1. INTRODUCTION

1.1 Purpose of the study

The purpose of this study is to identify the factors which influence the decision for companies listed in the Real Estate Sector of the Johannesburg Stock Exchange (JSE), to raise finance through the issue of listed debt, in an attempt to reduce their weighted average cost of capital (WACC). There may be potential to increase the returns for shareholders if the WACC can be reduced. The study would therefore be of particular interest to the management of these listed companies, investment bankers who structure these products, and to the investors who own shares within these companies.

1.2 Background to the research

The Modigliani-Miller theorems (1958) form the cornerstone for modern thinking on capital structure. All firms at varying times must obtain capital, and this may be done by borrowing the money (debt financing), or by selling a portion of the firm (equity financing), or a combination of both.

The first Modigliani-Miller (MM) theorem states that the conditions under which the choice between debt and equity to finance a given level of investment, do not affect the value of the firm, implying that there is no optimal leverage ratio. The second MM theorem states that under the same conditions, the dividend policy does not affect the firm's value, implying that there is no optimal payout ratio. *"MM argued that the expected return on equity is positively related to leverage, because the risk to equity holders increases with leverage."* (Ross, Westerfield and Jaffe, 2002: 399) These theorems are otherwise known as 'irrelevance propositions' and are based on the assumptions of an absence of taxes, bankruptcy costs, asymmetric information and an efficient market. Since these assumptions are not always met, there is potential to improve the value of the firm through a change in the financing structure between debt and equity (Myers, 2001; Pagano, 2005).

Much empirical work on asset allocation and the decomposition of debt and equity in real estate investment decisions, is based on the capital asset pricing model (CAPM). Wilson, Okunev and Ta (1996) demonstrate that in this model, the mean and standard deviation of each security's distribution summarises an investor's expectations of the return available on that security. Sharpe (1964) and Lintner (1965) indicated that, based on the CAPM, the expected return on a risky asset can be shown with the following formula:

$$E(Re) = Rf + ße \times (Rm – Rf)$$

This is also known as the security market line (SML) approach, where Rf is the risk-free rate, which is normally the three month treasury bill rate for South Africa; ße is the systematic risk of the asset relative to the average; and (Rm – Rf) is an estimate of the market risk premium.

The cost of capital is the expected rate of return that the market requires in order to attract funds to a particular investment. In economic terms, the cost of capital for a particular investment is an opportunity cost. This is the cost of foregoing the next best alternative investment (Pratt, 1998).

The weighted average cost of capital (WACC) is the cost of capital for the firm as a whole and it can be interpreted as the required return on the overall firm. WACC is essentially made up of two components: the cost of equity and the cost of debt (Firer, Ross, Westerfield and Jordan, 2004).

The cost of equity (Re) is the return that equity investors require on their investment in a firm. The cost of debt (Rd) is the return that lenders require on the firm's borrowings, and is usually the interest rate the company must pay to the lending institution to finance these borrowings.

The WACC is calculated by multiplying the capital structure weights with Re and the after tax Rd, and "*this is the overall return the firm must earn on its existing assets to maintain the value of its shares and debt*" (Firer *et al*, 2004: 472). The cost of equity (Re) is normally significantly higher than the after tax cost of debt (Rd) as equity investors usually require a higher rate of return than the lending institutions. The prime overdraft rate in South Africa was 10.5% in February 2006 (Appendix 2, Source: I - Net Bridge).

One potential source of listed debt financing for companies is through the issue of corporate bonds. In contrast to the United States, which has a mature corporate bond market, in which hundreds of corporate bonds are traded publicly, the South African corporate bond market, traded through the Bond Exchange of South Africa (BESA) is still very much in its infancy. The BESA was only registered in 1996.

The definition of a coupon rate, also called the nominal rate, is the interest rate that the issuer agrees to pay each year. The annual amount of interest paid to owners during the term of a bond is called the coupon (Fabozzi, 2000).

