergers and acquisitions. M&A can also be an avenue for improving REIT efficiency when better-managed REITs acquire those with potential intending to reduce costs and increase returns. This is called the inefficient management hypothesis

Sebehela (2020). The location of a targeted REIT's assets in primary real estate markets, or even in important growth markets increases the likelihood of mergers Freybote &Qian (2015).

Consolidation although a somewhat costly avenue, gives REITS access to diverse sources of capital and increased cash flows, as well as access to major indices. REIT mergers are often larger and perhaps more competitive (Mulherin & Womack, n.d.) than other corporations and are not usually hostile takeovers Kaldiyarov et al (2020). Larger REITs also command market power in leasing out their spaces, for example, international retail chains would prefer to operate their stores in malls in various locations with only one contract, favoring REITS with multiple property locations over smaller ones. Larger REITs gain more efficiency by exploiting their bargaining powers and negotiating utility contracts at less than market value, or even better loan contracts to find their activities.

REIT merger process in the US is a lot more transparent than other corporations and often utilizes an auction-like sales process involving an average of 19 potential buyers(Mulherin & Womack, n.d.).In recent years there has been some REIT consolidation in the Canadian REIT market for varied reasons. In February 2017, Nobel REIT and Edge Front REIT merged to create a $300 million diversified REIT renamed Nexus REIT. In 2018, Blackstone Group acquired Pure Industrial REIT for $2.48-billion and more recently in 2020 Choice Properties REIT acquired Canadian Real Estate Investment Trust (CREIT) in combined cash and stock deal worth $3.9 while GIC, Singapore's giant sovereign wealth fund this year is looking into acquiring Summit Industrial Income REIT for $4.5-billion. A similar trend is seen in South Africa, with Premium properties and Octodec investments merging soon after the new REIT legal structure took effect. Arrowhead Properties REIT and Induplace also considered a merger in 2020. More recently in March 2022, Heriot REIT acquired Safari Investment REIT CompetitionTribunal (2022),

Fairvest and Arrowhead REITS are currently in talks of merging, with a combined portfolio worth R12.7 billion

In Canada, each province has its own securities regulator as there is none at the federal level. Regardless for the most part the laws relating to public mergers and acquisitions are harmonized across Canada. Mergers and acquisitions involving REITS in Canada involve two transactions, a plan of arrangement and a takeover bid. In addition," REIT mergers and acquisitions transactions have been structured as "acquisition and redemption" transactions, which involve the acquisition of the REIT's assets by the acquirer in exchange for cash and/or securities of the acquirer followed by the redemption of the units of the REIT for the acquisition consideration. In cases where the acquisition consideration consists of securities of another Canadian REIT, this structure has been used to provide a tax deferral to the target unitholders." Some REITs may have ongoing arrangements with their sponsors regarding development agreements, head lease agreements, property management agreements, rights of first offer or refusal, or governance rights, all of which should be considered in planning for a mergers and acquisitions transaction.

Canadian REITs are MTFS, therefore there is no general statute governing them, but rather a declaration of trust overseen by a board of trustees. A declaration of trust contains provisions similar to those in Canadian corporate statutes and also, establishes the duties of trustees. Whereas mergers and acquisitions in South Africa are governed by the 2008 Companies Act 71, Company Regulations 2011 and to curb insider trading the Financial Markets 19, Act of 2012 Davids & Kitcat (2022) and for the case of REITS particularly, transfer of shares is exempt from securities transfer tax.

Smaller South African REITS have explored consolidation to gain scale to compete more favorably in the sector as was reflected by the REIT sector emerging as the most active in terms of mergers and acquisitions of the listed industries on the Johannesburg Stock Exchange, for example, Growthpoint properties planned a total buyout of Acucap Properties and Sycom Property Fund Oppendaal (2014). Further in the aftermath of Covid19 several businesses, and companies with stronger balance sheets have been gearing to acquire the easy targets Muller (2021). Sectoral and geographically diversified South African REITs like Dipula Income Fund have preferred to consolidate their dual share capital structure into one West (2021) a move that can raise new capital and open up possibilities of consolidation with medium and smaller REITs Whitehouse (2022). While many South African REITs are predominantly invested in the local commercial real estate market, some others prefer to invest in properties in developed European countries giving them superior diversification benefits Carstens, Freybotte, & De Villiers (2020).

The South African REIT regime is such that, "a qualifying distribution, however, can only arise if a dividend is paid or is payable. Under the South African Income Tax Act, a dividend, as defined, can only be paid by a resident. Distributions made by non-residents are defined as 'foreign dividends. Consequently, a foreign dividend paid to a South African REIT by a subsidiary cannot constitute a qualifying distribution, with the result that the receipt of this amount in the hands of the REIT will not constitute rental income and will not help the REIT to meet the criteria required for its distributions to be tax deductible ITR (2018)." This means that rental income earned from foreign property owned by South African REITs is not tax exempted, which is prejudicial to shareholders in a REIT who invested because of the expected tax treatments. On the other hand, a foreign dividend declared by a foreign-controlled company to a South African tax-resident REIT may be tax-exempt if the SA REIT holds at least 10% of the

total equity shares and voting rights in the foreign company. And where the conditions are not met a partial exemption at 20% tax is allowed.

Other legal considerations.

Beyond REIT-specific legal considerations though, the REIT sector is not immune to other laws governing the overall business environment as well as society as a whole.

Property Rights**.** The property right is entrenched in section 25 of the Constitution of the Republic of South Africa, 1996. There are two main pieces of legislation covering real estate in South Africa. The Deeds Registries Act, of 1937 sets out the registration requirements and processes necessary for the transfer of ownership or creation of real rights in respect of land (immovable property). It also regulates the process of registering the same as security for creditors. Secondly, all city and regional planning are subject to the framework legislation that was enacted in terms of the Spatial Planning Land Use Management Act, 2013 which provides for the establishment, functions, and operations of Municipal planning tribunals, provide for the facilitation and development of land use measures and provide for matters connected with the same. In Canada interests in land are generally held with absolute title to land, free of any other claims against the title, which one can sell or pass to another by will or inheritance. “As part of the constitutional package announced in September 1991, the federal government proposed that the Canadian Charter of Rights and Freedoms be amended to guarantee property rights Johansen, (1991). Property rights are recognized in the 1960 Canadian Bill of Rights. "It affirms the right of the individual to the enjoyment of the property and the right not to be deprived thereof except by due process of law." This was later included in the Canadian Charter of Rights and Freedoms a move that protects those who own real property from expropriation without compensation and also entitles those whose property rights were infringed to use the remedy section of the Charter

