Background to Study

Concept Presentation
- Defining characteristics and investor benefits of REITs in general
- Residential property as an investment asset in the context of REITs
- The experiences of developed markets with REITs in affordable housing
- Implementation of the REIT structure across Africa

Case Study Presentation
- Experience of Watumishi Housing Company REIT (Tanzania)

Analysis Presentation
- Overview of the case studies
- The critical enabling conditions for REITs in Africa
- Challenges facing residential REITs in Africa
- Approaches to increasing the financial viability of affordable housing REITs in Africa
Overview of Case Studies

Background
- Hybrid, diversified REIT.
- Objective: to provide investors with long-term capital appreciation.
- Not listed on the Ghana Stock Exchange.
- 95% of investors are local retail investors.

Portfolio
- Invests into securities / equity of real estate companies
- Holds property for rental income and engages in development.
- 14% of assets are in residential property.
- Does not pay out regular dividends.

Social Impact
- Original purpose: channelling long-term funds into development of affordable housing.
- Housing market dynamics shifted in 2010 / 2011 → focus shifted to upper end of market.
  Has developed various low end and upper end housing projects.

Performance
- Consistently exceeded inflation rate and one year Government of Ghana note benchmark.
- Challenges: absence of REIT legislation, poor public understanding, limited investor interest (want shorter maturity instrument), liquidity constraints.
Overview of Case Studies

**Background**
- **Objective:** long term capital appreciation.
- **Invests in diversified portfolio of real estate assets.**
- **Investors include pension fund administrators, financial institutions, individuals and corporates organisations.**

**Portfolio**
- **Hybrid REIT:** residential & commercial sectors.
- **Residential portfolio = 69% of total portfolio.**
- **Occasionally engages in property redevelopment.**
- **Distributes 90% of its annual returns.**

**Social Impact**
- **Does not prioritise socio-economic development.**
- **Luxury apartments (owns & manages 9 luxury residential apartments and 4 commercial properties in Lagos and Abuja).**

**Performance**
- **No profit distribution in 2014.**
- **Challenges: Limitations on development.**
- **Opportunities: high demand for and undersupply of real estate assets in Nigeria; limited institutional exposure to real estate.**

**Union Homes Hybrid REIT Nigeria**
Overview of Case Studies

Background
- SA’s first focused residential REIT.
- Objective: growing returns; aggressively grow its portfolio.
- Ownership: Arrowhead; management; professional fund and investment asset managers, large institutional investors.

Portfolio
- 5 400 residential units.
- Invests purely in residential property.
- Shies away from property development – invests in income-producing properties.
- Pays 100% of its profits as dividends.

Social Impact
- Only invests where the yield works.
- Inner-city portfolio (38%) caters for lower to mid-end of property market.
- Offers an exit for residential developers.
- Enhanced quality of management.
- Invests in improvement districts and involved in social programmes.

Performance
- Quarterly dividends.
- Challenges: market conditions; investor scepticism; limited property market information; management challenges.
- Opportunities: strong fundamentals; high demand for affordable, well managed rental housing.
Essential to understand the contextual factors that support or undermine REITs…

**Institutional context:** robust property rights; accurate records of title deeds; reliable property valuations.

**Legislative / regulatory context:** appropriate rental market legislation; defined REIT framework.

**Economic context:** economic growth that stimulates demand (renters); vibrant market; stable interest rates.

**Investor context:** institutional investor participation (market liquidity; enhanced monitoring).

**Property market context:** substantial existing housing stock; capable developers; critical mass (liquidity & tradability).
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- Residential REITs: Challenges & Constraints
- Affordable Housing REITs: Risks & Rewards
- Going Forward
Challenges and Constraints Facing Residential REITs in Africa

**Critical mass**: residential property market needs to be large enough for REITS to build up their portfolio.

**Urban Form**: economies of scale → high-density housing, single-ownership apartment buildings & large mixed-use developments.

**VAT**: property owners cannot claim VAT on purchase of residential property.

**Land regularization and residential re-zoning**: procedures = slow and challenging.

**Higher management costs**: management time and effort is significant – shorter contracts; more tenants.
Challenges and Constraints Facing Residential REITs in Africa

Can residential REITs give rise to competitive yields?