Data available from the BESA website indicated that by February 2006, three companies had issued bonds on the Commercial Property Securitisation Sector of the BESA. On 2 November 2004, iFour Properties Limited had issued bonds through a vehicle called Prime Realty Obligors Packaged Securities (PTY) Limited. They raised a total of R800 million at floating coupon rates varying between 7.43% and 8.89%. Then on 7 November 2005, the Vukile Property Fund Limited raised a total of R770 million at floating coupon rates varying between 7.526% and 8.186%. Finally, on 28 November 2005, Growthpoint Properties Limited raised R805 million at floating coupon rates varying between 7.519% and 8.229%.

These coupon rates were clearly below the prime overdraft rate of 10.5%. As a result, there was an opportunity for companies to restructure their debt, and utilise the issue of listed debt, in an attempt to reduce their WACC.

The capitalization (cap) rate as used in real estate literature is the ratio of net operating income to property value. This rate has a particularly important role in commercial and investment property valuation (Jud and Winkler, 1995).

Brueggeman and Fisher (1993) indicated that the income capitalization method converts the expected income stream from commercial property into an estimate of asset value by dividing the net operating income stream by the capitalization rate. The cap rate bears a close relation to the WACC. Discounting the cash flows from the corporate assets at the WACC reveals the value of the firm. This values real estate as a perpetuity.

The relation between WACC and firm valuation has extensive theoretical underpinnings extending from the firm valuation work of Modigliani and Miller (1958). Sharpe's (1964) development of the CAPM model revolutionized stock portfolio theory and provided a widely accepted method to empirically estimate the cost of equity, which is an embedded component of the cap rate.

1.3 The research problem

This research proposal will attempt to identify the factors which influence the decision for companies listed on the Real Estate Sector of the JSE, to utilise the issue of listed debt as a source of finance.

1.4 Assumptions and delimitations

Assumptions:

It is assumed that companies in the real estate sector will be able to restructure their debt and equity in an attempt to take advantage of potentially cheaper sources of capital through the BESA.

Delimitations:

The research will be limited to the factors influencing listed companies in the real estate sector of the JSE only.

The research will also be limited to those companies that have the majority of their property holdings within South Africa.

Real estate companies that have the trade of their shares ‘suspended’ will not be included in the research.

The research will be limited to Property Unit Trusts (PUTs) and Property Loan Stocks (PLSs). The research will not cover property development companies.

2. LITERATURE REVIEW

This chapter outlines the literature used to develop the propositions against which the research will be conducted. It commences with a definition of corporate bonds and an analysis of the current size of the corporate bond market in South Africa.

.

The background to the research problem has already identified that coupon rates issued for corporate bonds in the Commercial Property Securitisation Sector are lower than the prime lending rate. Through the issue of listed debt, therefore, opportunities exist for companies to reduce their cost of debt and WACC, which in turn will increase the company's valuation. What follows is an analysis of the factors which may influence the extent to which listed real estate companies utilise the bond market as a source of finance.

A foundation is therefore set in place for the proposed research which aims to identify what factors influence the decision for companies listed on the Real Estate Sector of the JSE, to utilise the issue of listed debt as a source of finance.

2.1 Corporate bonds

Listed debt in South Africa is largely made up of corporate bond issues. These may be uncovered, where there is no underlying security, or covered. The corporate bonds issued in the Commercial Property Securitisation Sector have been covered bonds. "*A corporate bond can be defined as a promise to pay a specified sum of money at a fixed date in the future, along with periodic payments of interest*" (Wilson *et al*, 1990: 3). The term is usually applied to a longer term debt instrument, generally with a maturity date falling at least twelve months after the issue date. Corporate bonds often pay higher rates than government or municipal bonds, because they tend to be riskier. Generally, changes in interest rates are reflected in bond prices. Bonds are considered to be less risky than stocks, since the company has to pay off all its debts (including bonds) before it handles its obligations to stockholders.

The Bond Exchange of South Africa (BESA) was licensed in May 1996 by the Financial Services Board (FSB) as a financial exchange on which bonds and related listed debt products were to be traded. On 12 September 2005, of the approximately R575 billion market capitalisation of the bonds issued in South Africa, only R97 billion, or 17% was made up of corporate bonds (Appendix 4, Source: BESA website). The vast majority of bonds were issued by the central government, municipalities, parastatals and water authorities.