(s. 24(1)). This provision, combined with the safeguards provided by s. 1 of the Charter, would protect property rights from arbitrary interference Johansen (1991). In 2014 the government reopened the period within which to submit land claims until 30 June 2019 a step towards addressing the dispossession of rights/ land, under racially discriminatory legislation in effect since 1913

Environmental laws. Every business must take into consideration policies aimed at preserving the environment. A study in Singapore shows how sometimes REIT regulations and Environmental laws may clash causing perhaps unintentionally, potential adverse environmental effects. REIT constructions also account for high energy and water use as well as emissions. In the US, more REITs are integrating sustainability-focused practices, through energy efficacy upgrades, with a focus on sustainability as a profit driver. Although in some cases these practices may only be put in place for the satisfaction of stakeholders, and to legitimize the firm Zahid & Ghazali (2015). Mariani et al(2018) validate that sustainable and environmentally friendly results in better REIT performance. Other laws include licensing, employment laws, bankruptcy laws, and more.

2.4 Causes of REIT performance differences in Canada and South Africa

Although REITS legal framework in different countries tends to be somewhat similar, the performance outcome especially in developed countries such as the United States, Canada way better than in emerging countries like South Africa and Mexico Testa (2010). What actual differences in REIT legal frameworks from country to country each represents a key determinant of REIT performance and risk-adjusted returns Ghosh & Milena (2021) Particularly the minimum capital and payout requirements as well as taxation of undistributed income show a consistent positive relationship to past and future risk-adjusted performance.

The listed property sector became active in South Africa in 2002, with the introduction of Property Unit Trusts and Property Loan Stocks. Property Unit Trusts were taxed were only taxed once in the hands of the investor, but were exempt from the capital gains tax, while Property Loan Stocks were subject to income tax at the 28% company tax rate, but in the hands of the investor, dividends were exempt from income tax but still subject to 15% withholding tax for distributions to non-residents. In terms of performance, between 2005 and 2015, the distributions of Property Unit Trusts and Property Loan Stocks averaged 8% and 9% respectively. These listed properties registered some negative capital returns in the periods of 2008-2009, 2011, and 2013-2014. Cumulative capital returns from 2009-2013 were at 2,3% for Property Unit Trusts and 14,55% for PLS. 2008 registered the worst performance due to the global financial crisis Erasmus (2015). However total returns were mostly positive in the 10 years leading up to 2013 when the modern REIT structure took effect. These listed property structures can be likened to the Real Estate Operating Companies in Canada which operate outside the REIT law.

REITs in Canada are structured as trusts, which unlike corporations are not governed by general statute but rather by a declaration of trust, overseen by a board of trustees and subject to the principles of common law and trust law Goodmans LLP (2015). Dividends paid to an individual or trust that is resident in Canada are subject to a gross-up and dividend tax credit intended to offset corporate tax paid by the corporation. Dividends paid by a resident Canadian corporation to a non-resident are subject to a 25% withholding tax on the gross amount of the dividend, unless an applicable bilateral income tax treaty if any, provides a lower rate. Distributions received as a reduction of capital on the shareholder's shares are not taxed.

In 2013 the modern REIT legal structure took effect and within the very first year, the listed real estate sector in South Africa experience remarkable growth. This new structure was intended to encourage local and international investment, and one year later South African listed property was reported to have outperformed the UK, European, and Asian REITs. This new structure also incentivized REIT investment. The reduced tax burden enabled South African REITs to grow. The new REIT structure mirrored the more transparent global best practice, encouraging more foreign investors. A study concurred with this and predicted increased liquidity, long-term performance, and growth in South Africa's listed-property sector.

The market capitalization of the South Africa REIT index has grown from R335 billion in 2013, exhibiting a 43% increase in market capitalization in a year by August 2015, and the monthly value of REIT trades by 220%. By November 2017 market capitalization had increased by a further 24% to R422 billion. South Africa's REITs have had superior performance compared to other asset classes over the past 20 years with an average annual return of 19%, followed by equities (16%), bonds (12%), and cash (9%). Market capitalization stood at R652 billion in 2019 South Africa REIT was included on prominent global indices like the S&P Global index and FTSE EPRA/NAREIT where it represented the second largest REIT market based on market capitalization in 2015 Akinsomi et al (2016). South African REITs grew from a US$18.7 billion market capitalization in April 2013 to a record high of US$30 Billion in September 2018, more recently stood at US$8.4 billion in September 2020, a decline attributed to the Covid-19 pandemic. Regardless the SA REIT still ranks as number 1 in Africa and ranked number 21 globally based on EPRA FTSE NAREIT indices in 2020.

Before 1995, REITS did not technically exist in Canadian law. Operating as REITS were simply open-end mutual funds that held interests in real property until amendments were made to the federal Income Tax Act qualifying REITS as closed-end mutual fund trusts (MFT) with a few special benefits. Further amendments in 2007 shut down a tax benefit being taken advantage of by specified flow-through (SIFT) entities (trusts that engage in commercial activities; income generated flows through the trust and into the hands of the unitholder). REITs a sub-type of SIFTS are however tax-exempt at the entity level. A four-year grace period allowed for feedback from the real estate industry which was taken into consideration in subsequent amendments to the new laws, effected in 2013. Market capitalization from 1993 to 1995 was between $175million and $300million, continuing a steady rise to about $ 1 billion in 1996 from 5 REITS, almost $ 3 billion in the next year, and halfway through 1998, the 14 listed REITS registered a market capitalization of more than $3.8 billion. Although not immune to the global financial crisis either, by 2005 market capitalization had risen to about $12.5 billion as the Canadian REIT marked 25 years Chandler (2018). By 2015 the number of REITs operating in Canada had grown to 48 with a market capitalization of over CAD 50 billion and more recently estimated at $80 billion. As of October 2021, market capitalization stood at about $99 billion.

2.6 Strategies for improving REITS performance in Canada and South Africa.

As in any growing industry, there is always a need to continually explore and or improve strategies to fully exploit the potential therein. It would be all-around beneficial for the majority of South African REITS to improve performance and grow in size to attract more international investors, in the case of Canada growing the smaller REITS would especially attract the attention of institutional investors, whose influence and resources can help push forward the REITS strategic plans Owens (2018).

