Growthpoint leads but others will follow

By Nick Hedley

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Other listed property companies are expected to follow sector heavyweight Growthpoint Properties' lead in converting its historically complicated capital structure to one of ordinary shares.

Most listed property companies have already been granted real estate investment trust (Reit) status, although Growthpoint is the first company to convert its linked units to the straightforward ordinary share structure.

The internationally recognised Reit structure was adopted in SA in April, allowing property loan stock companies and property unit trusts to operate under a single regulatory umbrella, as company Reits and trust Reits.

The linked unit structure of property loan stocks, where debentures are linked to shares, has been flagged as an area of concern for analysts and tax authorities. This is because of the tax deductibility of the interest paid to debenture holders and the often excessive levels of interest that debentures carry.

Growthpoint's previous capital structure comprised ordinary shares linked to unsecured and variable-rate debentures, or "loan stock", in a ratio of one ordinary share to 10 debentures.

This meant that each share and its debentures could trade on the JSE only as linked units. The company has delinked its linked units and is capitalising its debentures to stated capital. Once this is done the debentures will be cancelled.

Conversion

Growthpoint's chief executive Norbert Sasse says the conversion to the cleaner and simpler capital structure was a natural step for company in becoming a full Reit. The ordinary share structure was in line with international best practice for Reits and for other publicly traded investments and was welcomed by investors.

Growthpoint executive director Estienne de Klerk says while it is not compulsory for company Reits to abandon the linked unit structure, practically speaking it's really the only way to go.

This is because it will become complicated for companies to receive deductions and allow the flow through system to continue, given that the JSE - the regulator of listed Reits - considers debentures as debt.

Under the new Reit structure, distributions paid are not considered interest but are deemed as being effectively a taxable dividend, which is exempt from withholding taxes for local investors.

De Klerk says the capital structure conversions are expected to have other positive effects on the industry. "Hopefully in the future, when all the companies are structure in the same way in terms of their conversion, they will be able to implement some of the proposed new standard disclosure measures that the South African Reit Association will be looking to publish."

These standards are aimed at improving disclosure and standardising accounting standards across the sector.

Ashburton Investments listed property fund manager Lesiba Ledwaba says the conversion will have no implications for shareholders. "Individual investors, for example, will still be liable for tax on distributions received at their applicable marginal tax rates," he says.

Benefits of conversion

Ledwaba says the major benefit of converting to an ordinary share structure is that it is simple. In addition, it is globally recognisable and in line with global Reit standards.

"It is a positive move for Growthpoint and I would not be surprised to see other funds following this trend," he added.

Grant Alexander, director of Private Client Holdings, says the introduction of Reits to SA will make real estate more attractive to foreign investors. This is despite the fact that Reits do not significantly change the local property investment structure compared with the previous regime.

"It is thought that one of the main benefits provided by the Reit structure is the tax change," Alexander said. "South African investors will receive gross distributions from a South African Reit entity without the 15% dividends withholdings tax being levied.

"However, investors will have to pay tax on the distributions at their applicable marginal income tax rate so paying tax is unavoidable," he adds.

Alexander says real estate is a complicated asset class with several factors to consider when investing, but Reits are a good diversifier and should be held as part of any balanced portfolio.

According to Novare Equity Partners, Reit legislation is expected to help grow the property market as international investors are likely to be more willing to invest on the basis that they have a better understanding of the sector.

Naledi Mongoato, investment analyst at Novare Equity Partners says that in developing countries, the three main benefits of Reits are their flow-through taxation, greater liquidity and capital flexibility, and high yields.

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