Navarette (2001) indicates that the role of a healthy corporate bond market is to provide a channel that links society's savings into investment opportunities. This is of vital importance for the issuers of bonds. Firstly, it provides lower costing funds than traditional banking loans. Secondly, it allows for greater diversification of funding sources, and finally, it provides information disclosure about the firm, which helps to access public funds more rapidly.

There are several factors which will affect the extent to which real estate companies will utilise the bond exchange as a source of funding, and these are detailed in the balance of the literature review.

2.2 Competition between banks and bond markets

As the financial system of most emerging economies, which includes South Africa, is centred on banks, an important aspect of the development of the corporate bond market is the impact on the banking system. Bank loans have typically been the single most important source of financing for South African companies. Hawkins (2001) indicates that bond markets could take some potential business away from banks, which may raise some concerns for bank supervisors. In South Africa, where the financial system is largely controlled by four large banking groups, this may hold true (Falkena, Davel, Hawkins, Llewellyn, Luus, Masilela, Parr, Pienaar and Shaw, 2004).

According to Diamond (1991), there is a life-cycle effect in the use of borrowing through intermediaries. New borrowers borrow from banks initially, but may later issue debt directly, without using an intermediary. A borrower's credit record acquired when monitored by a bank, serves to predict future actions of the borrower when not monitored.

Bond financing allows companies to diversify their financing sources and to broaden their creditor base beyond the banking industry. Rather than drive up corporate debt, bonds have become an alternative to bank loans as a borrowing instrument (Wacshiczek, 2004).

The banking sector plays an important role in developing a private sector bond market as banks are often among the most important issuers, holders, dealers, advisors, underwriters, guarantors, trustees, custodians and registrars in this market. Indeed, banks have the potential to generate more of their profits from these activities than from lending (Hawkins, 2001).

The absence of a sizeable corporate bond market in South Africa could aggravate the imperfections present in the financial regulatory system. Associated inferior risk assessment by the over-sized banking system can lead to productive over-capacity and non-performing loans, which could finally result in a crisis (Hakansson, 1998). When a full-fledged corporate bond market is present, market forces have a greater opportunity to assert themselves, thereby reducing systematic risk, resulting in a healthier banking system.

Peterson and Rajan (1994) indicate that creditors are more likely to finance credit-constrained firms when credit markets are concentrated, because it is easier for these creditors to internalise the benefits of assisting the firms. Since uncertainty about a firm's prospects is high when the firm is young or distressed, creditors in a competitive market may be forced to charge a high interest rate until the uncertainty is resolved. A monopolistic creditor, on the other hand, can backload interest payments over time, subsidising the firm when it is young or distressed and extract rents later.

The attitude of the banking sector will certainly affect the extent to which real estate companies will utilise the bond exchange as a source of finance. The banking sector may reduce their lending rates to a degree which makes it less feasible for companies to issue listed debt. Alternatively, the banking sector may become an active participant in the process.

2.3 The early stage of development of the corporate bond market

Since the Bond Exchange of South Africa was only licensed in 1996, it may still be considered to be in its early stages of development, and as a result, the corporate bond market is still not generally considered an alternative to the banking system.

The general pattern observed in advanced economies has been for banking to emerge at a much earlier stage of development than bond markets. In the United States where the corporate bond market is most developed, bond market financing is significantly larger than borrowing from the domestic banks (Fabozzi, 2000).

As economies mature, banking markets tend to become more developed before bond markets. Yoshitomi and Shirai (2001) suggest several reasons for this: in poorer countries, individuals have a greater preference for liquid short-term bank deposits; institutional investors are under-developed or non-existent; few companies are sufficiently large and reputable to issue bonds; and the requisite legal, judicial and informational infrastructure is not in place.