REIT Property Management. This may not be considered critical until situations arise out of poor governance. There are generally two options to consider. Property management by internal staff, or the more popular Saleh & Mali (2015) option, outsourcing. REIT management can be outsourced to another firm that usually has extremely qualified and experienced Saleh & Mali (2015) professionals, but still, answer to the board. 'Outsourcing core functions to a reputable property management company is an easy and affordable way for an investor to ensure that their property remains in great condition and maintains its value Rosengarten (2018).' Such a REIT gets the best of both worlds, expertise and personal interest (most board members are usually investors too) intersecting for higher profitability.

Effective communication of the product / Financial Literacy. There is still very limited knowledge of REITS in Africa. Reports show South Africa continuing to score poorly in international surveys of economic and financial literacy Wentzel (2016). Financial training and education Oberholzer & Fouche (2013) tend to fail in South Africa, most tertiary institutions send students into the world with this deficiency hence the need to try unconventional methods. In Canada for example teaching investment options such as REITs can be included in newcomer orientation programs and the programs sponsored by these very REITs. In South Africa, this can be done at churches and sports gatherings because this is when the public's attention can most easily be captured.

Policy adjustments. Canadian REITs are currently limited in the types of properties they can hold thereby limiting growth potential. The government could help the industry by expanding the pool of REIT-qualified properties and allowing the re-investment of capital gains Grant Thornton (2018). A policy could further create an incentive for the re-investment of dividends received. For example, in the US, one can re-invest earnings within a specified period, and that income is

not taxed. Such REITs appear more attractive to investors. Japan, Germany, and Ireland all have similar policies.

Brand awareness. Smaller REITs should especially aim to increase brand recognition, a value bigger franchises capitalize on to increase income. It commands the loyalty of consumers which is closely associated with a brand's success in the market Seturi (2017). REITs with good brand recognition can afford to charge higher rents than the rest and also gets to attract the attention of institutional investors.

Optimal capital structure. This is especially critical in the current economic environment. Studies show that capital structure has a positive impact on firm performance in developed countries Olusola et al (2022). REITs that operate with lower leverage generally outperform those with more leverage. Smaller REITs that operate with strained balance sheets often trade lower prices compared to their better-leveraged peers. On the operational level, it is also important to explore ways to keep overhead costs down to compete favorably with bigger enterprises.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0. Introduction

This chapter presents the research design, sample size, sampling method, validity and reliability, data analysis as well as ethical considerations.

3.1 Research design

A cross sectional qualitative study was carried out. A qualitative approach is used to get an in-depth understanding of the study topic and allow respondents to express themselves freely Amaratunga et al (2002).

3.2 Unit of analysis and unit of inquiry

3.2.1 Unit of Analysis

REITS companies listed on the Toronto Stock Exchanging Canada and Johannesburg stock exchange and members of REALPAC and SA REIT. the unit of analysis.

3.3.2 Unit of Inquiry

Each participating REIT company in Canada and SA is represented by a senior management employee.

3.3 Sampling methods

Purposive and snowball sampling methods were used to determine the study participants. An evaluation was carried out, and participants / respondents chosen based on their knowledge, experience, and expertise in real estate in both Canada and South Africa. There after snowball sampling was used, as respondents made introductions and referred the student to their peers in the industry with a willingness to share their insights.

3.4 Source of Data

We gather only primary data collected through Zoom interviews and a focus group held on Microsoft Teams.

3.5 Measurement of variables

3.5.1 Qualitative

An unstructured questionnaire is used to guide our interviews with the different executives, allowing for very detailed responses from participants.

3.6 Validity and reliability

3.6.1 Validity

The tool was reviewed by 3 academic experts and tested out on an industry expert with a legal background. Analysis was done in the course of interviewing the tool was continually adjusted (Charmaz,2014) as is necessary in qualitative research.

3.6.2 Reliability of the instrument

To ensure reliability, the researcher established guidelines and procedures for data collection, with standardized interviews and consistency in interaction with participants. All interviews were recorded and transcribed using otter.ai, double checked and verified by participants, most of whom have been in the industry over twenty years.

3.7 Theoretical saturation

The total number of interviews conducted was 10. The number of interviews conducted in Canada was 7, In South Africa were 3 Interviews & and 1 Focus group consisting of 3 people.

3. Data analysis and design

Qualitative data analysis is carried out as summarised in the table below

No.	Objective	Analysis	Source
1.	To explore the legal structure surrounding REITs in Canada and South Africa.	Qualitative approach Thematic analysis with NVIVO	Azuogu et al (2016)
2.	To examine the relationship between legal factors and REIT performance in Canada and South Africa	Qualitative approach Thematic analysis with NVIVO	Mulupi et al (2013)
3.	To suggest strategies for improving REITs' performance in Canada and South Africa.	Qualitative approach Thematic analysis with NVIVO	Azuogu et al (2016)

3.7 Ethical considerations

We obtain introductory letters from both Makerere University Business School and Toronto Metropolitan University, as well as the Toronto Metropolitan University Research Ethics Board approval letter, which is used to introduce the researcher to the respondents. We only include willing participants in the study and maintain their anonymity. The information gathered is kept confidential, and all interview recordings are deleted immediately after the participants verify the transcripts from the interview. Non-verified transcripts were not included in the report. All other information sources used in the current study are properly cited and referenced.

CHAPTER FOUR

PRESENTATION, ANALYSIS, AND INTERPRETATION OF RESULTS

4.0 Introduction

This chapter consists of the results of the study and the interpretation of the same.

We carried out a thematic analysis of interviews with industry experts on REITs and their regulatory factors.

4.1 The legal structure surrounding REITs in Canada and South Africa?

Canada and South Africa both saw a transition from REIT-like listed real estate in the past into their current stable REIT structure which has only undergone limited legal changes over the years, except for some minor adjustments and fine-tuning.

Table 1 Themes of REIT structure

Themes	Findings Canada	Findings South Africa
REIT transition	Transitioned from MTF-like structure to the Canadian REIT as we know it today after the legal framework was formulated.	Existing listed real estate types PUTs and PLSs transitioned into REIT structure when the legal framework was instituted.
Compliance	Higher level compliance is required of REITS. E.g. Quarterly reporting on SEDAR.com .	Higher level compliance, but a bit lower by comparison E.g. Annual reporting.
Rewards and Risks	Tax incentive rewarding. Increased investor protection.	Tax incentive satisfactory Risks from operating in a Debt cycle.

