REITs GUIDELINES SUPPORTING INDUSTRY GROWTH

***KIM MAXWELL** speaks to the SA REIT industry about how its Best Practice Recommendations for financial reporting can address issues and positively grow sector performance and reputations*

The REIT sector has been operating in a challenging trading climate in recent months. Industry players are in agreement that 2019 needs to be about collectively working to improve the REIT outcomes.

In March, the SA REIT sector published a draft second edition to its Best Practice Recommendations (BPR) for financial reporting, open for public comment before Friday May 3.

SA Reit Association chairperson Izak Petersen says SA REITs have an outstanding track record of transparency and that the listed property sector has performed well for two decades. "What necessitated the guide for financial reporting in 2019, is the need for standardisation of reporting amongst our members and improved transparency," he says.

Petersen is the founder and CEO of Dipula Income Fund, a JSE-listed REIT with a retail bias.

Liberty Two Degrees (L2D) CEO Amelia Beattie points out that in practical terms, more transparent financial reporting standards are good for business. "Investors are constantly looking for additional and better disclosure in order to evaluate companies, so striving for higher standards should be more appealing to our current and potential investor base," she says. "The process would also achieve better alignment with global REITs and allow for more meaningful comparisons across geographies."

Liberty Two Degrees converted to a corporate REIT and listed on the Johannesburg Stock Exchange as Liberty Two Degrees Limited in November 2018. L2D is a precinct-focused, retail-centred REIT with a 100 per cent South African property portfolio.

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CONSISTENCY AND TRANSPARENCY

Equites Property Fund chief financial officer Bram Goossens is driving the second edition of the BPR, in his capacity as SA REIT Association Accounting and JSE Committee chairman. Equites Property Fund is focused on the development and strategic acquisition of prime logistic properties in SA and the UK.

Goossens says local REITs have generally had high levels of International Financial Reporting Standards (IFRS) compliance. Yet shareholders and analysts have increasingly focused on a number of non-IFRS measures to evaluate REITs, primarily distribution (dividend) per share and dividend yield.

"This is problematic, as there is limited consistency in how REITs calculate these metrics and there are structures that can increase the distribution per share, not necessarily correlated with an increase in underlying IFRS earnings," he says.

"After many years of very good total returns, 2018 and year-to-date 2019 have proven to be abysmal for shareholders." Goossens believes this is reflective of a loss of confidence in the accuracy and sustainability of companies' disclosed distributions and underlines the need for improved sector transparency.

Growthpoint South Africa CEO Estienne de Klerk says the SA REIT sector is now the ninth largest REIT sector globally. "Levels of transparency do vary between different companies, but standards are high generally," he says.

"Growthpoint, for example, has been repeatedly recognised for excellence in transparent reporting by key stakeholders, such as the Investor Analysts Society of South Africa and the JSE." Growthpoint Properties is the largest South African primary listed REIT. It owns and manages a diversified portfolio of 559 property assets across three continents and across property sectors.

Liberty recently introduced a Cost of Occupation (CCO) › ratio, released in its L2D 2018 financial results. "The L2D CCO is calculated as the total rental charge (includes basic rent, property expenses, rates and utilities recovered) as a percentage of turnover," says Beattie. "Our view is that the L2D CCO ratio is a more meaningful and comparable ratio than the previously used rent-to-sales ratio in that it provides a more accurate, comparable indicator of the cost of occupation of tenants." Aligned with similar international cost of occupancy ratios, L2D hopes the CCO ratio will allow better global benchmarking for SA REITs.


Izak Petersen

NEW METRICS

Fortress REIT Limited CEO Designate Steven Brown says the market has historically priced REITs on a forward dividend yield with a perpetual growth assumption. This was a relatively simple model and correctly applied when REITs owned primarily South African assets.

"However, international expansion by many REITs into offshore markets probably required other valuation metrics to be applied by the market," he says. "We flag this as a positive change, given the more internationally recognised metrics now being applied and the focus on total returns over time rather than simply the forward dividend yields.


Steven Brown

"For Fortress, having a large development capability and pipeline, this is positive as it aligns the market metrics more closely with our view of creating long-term sustainable income from our portfolio and developments." Fortress REIT Limited focuses on prime logistic warehousing, retail centres and strategic offshore investments.

Liberty's Beattie says the pace of transformation of black and female appointments in SA REITs is another element of corporate transparency that is frequently under scrutiny. "Transformation remains a priority at L2D and we are pleased with the progress made to date, with 69 per cent of the team being women and 46 per cent black women," she says.

"At a board level, 43 per cent are female and 43 per cent are black. L2D hopes that it sets an example for implementing an environment where diversity can be practised on a daily basis."

MOVING FORWARD

But will one set of industry guidelines make a significant difference to the REIT sector? According to Goossen, SA is characterised by a lack of investor confidence and a trust deficit in the corporate sector.

"Understandably so, after the seemingly never-ending stream of corruption and corporate scandals. Specifically in the corporate space, recent scandals involving Steinhoff, ABIL, EOH etc. have left some investors nervous and sceptical of the accuracy of financial reporting and the value of external auditing."


Bram Goossens

Goossen says the second edition of the SA REIT BPR is a positive step towards rebuilding trust. "It has drawn from global learnings and aims to improve interpretation of South African REITs by potential foreign investors."

Petersen says REITs have a responsibility to a wide pool of stakeholders, from individual investors, to buy and sell side analysts, to institutional investors and regulators, in particular the JSE. "We, therefore, needed to consult widely to ensure that we strike the right balance and accommodate as many interests as possible."

Goossen believes there are leadership lessons in 2018's market performance for local property and the REIT sector specifically. "For me one of the key take-outs was that some companies probably took too long to clearly signal to the market the level of strain their portfolios were under," he says.

"This meant that some of the poor results in the last earnings season came as a surprise to the market, which resulted in rapid, large share price depreciations.

"Often these sell-offs are overdone, but result in lasting damage to the company involved. Going forward, timeous, transparent communication with shareholders will improve expectations of total returns."

De Klerk reminds that there has been little economic growth in SA for five years. "We are seeing the results of this play out across all sectors of the JSE. Many of the headwinds faced are economic in nature and are unrelated to how REITs report and are governed.

"In fact, most REITs have shown themselves to be well governed and reasonably defensive, whereas equities have come under real pressure," he says.

SA REIT members continue to deliver good results despite operational challenges and the sector remains well managed with a good track record of corporate governance, according to Petersen.

"The leadership lesson of 2018 for SA REITs is that as a relatively newly established sector, there are areas for improvement in our reporting standards, and there is no room for complacency if we want to keep the bar high in terms of governance, performance and transparency." ■

THREE SA REITS ISSUES THAT NEED WIDER AWARENESS

1. Uniformity and transparency in the distributions per share figure as reported by individual REITs, in terms of its make-up.
2. Transparent disclosure of non-property and non-recurring income.
3. Uniformity of disclosure of financial and property ratios.

Improving on these issues will contribute towards greater transparency and comparability between industry participants.

Source: Izak Petersen, SA REIT Chair

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