According to Duca (2001) before the 1980's only large, well-established corporations were able to issue bonds in the United States. These bonds were typically bought by large institutional investors such as pension funds and life insurance companies. These institutional investors faced legal or fiduciary constraints from investing in below investment grade bonds. As a result there was little investment in below investment grade, or junk-bonds, which lacked a track record. Since the 1980's there has been a rapid development in the high yield bond market. As the market has gained experience with new junk-bond issues, their risks have become better known and the junk-bonds have become more acceptable to investors.

Real estate companies may perceive the high yield market of the BESA to be less developed, compared with the situation in the United States. As a result, they may presume that the BESA is still not a viable alternative to access cheaper debt, with the issue of listed debt or bonds. This factor may influence the decision for real estate companies to utilise the BESA as a source of finance.

2.4 The importance of the bond rating

"*A bond rating is an indicator or assessment of the issuer's ability to meet its principal and interest payments in a timely manner in accordance with the terms of the issue*" (Wilson and Fabozzi 1990: 23). The bond ratings are an assessment of the credit-worthiness of the issuer. According to Firer *et al* (2004), the definition of credit-worthiness depends on how likely it is for the firm to default and the protection lenders have in the event of a default. The ratings issued by the agencies should be accepted by the vast majority of investment professionals and by regulatory authorities. The ratings are normally assigned to a particular issue and not the issuer. It is for this reason that a company may have several different ratings on its debt.

Prudent investment management requires that definite standards be applied in the selection of bonds. Many institutions and government bodies have established investment parameters and can only invest in a certain grade of bond. A lower bond rating means that it will cost the issuer more to raise funds than if the security were higher rated. This is because investors expect to be paid more for the additional risk of default as a company moves down the quality ladder (Hand, Holthausen and Leftwich, 1992).

Diamond (1991) proposes that companies with higher credit ratings have a lower cost of capital, and such a rating needs to be maintained to retain this source of higher present value for future profits.

In addition, highly rated companies issue more bonds than do lower-rated companies (Hawkins, 2001). One reason for this is that many investors are confident about buying securities issued by blue chip companies but feel it is hard to evaluate the credit-worthiness of less familiar companies. In addition, growing companies that lack a high bond or credit rating will often be faced with restrictive clauses, or covenants, in the actual terms of the bond, which govern their activities during the life of the bond. For example, a clause may be for the company to maintain a certain debt to equity ratio at all times. The prevalence of higher rated bonds may also be due to the stringent regulatory requirements for companies to list bonds.

According to Hakansson (1998), a key ingredient to a healthy corporate bond market is a strong community of financial analysts and rating agencies such as Moody and Standard & Poor. They assist bond investors by assigning companies and new issues a grade from a pre-determined and well-known scale. Their reports provide a clear, objective basis for determining the fair interest rate for a given bond issue.

Hakansson (1998) further highlighted that this is particularly important where the process of disintermediation is present. Disintermediation is where corporations needing finance may bypass banks and go directly to the bond market. The main consequence of this is that the requisite credit evaluation previously performed by banks must now be done by investors themselves. A strong analyst and rating agency community in South Africa would certainly improve the efficiency of the corporate bond market, making it more accessible for investors.

The rating agency is the nexus of the supply and investment sides of the market in which they greatly impact security design. Through their ability to control security structure, the rating agency simultaneously enforces product standards and certifies credit quality, for real estate companies requiring bond or listed debt financing.

2.5 The development of the securitisation market

In a securitisation, a company party deconstructs itself by separating certain types of highly liquid assets from the risks generally associated with the company. The company could then use these assets to raise funds in the capital markets at a lower cost than if the company, with its associated risks, had raised the funds directly by issuing debt or equity. The company retains the savings generated by these lower costs, while investors in the securitised assets, benefit by holding assets with lower risk (Schwarcz, 2000).

Hawkins (2001) identified that where bond markets have been developed, companies may be able to use them to sell off some of their loans, and restructure their debt. This may enable the companies to economise on capital, reduce maturity mismatches, enhance their liquidity and diversify their credit exposures. Often securitisation is done by parcelling up or aggregating similar loans and selling them to a special purpose vehicle (SPV) which then issues bonds backed by the loans and their underlying collateral. These bonds can then be transferred freely among a multitude of investors.