REIT transition

The REIT in Canada was born in the early 1990s, many years after they had been established in the US, and many more until they were established in the South African market.

The Canadian REIT was born out of a crisis. There was a need to liquify the overly leveraged real estate market, and so REITS, or initially what was close enough to the REIT was developed for this purpose. While in South Africa on the other hand, REITs were developed to tap into the international listed real estate market better.

> *... you have to go back to the early 1990s, in Canada. There was a very well-established regime in the US before that. But what there was from 1986 to 1989 was a huge speculative building boom centered around commercial real estate, principally office properties, large malls, and the like. And it was financed with an incredible amount of financial leverage, little to no equity...* ***(Extract from interview)***

During the crisis of the early 90s in Canada, they were exempted from some listing rules and permitted to list to provide unit holders with a de facto redemption, as an exit strategy for those people frozen with units in a dead real estate market with no one on the buy side and hardly any transactions. This allowed them to at least trade amongst themselves. These REIT-like listed properties were mutual fund trusts and traded on the stock markets with quite significant gains, even though this was not necessarily a sustainable business model. These MTFs actually had many similar attributes to the US REIT legislation, however it took many more years of fine-tuning to achieve the actual REIT structure we have in Canada today.

> *... over the years, we got codified REIT legislation. We got a structure that was much more, I'll call it corporate in nature in terms of ring-fencing REITs as a standalone legal entity.* ***(Extract from interview)***

The South African REIT structure on the other hand was a lot more deliberately created, with less of a crisis aversion, and more of an economic gain end in mind. South African REITs were from the beginning subjected not only to the already well-developed REIT regulation but also accounting and listing requirements. The Johannesburg stock exchange did not have to make exceptions on listing requirements for the South African REIT, however, what the REIT structure allowed for was the easy conversion of other listed property types such as property loan stocks (PLS), property unit trusts (PUT) into the more competitive REIT structure. The property unit trust was as close to the REIT structure as could be, and not much changed in structure except in terms of aligning it more to the international standard, as well as in terms of the tax treatment.

> *Before that, we had property unit trusts and property loan stocks. And the property unit trust was probably fairly close to REITs but it wasn't a REIT. And I think that was an important marketing issue. That, especially if some of these structures wanted to go overseas, as many have over the last few years…* ***(Extract from interview)***

The present-day Canadian REIT was a derivative of a unit trust, which is kind of a mutual fund trust and governed by trust law. In South Africa, there are two types of REIT structure formally, the Company REIT (Companies Act and Trust law) and the Trust REIT (Collective investment Schemes Act and Trust law), however the latter is hardly existent anymore, as many have converted to the company REIT structure.

"… there are two types of REITs. That's a corporate company-like company name (Company REIT) and there's also a collective investment scheme of property (Trust REIT). ***(Extract from interview)***

Compliance

Transitioning into the REIT structure came with the responsibility of compliance with several regulatory requirements from the various institutions that govern REIT activities, including in the case of Canada adhering to quarterly financial reports, strictly using IFRS since 2011, Listing requirements of the Toronto Stock Exchange and the Johannesburg stock exchange, REIT regulation as well as a whole host of other policies.

> *So, there's a whole framework for that. Not just legal. And so, several so I call it frameworks or you that govern REITs. And that one of the most important ones is the income tax across South Africa that makes provision for REITs.* ***(Extract from interview)***

Overall, there have not been a lot of legal changes in the REIT structure over the years. In Canada, except the SIFT laws which somewhat altered the REIT structure, as to exclude active businesses. This meant that all mutual trusts with an active business component such as hotels, and seniors homes lost their special flow-through status. Some of these entities such as Chartwell REIT and Sienna Seniors Housing REIT still exist, but only as mutual fund trusts, although some others sold off their assets and dissolved. The American Hotel Income Properties (AHIP), is only listed on the Toronto Stock Exchange but all of its assets are in the US, therefore it is technically not a REIT in Canada. This essentially put them in the same tax category as regular corporations, as opposed to REITS that enjoy a tax exemption after meeting the requirement of paying out at least 90% of their income as distributions. This tax exemption is the one main perk to being a REIT, in most jurisdictions with income only being taxed in the hands of the unit holders.

> *... in Canada, to maintain its flow through tax status, you have to pass several tests, one being you need 90% of your property to be real property you can't be investing in operating businesses, you need I think it's 90% of your income to come from, from passive income, like from rental income. But what that does, and to not pay tax at the REIT level, you have to pay out 100% of your taxable income every year to your unit holders.* ***(Extract from interview)***

In South Africa, REITs are expected to distribute at least 75% of their income as dividends to benefit from this. Landlords, therefore, prefer to pay out even 100% distribution out of the taxable income to avoid paying corporation tax, even when it might have made more sense in the circumstances to hold onto some earnings towards capital projects. It is no wonder the South African REIT structure is described as some sort of debt cycle by industry officials. There has been some debate around the viability and feasibility of maintaining REIT status in South Africa, especially during challenging economic times. The cost pressure on property companies in South Africa is significant, with high expenses compared to rental income.

> *Coming under increasing scrutiny is, you know, how feasible is it to have to pay the 75% out as a dividend. And obviously, the sort of key driver behind landlords wanting to maintain that 75% or rather even payout 100% is because the retained earnings then attract tax, which is, which is just, you know, an unnecessary leakage from the business* ***(Extract from interview)***

One of the respondents further described the REIT structure in South Africa thus;

> *So, another way to think about it is that the way the legal framework is designed is to ensure that REITs collect or can achieve a certain critical mass from like an investor perspective. What I mean about that is that as an investor, different kinds of institutional investors will invest in REITs and what they get from REITs versus any other company is the mere fact that REITs are obligated by law to distribute at least 75% of the distributable earnings to shareholders.* ***(Extract from interview)***

Some REITS in Canada found it more feasible to run a separate corporation for the development of the business as the REIT structure is not ideal.