Union Homes Hybrid REIT:
- failed to distribute dividends in 2014
- negative performance

Indluplace:
- annual returns of 9.5%
- average rate of inflation (5-6%)
- average annual commercial REIT dividends (9%)

HFC REIT
- yield of 24% in 2015
- year end inflation rate (17.5%),
- 1 year Govt. of Ghana note (22.5%)
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REITs: Critical Enabling Conditions

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Affordable Housing REITs: Risks & Rewards

Going Forward
Risks and Rewards in Affordable Housing REITs

Are affordable housing REITs able to offer investors returns that are appropriate given the level of risk associated with the investment portfolio?

Affordable housing is perceived to be substantially riskier than traditional asset classes:

- Uncertain effective demand
- Eviction constraints
- Urban decay

Affordable housing REITs have to compensate for this risk by offering higher yields than traditional investment assets.
A key determinant of the risk-reward profile of a given affordable housing REIT is the segment of the affordable housing market being targeted.

- Income levels ↓ → Risk levels ↑
- Income levels ↓ → Return levels ↓

Rental affordability → levels of rent

Lower income REITs need to accept lower rental revenue

Operating costs = fixed → lower operating profit.

Need to reduce financing costs.
Risks and Rewards in Affordable Housing REITs

Private sector approaches to getting the financial model for lower-income housing to work in the REIT context...

Development as a tool in the context of innovative housing typologies

Nesting affordable housing assets within a larger residential or diversified portfolio
Risks and Rewards in Affordable Housing REITs

Private sector approaches: The Case of AFHCO

- AFHCO re-developed 2 buildings in Jhb inner-city
- Factored affordable nature of units into construction process.
- Communal ablutions model reduced capital expenditure.
- Units nested within SACorp’s larger property portfolio.
Risks and Rewards in Affordable Housing REITs

Private sector approaches ...

Developing to Rent

- Revenue source = rental income (regular & predictable)
- Incubation and investment of capital upfront (higher risk; short-term dilution of returns)
- Allows for affordable nature of property to be factored into construction process → higher returns.
- Able to distribute regular & predictable profits
- Positively impacts the risk-return profile

Developing to Sell

- Revenue source = proceeds from sale of properties (irregular; unpredictable)
- Purpose: generate long term capital growth (not to distribute regular, consistent dividends)
- Does not exhibit distinguishing characteristics of traditional REIT
- Introduction of “hidden” risk into a traditionally safe investment asset?
- Sale of multiple affordable housing units could be viable (below 30% of total portfolio)
Affordable Housing REITs in Africa Going Forward

The role of government ...

Institutional Reform
- Property rights; property market transparency; rental market legislation; economic stability and growth; REIT legislation and regulations.

Municipal Cost Reductions
- Increasing pace of land regularization & residential re-zoning;
- Lowering municipal levies and services charges;
- Enforcing effective urban management.

Effective Demand Risk Mitigation
- Deduct rent directly from officials’ salaries;
- Enter into head leases with REITs → underwriting rentals paid by the affordable housing tenants.

Innovative Financial Instruments
- Experiment with approaches to incentivising market investment.
- Application of innovative financial instruments.
- E.g. provision of grants in the form of concessionary financing.
Conclusion

- Internationally: REIT structure = effective mechanism for attracting retail and institutional investment capital.

- Nascent REIT market in Africa has demonstrated need for certain enabling conditions; has also confirmed huge potential for channelling investment into African real estate markets.

- REIT structure in context of residential property & affordable housing in particular introduces unique challenges → Are REITs in affordable housing able to generate competitive returns, given the costs and risks?

- Addressing question requires private sector experimentation & government support:
  - Private sector needs to experiment with: various segments of the affordable housing market; appropriate role for property development.
  - Government needs to intervene to minimize the risks and costs.

- Viable financial model → affordable housing segment attractive to REITs → stimulate retail & institutional investment in affordable housing markets across Africa.
REITs in Africa report available at:

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