The cash flow and credit characteristics of the collateral will determine the performance of the bonds and drive the structuring process (Davidson, Sanders, Wolff and Ching, 2003). In the case of real estate securitisation, the underlying asset or collateral is usually the loans on the income earning real estate assets themselves. This includes retail properties, office properties, industrial properties, multi-family housing and hotels.

Foo (2000) acknowledged that real estate had been traditionally regarded as an illiquid investment. The acquisition of a real estate asset involved large capital outlays, which in some cases were beyond the reach of small investors.

Investors do however have ready access to commercial real estate through four channels: private equity, private debt, public equity and public debt. The most recent of these to emerge was public debt in the form of commercial mortgaged-backed securities, or CMBS. CMBS is simply an investment instrument, the performance of which is determined by the performance of a pool of non-recourse commercial real estate loans. Typically, the loans that are securitised in a CMBS pool are fixed-rate loans structured in one of three ways: as fully amortising, amortising balloon or as interest-only balloon obligations. It is also possible to have floating-rate issues. CMBS is typically structured as sequential-pay bonds (Hess, 2001).

Foo (2000) defined one form of securitizing real estate as the process of turning equity interest in real estate, which is illiquid, into tradable securities such as bonds or shares. The structure of a typical real estate securitisation transaction is where the owner of the property will legally transfer off the balance sheet the ownership right of the securitised property to an SPV in return for sale proceeds, which are determined on the basis of an open market valuation. The owner would then be allowed to lease back the property for a period no longer than the bond maturity and the owner has the right to re-purchase the property, typically after three years of the origination of the security at a price between 65% and 75% of the prevailing market value. The SPV will be able to finance the purchase of the securitized property by issuing bonds on the bond exchange.

The benefits provided by the securitisation market are manifold. Securitisation can provide off-balance sheet funding, which allows companies to de-lever while improving capital efficiency. It frees up balance sheet capacity such as trade credit lines or working capital, and provides an alternative source of funding and liquidity. Securitisation transfers asset risk to the capital markets, while structures can often be tailored to afford corporates better asset-liability matching. Structured debt issued typically benefits from rating enhancement, thus potentially opening up a wider investor base. Finally, depending on the assets securitised, the quantity of debt raised in structured credit markets can often surpass the amount that can be raised in unsecured or bank markets (Rajendra, 2002).

Fife (2005) identified the first listed JSE real estate company to have utilised the issue of listed debt in an attempt to reduce their WACC. iFour became the first fund to securitize its borrowings through Absa with a commercial mortgage-backed securities programme. The programme was called Prime Realty Obligors Packaged Securities and it provided direct access to the cheaper debt available in the capital markets, rather than borrowing from banks. Rating agency Moody's gave the first R568m of the R800m securitization an Aaa.za rating because its first call on iFour income made it almost a certainty.

Davidson *et al* (2003) highlights the fact that the rating agencies play a critical role in the CMBS market. The role of the rating agency is to provide a third-party opinion on the quality of each bond in the structure. Typically, the CMBS issuer submits the underlying portfolio of real estate loans to the rating agencies. The rating agencies will then analyse the critical characteristics of the underlying pool of loans, such as the debt service coverage ratio (DSC), and provide a rating on the bond. This rating will define the risk of the security, and the resultant cost, or coupon that the issuer will have to pay to the market, for the listed debt issued.

2.6 The extent of regulation of the bond market

According to Hakansson (1998), the natural evolution of an unconstrained corporate bond market can be hindered by excessive regulation. A pre-condition for a genuine corporate bond market is that it must be free from government interference. Investors must be free to base their decisions on economic criteria alone, such as risk and expected return. Pressure on bond investors or prices based on regulatory policy, either direct or indirect, must be absent. The single most important element of a well functioning bond market however, is a financial reporting system for companies which is reliable, timely and relevant.

The BESA website indicates that the South African authorities recognised that the 'self regulation' by market participants was more desirable and acceptable than imposed regulation. To this end, the majority of the major bond market participants formed a voluntary association in 1989 under the auspices of the Financial Market Control Act (FMCA), with the intention of formalising the licensing of a self-regulated Bond Market Exchange (BME). This was based on the recommendations of the Stals / Jacobs Report, after Drs Stals and Jacobs, both of the Reserve Bank, undertook an extensive examination of the financial markets.