> *It's a vehicle built for finished property and collecting rent. That's not to say that you can't do some, and many of us in Canada do some development. But if you're going to do development, a corporation is in a much better position to do that. Because you don't have to pay out all your income, you can retain some of your profits. And that enables you to certainly manage a lot of the risks that come with development*. ***(Extract from interview)***

The REIT structure was utilized by companies like Loblaws, Canadian Tire, and Sobeys to separate their real estate assets from their core businesses. These companies created their REITs to monetize their real estate holdings by going public with them. This approach separated the real estate assets from their core businesses, and allowed them to monetize the real estate by going public while also freeing up capital for better business management. These REITs are primarily owned by the retailers themselves, giving them control over the real estate assets and providing advantages in terms of capital allocation and taxation.

The REIT framework in both Canada and South Africa aimed to provide liquidity to investors and democratize real estate investment. By dividing large real estate assets into tradable units, REITs allowed small investors to participate in the real estate market. The legal and regulatory frameworks for REITs in both countries play a crucial role in defining the types of assets, income sources, tax obligations, and distribution requirements for these investment vehicles.

Risks and rewards

While some of the sentiment was that an entity could just as easily run an IPO for a corporation as that of a trust to provide liquidity to investors, others cited the selling feature of REITs as the aggregation of capital for something physical and tangible unlike shares, to enable the growth of the very capital-intensive Real Estate industry. A scenario where the public aggregates funds to enable the building of more apartment buildings, hospitals, shopping centers, or office buildings that grow the economy, on a tax-efficient basis. This was a big selling feature of REITs in other economies like the United States.

In Canada, coming out of a big recession, where a lot of public real estate companies had gone bankrupt and disappeared off the landscape in the early 1990s the legal framework of the REITs helped get investors back into owning properties. Up until then, it was very difficult because they were not liquid, and the tax side was very burdensome. REITs, not only provided investors liquidity but also provided them options to shelter their returns, as REITs are not taxed at the entity level but taxes are passed on to unit holders. The structure also protects investors as there is a set cap on the amount of debt a Canadian REIT can take, and also a limit to how many developments a REIT is allowed to take on. These two elements contributed greatly to the recession in the 1990s causing a lot of big real estate companies in the early 90s to go bankrupt,

as they took on way too much debt, and they tried to develop way too much. So, from this perspective, those are the two keys to the REIT structure that benefit the Canadian market.

> *... the pro formas in many cases were based upon development yields that were lower than the costs of financing. A very bad recipe when you had huge, huge amounts of financial leverage speculative development with low pre-leasing thresholds.* ***(Extract from interview)***

In South Africa on the other hand, a respondent described the REIT model as "just a function of debt". This is a country with very limited debt financing options and very high-interest rates. REITs use long-term debt usually between three- and five-year debts to acquire properties. The returns from these properties in the form of rental income are then distributed after removing all the costs associated with managing the business. Capital expenditures although based on capex computations are funded by a combination of debt and equity on occasion, it's largely funded through debt as a way to avoid paying taxes on retained earnings.

> *That is the trap of a REIT that they're continuously after loan money, and most REITs payout 100% of their distribution. So, they're continuously having to fund the operations and stuff with debt. It's a trap. So, once you're on the treadmill, once, you can't get off.* ***(Extract from interview)***

While the REIT structure has no specific requirement for management structure in either country, there was a common preference for internal management structure. REITs have the option to choose between internalizing their management functions or outsourcing them to external management companies. The majority of the respondents favored internal management, although a few favored external management systems at least in the initial years of

establishment, with safeguards and measures in place to keep interests aligned. One cited as a major concern, is the disconnect between what incentivizes the property manager and that which incentivizes the REIT, because no matter the situation in the market, the REIT still has to pay the service provider.

> *... I hear all sorts of over the years, rationale put forth for external management. In my view, 9 times out of 10 it doesn't hold a lot of water.* ***(Extract from interview)***

The decision to internalize or outsource can be influenced by factors such as scale, cost, expertise, and alignment of interests. Some argued that internal management has provided better control and alignment, while others preferred external management to leverage specialized expertise and cost efficiency. The REIT structure in South Africa has faced scrutiny, with concerns raised about governance practices and external property management teams. The industry has witnessed a shift towards internalizing property management functions to align interests better and ensure effective management. However, the decision to opt for internal or external management depends on factors such as the scale of the REIT, cost considerations, and the alignment of incentives between the property manager and the REIT, but some REITs have still managed to utilize a little bit of either structure to their advantage.

> *... we have what's called a hybrid structure. So, the REIT had several dedicated employees. But some of the senior executives were called dual employees, they would spend part of their time in public and part in private. We stated at the outset that we were going to move to a fully internalized structure as the REIT achieved critical scale.* ***(Extract from interview)***

The governance structure of REITs is very stringent, with a focus on ensuring proper oversight and alignment with shareholder interests. The choice of management style and structure should align with good governance practices, including clear reporting lines, transparency, and safeguards to prevent conflicts of interest. REITs have historically been criticized for focusing too heavily on financial engineering and balance sheet management, rather than property expertise. However, recognition of the need for REITs to have a deeper understanding of the real estate market, including vacancy rates, rentals, and property performance has grown. This shift highlighted the importance of having property experts involved in REIT management decisions.

4.2 Causes of REIT performance differences in Canada and South Africa.

Themes	Findings Canada	Findings South Africa
Market entry and exit	Very costly to enter. Requires approval of majority unit holders. Exits due to SIFT laws.	Was easier to enter at the outset by transition, but harder to meet entry requirements if entering the market outright because of current market conditions. Only noted exit due to struggle with tax advantage condition.
Conditions (REIT specific regulations)	Thriving despite tax advantage conditions of 100% distribution. Canadian REITs are not as dependent on debt financing.	South African REITs opting to pay even more than the minimum requirement of 75% And operate largely on debt which is unsustainable and many are struggling.
Consolidation	Been a few, but mostly grow organically	Consolidations deliberately for scale and better performance.

Although the basic REIT regulation on the surface appear quite similar world over including Canada and South Africa, industry sentiment alludes to legal factors as a contributor to REIT performance differences with in the two countries when analyzing the success and challenges faced by REITs. The legal framework surrounding REITs establishes the rules and regulations

that govern their structure, operations, and financial performance. These legal factors both enable and constrain the ability of REITs to generate revenue, grow their portfolios, and attract investors.

Market entry and exit

In Canada, the REIT structure was a welcome solution to the liquidity problem in the real estate sector at the onset and therefore the REIT vehicle became very popular over the years with many REITs listed across different sectors apartment REITs, Industrial REITs, office REITs, and more.

When converting to the REIT structure in Canada, the company's capital structure remains unchanged, with the share price becoming the unit price and dividends becoming distributions. The conversion today has mostly been done to maintain tax advantages and shield the company from entity-level taxes. Some of the respondents shared that this tax benefit is the reason they have been able to survive on the market.

However, the decision to go public as a REIT or to convert the structure can be complex and requires the approval of a majority of unit holders. Respondents shared that taking a REIT public is an expensive process however the costs are negligible compared to the benefits received under the REIT structure, as well as the ability to raise funds by going public as a REIT.

The amendment of the income tax act that birthed the SIFT laws affected the performance of the REIT industry in terms of numbers because by several REITs lost their status under being active businesses. Furthermore, REITs are required to meet all regulation requirements all through the year or lose status and get taxed as a corporation at the highest rate, 30% corporate tax.

In South Africa, the emergence of REITs followed the need for equity injection in private real estate companies. Similar to what Canadian respondents said, the transition to a REIT structure brought higher costs and reporting obligations. While the law allowed for Property Loan Stocks and Property Unit Trusts to easily convert into REITS, somewhat easing market entry, legal requirements have become challenging to meet during market downturns, affecting their returns.

> *I mean, we've recently seen that some REITs may well get out of the sector because they just can't meet the conditions of the 75% disbursement on the REIT so I suppose it comes back to my point that the REIT structure is fairly effective on the way up.* ***(Extract from interview)***

Dissolving a REIT in South Africa according to respondents involves considering the tax implications for unit holders and settling creditors before distributing net profits. Respondents in Canada could only relate with the REITs that lost status due to SIFT laws, but not anything voluntary, as for a number of them acquiring the REIT status has been worthwhile as the REIT structure has proved well aligned with their goals set going in. While REITs have gained traction in both markets, there are differences in their implementation and the challenges faced by companies entering or exiting the REIT structure.

Conditions

One important legal factor that affects REIT performance is the REIT-specific TAX treatments. The flow-through status of REITs allows the entity tax exemptions, reduced their expenses and increased returns. This is the reason most corporations switched to REIT status and some respondents expressed satisfaction with their decision to take on the REIT status in Canada. A couple of Canadian REITs mentioned that this tax exemption is the reason some of them have

managed to stay afloat in the current financial times, especially with the way Covid 19 badly affected some of the REIT sectors, like office although this is now steadily recovering. However, in some cases, as was shared by the South African REITs this tax treatment has not been particularly favorable to REITs as some of the smaller REITs find it hard to meet the 75% distribution condition and still meet their other obligations or retain earnings for reinvestment or expansion. According to a respondent some entities such as Fortress in South Africa, were on the verge of exiting the REIT status.

The REIT structure in both countries imposed certain limits on debt levels and development activities, which has been beneficial in preventing excessive leverage and over-expansion and helped to maintain a healthy balance. Respondents in both countries agreed that development work carries more risk than buying finished property as REITs. The South African REITs still operate largely on debt, which also comes at a cost to the overall returns.

> *Part of what we do is build condo buildings. So, we don't own the buildings at the end of the day, but they're sold as condos, we make CAD 60 or $70 million, one year just from the sale of a condo building or closing, and one, we don't get recognition from the market on that. So, I'd say the existing structure is a little frustrating because it's very tough to grow your revenue streams.* ***(Extract from interview)***

Furthermore, the legal structure of REITs restricted REIT activities or income recognition. For example, REITs in Canada have limitations on the types of assets they can hold or the sources from which they can generate income. The SIFT laws do not allow REITS to run active businesses, for example, they cannot sell Christmas trees to tenants during the holidays.

SIFT rules were detailed and very technical rules designed to eliminate income trusts in Canada in 2006. And secondly, to eliminate active businesses from being part of a REIT. So, they tightly controlled what kind of assets a REIT could own. What kind of income a REIT could receive? ***(Extract from interview)***

Consolidation

While consolidation is a way of improving REIT performance, respondents did not speak of any specific legal requirements for this. REIT consolidation has been relatively limited in Canada especially, where the market does not have an abundance of commercial real estate per capita compared to the United States. Consolidation can provide benefits in terms of building scale, saving on costs associated with being a public company. Further consolidations provide an avenue for diversifying asset classes which spreads risks as well as rewards. However, the consolidation decision is influenced by factors such as the compatibility of portfolios, asset types, regional concentrations, and strategic fit. Efficiencies and economies of scale are also considered in consolidations, and in some cases, underperforming assets may be divested to maximize value for unit holders. The lack of significant REIT mergers and acquisitions in Canada suggests that growth has largely been achieved through equity market fundraising and property acquisitions.

> *I would say there, it's really about business fit and strategy and to some degree the ability to add mass, or bulk up.* ***(Extract from interview)***

In South Africa, consolidation has been driven by the need for liquidity and scale. The South African property market has a large number of smaller property companies that lack sufficient size and market capitalization to attract desired investors. Consolidation has offered an opportunity to enhance liquidity, increase market capitalization, and potentially be included in

property indices, which is important for some fund managers. However, the diverse nature of the South African property market, combined with varying investor preferences and the challenges of integrating different property portfolios, can make consolidation more difficult. The consolidation trend in South Africa has been limited in recent years.

> *I think that what happened is that there was around 2013/14/15, a fair number of mergers and acquisition was happening, and I think that those would probably have never happened, whether the REIT legislation was in place or not. So, I think that the determining factor there is much more the state of the market*. ***(Extract from interview)***

Overall, while REIT consolidation occurred in both Canada and South Africa, the extent and frequency differ. Canada has seen relatively few REIT consolidations, with growth primarily driven by equity market fundraising and property acquisitions. In contrast, South Africa has a greater need for consolidation to enhance liquidity and increase market capitalization, but factors such as portfolio compatibility and market dynamics have posed challenges to consolidation efforts.

4.3 Strategies to improve REITS performance in Canada and South Africa

For this objective, respondents shared some thoughts on various strategies that can be employed to enhance REIT performance, some country-specific but some cut across. Table 2 summarises a few strategies that stood out. We examine some of these strategies and compare their applicability and effectiveness in Canada and South Africa.