The issue of bonds is subject to fewer legal provisions and constraints than shares. Bonds may be tailored to the requirements of the issuing entity or to capital market conditions in terms of maturity, interest rates, coupon payments and asset securitisation (Wacshiczek, 2004).

The extent to which real estate companies will utilise the BESA as a source of finance would certainly be affected by the regulations of the bond market. If real estate companies find the listing requirements and regulations too onerous, they may choose to utilise bank loans instead.

2.7 High upfront costs

Compared with traditional bank loans, the issue of listed debt allows companies to borrow money over longer periods, but high upfront costs make this instrument more attractive for companies that need to finance larger volumes. Unlike bank loans, where costs are basically proportional to the amount borrowed, bonds come off high upfront once-off issuance costs. These costs include underwriting fees that banks charge for handling a public offering and a guarantee to purchase any shares that the issuer cannot sell; marketing costs, such as costs to produce prospectuses; road show costs; and the actual listing cost to the BESA (Bierman, 1966; Wacshiczek, 2004).

2.8 Lack of flexibility

Many bonds have a standard call provision which restricts the firm from calling the issue for a certain time period, followed by a period during which firms have the option to call the bond at a stated call price. Another group of bond issues may contain a two-tiered type of call provision which allows the corporation to call the bond for purposes other than refinancing at a lower coupon rate, during the initial years of the life of the bond (Thatcher, 1985).

In addition, the coupons may be fixed or floating, as defined on issuance, for the entire maturity period. The coupon rate will typically reflect the current benchmark condition for risk-free investment with a premium for the issuer's default risk and credit risk at the time. This may be perceived to be inflexible compared with bank loans which may carry a variable interest rate (Wacshiczek, 2004).

It is also virtually impossible to change the contract once a bond has been issued, as there are normally a large number of creditors. Credits originated from banks may be easier to renegotiate if there is a liquidity problem, as it is easier to obtain bridging loans or deferrals in payments when negotiating with a single party. As a result, listed debt issues may be perceived to be less flexible than traditional bank loans.

2.9 Tax implications

The Modigliani-Miller proposition (1958) implies that the value of an asset is independent of how the asset is financed between the choice of debt and equity, except for changes in agency costs and tax shields. Thus the key issue in component separation is how to maximise the present value of the net changes in agency costs and tax shields.

Graff (1992) indicates that commercial real estate can be regarded as the sum of two components with different investment characteristics: a pure equity asset, and a portfolio of debt instruments similar to corporate bonds. The equity component captures all property appreciation, while the debt component captures all income from existing leases.

Gearing or leverage is the term used to describe the portion of debt funding within a company. The interest portion of the debt will normally result in a reduction in the nominal profit of a company. This will result in the tax shield effect where the corporate tax on the debt interest will result in a reduction of the company's cost of debt. The smaller portion of equity will also enjoy a magnified Return on Equity (ROE). Mathematically, the higher the gearing, the higher the ROE. In practice, higher debt levels will increase the perceived risk on an investment, which can result in financial distress (Hartley, Firer and Ford 1999; Graham 2000; Mackie-Mason 1998).

Firer *et al* (2004) states that a firm can take on debt up to the point where the tax benefit from an extra rand in debt is exactly equal to the cost that comes from the increased probability of financial distress. This is known as the static theory of capital structure. Firms with a greater risk of experiencing financial distress will borrow less than firms with a lower risk of financial distress.

Each of the factors stated has the potential to influence the extent to which real estate companies listed on the JSE can utilise the issue of listed debt on the BESA as a potential source of finance.

3. PROPOSITIONS

The following propositions flow from the literature review and are the statements around which the research is being conducted. More specifically, they are statements about the factors which influence the extent to which real estate companies utilise the issue of listed debt on the bond exchange, as a source of finance.