Table 2 Strategy for REIT performance improvement in Canada and South Africa

Strategy	Category	Comment
Policy Adjustment	Legal strategy	"… we've recently seen that some REITs may well get out of the sector because they just can't meet the conditions of the 75% disbursement on the REIT so I suppose it comes back to my point that the REIT structure is fairly effective on the way up."
Governance	Business Strategy	"… I hear all sorts of over the years, rationale put forth for external management. In my view, 9 times out of 10 it doesn't hold a lot of water."
Bench marking	Business strategy	"I think the simple answer is to look around the world and take the best practices."
Market risk mitigation	Business environment strategy	"Big REIT kicks out single mother", you know, headlines, whereas when you kick out an industrial tenant, it's not as socially involved. So, I think that what sectors they play in is, is of importance as well."
Others	Financing strategy	"…strong financial market...."

Policy Adjustments

One respondent simply recommended looking around the world for best practices from already established markets because conceptually it's not a difficult business. Its fixed assets generate rental income. It is also one of the oldest businesses so the structural framework should be fairly simple. Another respondent recommended the South African REIT (SAREIT) association website as a good resource for up-to-date best practices.

> *... the KPMG guidance on good and bad income, like those, are some of the requirements that make a REIT. I think those policy decisions for countries starting a REIT industry are important because it determines the nature of the assets that make it into REITs.* ***(Extract from interview)***

Another recommendation was that policymakers consider using the REIT regulation to compel REITS into buying less risky assets to protect the average investor.

> *At an average risk, investors shouldn't be way out on the risk spectrum, they should be able to get the benefits of owning real property over the long haul*. ***(Extract from interview)***

Another respondent proffered a recommendation, that rather than give the tax exemption for a 75% pay out and tax the remaining 25%, a better approach would be to encourage the entity to retain say 10% untaxed, and tax levied once they drop below say 85% or 90%, down to that 75% requirement on that portion, just so that there is some ability for property companies to retain some of the earnings to put towards things like maintenance capex, and other such costs which are inherent to a property company. Otherwise, to avoid tax leakage, property companies continue to pay out 100% to investors and take out debt to finance and maintain capex which is not ideal from the accounting perspective, using long-term borrowings to fund short-term expenses. One participant from the focus group echoed the same sentiment about being able to retain some earnings untaxed as beneficial.

Governance

In terms of REIT governance, one respondent emphasized transparency around internal and external management as key for REIT growth. He also recommended external management as a

practical solution for smaller REITs when just starting. However, it is important to ensure that all contracts in place are fair and consider all parties should there be a need to terminate the structure. Strategies suggested by the focus group also emphasized improving corporate governance systems, especially in Africa where there is a reputation of rather less effective governance structures.

Market risk mitigation

Another strategy suggested centers around choosing the right REIT sectors for particular markets. For instance, in the African market, office industrial and retail REITS may be more preferable to apartment REITS. The housing needs and preferences in the African market are not very well aligned with the apartment REIT.

> *I mean, are we only dealing with when there are economies of scale? I mean, are we not going to buy 40 square meter houses down the road? Right, you know, you've got to build at scale. For them to be able to deal with this*. ***(Extract from interview)***

And the other issue is that the residential market in Africa is very different. In this market, it also becomes a social issue to terminate the lease of certain kinds of defaulting residential tenants.

> *I mean, the residential hits the news, "Big REIT kicks out single mother", you know, headlines, whereas when you kick out an industrial tenant, it's not as socially involved. So, I think that what sectors they play in is, is of importance as well.* ***(Extract from interview)***

Finance

Other strategies suggested were the need to develop strong financial markets, increase access to debt financing options, as well as building robust financial systems. There is also a currency disconnect that becomes a huge risk to manage, where properties are paying interest in the US dollar, yet tenants paying in the local currency and therefore when this currency depreciates against the dollar it becomes a problem. In the instances where properties decide to charge tenants in USD, the local population tends to shy away from these properties, that's the reason why the developments of property REITs in Africa even in countries such as Kenya, Nigeria, Egypt, Morocco, South Africa, and Botswana. Property developments have continued to happen regardless, but not from a REIT perspective because they can't guarantee that they'll consistently have distributions in place to pay the shareholders. So, it's important to develop a strong financial market in the sense of saying that there need to be enough foreign currency reserves, making the local currency a little more stable against the dollar.

CHAPTER FIVE

DISCUSSION, CONCLUSION, RECOMMENDATIONS

5.1 Introduction

In this chapter, we discuss key findings, and offer recommendations, especially for markets in which REITs are only just starting, as well as recommend areas for future research.

5.2 Discussion of the Findings

Objective one. Results indicated that the mandatory quarterly financial reporting for Canadian REITs in a public database SEDAR, where anyone with an interest in the REIT market can easily access this information. This is consistent with findings that transparency a good corporate governance practice that increases firm credibility (Spatacean 2015) and results in improved firm performance. This is an advantage the South African REITs have not harnessed. Over all, the REIT structure demands adherence to various reporting, disclosure, and governance requirements imposed by securities regulators and tax authorities. These practices have unfortunately as one of the respondents said always been a challenge to African establishments. The REIT structure has forced some improvement in these areas, and this goes a long way in improving investor sentiments towards the entity based on reputation built. This aligns with the performance improvement theory which hypothesizes that critical success factors may be improved through quantum leaps or continuous improvement. The improved compliance also aligns with the public interest theory of regulation.

Objective two. While South African REITs struggle with debt financing. Many Canadian REITs set up a corporation arm of the entity, which they use to carry out developments. The REIT structure does not recognise income from developments. Corporations are not required law to distribute all of their earnings but rather have the option to retain them. The findings of

(Rubunda, Namusonge &Oluoch,2019) that retained earning financing has a positive bearing on firm growth is then evident in the thriving of Canadian REITs despite having to pay out 100 % of their income as distributions as required by the REIT law. Earnings from the corporation can provide an alternative financing avenue for the REIT arm of the entity, which them means the REIT is still able to finance its obligations without necessarily opting for debt financing.

While South African REITs are only expected to distribute 75% which in itself appears to be unsustainable, they still prefer 100% distribution so as to avoid paying taxes on the retained earnings. With very high cost and limited options of debt financing options most South African REITs are caught up in an endless cycle of debt, with very high interest rates often in foreign currency, this further increases the performance gap between Canada and South Africa.

Objective three. South Africa can benchmark (Fetais,2022) more efficient best practices from Canada for example better leverage practices. Canada learned its lesson in the 90s on how crippling debt can be in real estate, South Africa can take a lesson too. This aligns with the performance improvement theory and agrees with Fetais (2022) that even as the REIT improves performance, it has to be sustainable by adopting means of organizational survival in the long term by ensuring efficiency. It is important to evaluate as cost of debt, especially with rising interest rates in the current economic environment. It may be beneficial for REITs to explore strategies to optimize capital structure, ensuring an appropriate balance between debt and equity to support growth and minimize risks.

Secondly, Canada and South Africa are both fairly big REIT markets in terms of the number of REITS, but their different geographical locations seem to be a bigger contributor to performance than legal factors, aside from the differences in the macroeconomic environment. Canada's proximity to the United States, where the REITs first began seems to have also been

advantageous towards their growth as several Canadian REITS have properties in the United States where the property market is even more robust, and American REITS with properties in Canada as well further boosting their REIT market performance. Such locational advantages unfortunately South Africa doesn't not have. Furthermore, the opacity in the African real estate market doesn't align well with the REIT structure.

5.3 Conclusion

In conclusion, the REIT legal structures in Canada and South Africa were created with different motivations, and while Canada has achieved the purpose long-term, In South Africa there is still a question as to where it is an ideal fit because alignment with international standards as was the goal may not necessarily hold water if it doesn't properly align with the market in which the REITs operate. Otherwise, legal factors set the boundaries within which the entity operates and therefore a stronger perception of investor protection in this context increases the likelihood of acceptance in international markets, as regardless of their individual performance levels, both Canadian and South African REITS have crossed over to markets beyond their borders.

5.4 Recommendations

Recommendations from the study include;

- Increasing reporting frequency in SA more over on a publicly accessible forum as is the case in Canada improves credibility and reduces the risks of non-compliance.
- REITs should explore alternative funding such as Canadian REITs have done / more stable financing mechanisms. Other alternative financing options with lower costs of debt such as Islamic banking practices, where interest is not charged rather, alternative arrangements like profit and loss sharing can also be explored.

- Tailor Regulations to the Country's Specific Context: While there are well-known global standards for REIT regulations, consider making country-specific variations when setting up a REIT structure. Find the balance between aligning with international standards and tailoring the regulations to suit the country's unique needs, market conditions, as well as cultural leanings.
- Align REIT Structures with market maturity level: It is essential to have a relatively transparent and mature market before introducing REITs. Premature implementation may lead to complications due to inadequate market transparency and data availability which are vital for the successful operation of REITs.
- Implement Strong Corporate Governance: Good governance practices to maintain transparency, integrity, and accountability within the REIT sector.
- Consider Taxation Policies: Design REIT tax structures that encourage prudent financial management and allow for reasonable retention of earnings, while still keeping the product attractive to institutional investors.
- Encourage Internal Management: While external management can be a practical solution for small REITs initially, it is advisable to promote a transition toward internal management as the REIT grows to manage conflict of interest.
- Emphasize Asset Quality and Risk Management: Implement regulations that encourage REITs to focus on less risky assets, prioritizing income-generating properties rather than speculative development.

These recommendations aim to provide a solid legal framework for the establishment and operation of REITs, taking into account the specific needs, market conditions, and regulatory environment of the country initiating the REIT market. Recommendations for REIT market

improvement, especially in South Africa may help young REIT markets like that of Uganda, in the sense that most African countries have homogenous characteristics in the real estate sector, and therefore tend to face similar challenges.

5.5 Limitations

Several limitations are faced while carrying out the study including;

- Personal bias. A little bit of personal bias may have influenced that study as it is not possible to be completely objective, as every researcher goes into the study with a mindset formed from the literature read before data collection.

- Availability of respondents. Many potential participants, even those who expressed willingness to participate were often too busy to commit time for interviews. This was particularly hard because the category of participants interviewed are very busy people.

- Limited literature. There is still very limited literature on REITs from the African (South Africa) perspective.

- Funding limitations. Due to this, the researcher was not able to travel to South Africa, making it harder to connect with respondents by relying on online approaches, unlike Canada where I was able to physically travel for data collection. This very much limited the number of participants we got from South Africa.

5.6 Areas for further research.

- To what extent do African REITs address the need for affordable housing and other critical real estate needs within their respective markets?
- How do emerging REIT markets in the Americas differ from established North American REIT markets in terms of regulatory frameworks, investor sentiments, and growth trajectories?
- Can AI-driven advancements enhance sustainability within established REIT markets, and what are the potential impacts on operational efficiency, environmental responsibility, and investor confidence?

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APPENDICES

APPENDIX ONE: INTERVIEW GUIDE

MAKERERE UNIVERSITY

MAKERERE UNIVERSITY BUSINESS SCHOOL

Dear respondent,

My name is **Fiona Toliva,** I am a student of **Makerere University** at **Makerere University Business School,** pursuing postgraduate studies for the award of Master of Business Administration. I am currently carrying out a research study, **an assessment of legal changes on REITS performance in the Canadian and South African markets.** I appreciate your taking the time to answer a few questions to enable me to complete this study. The information that you will provide will be treated with the utmost confidentiality and under no circumstances will it be personalized. The discussions here deal with general patterns and in no way, require sensitive issues. Your invaluable contribution is much appreciated.

Eligibility criteria: Managers/legal representatives of REITS under REALPAC for Canada and under the South African REIT Association (SAREIT)

Total number of participants: 10

Estimated time commitment:30 Minutes

INTERVIEW SCHEDULE

BIODATA

1. Position in organization
2. Education level
3. The field in which the last educational degree is attained
4. Gender
5. Length of experience in the industry

What is the legal structure surrounding REITs in South Africa?

6. How has the implementation of the REIT legal framework affected REITs' viability in this market? Suggest all dimensions of the legal framework that you deem crucial for REITs' viability and growth in this market.
7. Have legal changes led to more REIT consolidations?
8. What do you think is the most common reason for consolidation?

How do legal factors affect REITS performance?

9. When was this REIT born?
10. What is your current market share?
11. What is your average annual revenue? Does the legal structure have any effect on this?
12. What is your average annual operational costs? Does the legal structure have any effect on this?
13. How have legal changes affected your management team's performance?
14. What are the major considerations when winding up or dissolving REIT status?

What strategies can be employed to improve REITS performance?

15. What is your current management style? What are your thoughts on the internal and external management of a REIT?
16. What management style would you recommend for a new REIT vs established REIT?
17. What was most challenging about starting as a REIT?
18. What recommendations, especially from a legal framework perspective, would you give to a country trying to establish REITs for the first time?

Thank you!