Proposition 1

The bond exchange provides a cheaper source of debt finance than traditional bank loans. (I-Net Bridge 2006; BESA website 2006; Navarette 2001)

Proposition 2

The level of competition between the traditional banking sector and the bond market will influence the decision for real estate companies to issue bonds. (Hawkins 2001; Diamond 1991; Wacshiczek 2004; Hakansson 1998)

Proposition 3

The corporate bond market in South Africa may be perceived to be at an early stage of development. (BESA website 2006; Yoshitomi and Shirai 2001; Duca 2001)

Proposition 4

A high bond rating will reduce the cost of funding of the debt. (Firer *et al*. 2000; Diamond 1991; Hawkins 2001; Hakansson 1998)

Proposition 5

The recent emergence of the Commercial Mortgage Backed Securitisation Market in South Africa provides a new channel for real estate companies to obtain cheaper debt through the use of bonds. (Schwarcz 2000; Hawkins 2001; Hess 2001; Rajendra 2002; Fife 2005)

Proposition 6

Real estate companies may choose to utilise traditional bank loans instead of bonds if they find the regulations and listing requirements of the bond exchange to be too onerous. (Hakansson 1998; BESA website 2006; Wacshiczek 2004)

Proposition 7

High upfront costs make the use of bonds more attractive for companies that need to finance larger volumes. (Bierman 1966; Wacshiczek 2004)

Proposition 8

Bonds are perceived to lack the same flexibility that traditional bank loans offer. (Thatcher 1985; Wacshiczek 2004)

Proposition 9

Companies will need to analyse the tax implications of the use of bonds as this will affect the cost of debt, the nominal profit of the company, and the return on equity for shareholders. (Mackie-Mason 1998; Graham 2000; Hartley *et al* 1999; Firer *et al* 2004)

4. RESEARCH METHODOLOGY

4.1 Qualitative research paradigm

This study is intended to identify the factors which influence the decision for companies listed on the Real Estate Sector of the JSE, to utilise the issue of listed debt as a source of finance. The proposed research paradigm is largely qualitative in nature.

"*A quantitative research problem often begins with theory and examines hypothetical relations within it – a deductive process. Qualitative theory more often builds theory, moving from observations and open questions to more general conclusions – an inductive process*" (Ulin, Robinson, Tolley and McNeill, 2002: 11).

According to Leedy and Ormrod (2001), qualitative research is typically used to answer questions about the complex nature of phenomena, often with the purpose of describing and understanding the phenomena from the participant's point of view. The qualitative approach will focus on phenomena that occur in natural settings, that is, in the 'real world', and it involves studying those phenomena in all their complexity.

In this research survey, the complex nature of phenomena can be identified by the factors influencing the utilisation of listed debt as a source of finance for listed real estate companies.

4.2 Research design

The **population** in this research includes all the listed real estate companies on the JSE, the South African banking sector, which has the expertise and knowledge of structuring bond issues, and the Bond Exchange of South Africa (BESA), which is the platform where these bonds, or listed debt instruments, are issued and traded. There are presently thirty-eight actively traded companies listed on the real estate sector of the JSE (Appendix 3, Source: Share Data).

From this list of real estate companies, the author has already identified data available from the BESA website which clearly indicates that by February 2006, three companies had issued bonds on the Commercial Property Securitisation Sector of the BESA. On 2 November 2004, iFour Properties Limited had issued bonds through a vehicle called Prime Realty Obligors Packaged Securities (PTY) Limited. They raised a total of R800 million at floating coupon rates varying between 7.43% and 8.89%. Then on 7 November 2005, the Vukile Property Fund Limited raised a total of R770 million at floating coupon rates varying between 7.526% and 8.186%. Finally, on 28 November 2005, Growthpoint Properties Limited, raised R805 million at floating coupon rates varying between 7.519% and 8.229%.

This research aims to identify the factors influencing the decision for listed real estate companies to issue bonds in an attempt to reduce their WACC. In order to determine this, a qualitative survey will be utilised which will involve a semi-structured interview process. Ulin *et al* (2002) describes the qualitative methodology of in-depth interviewing as a natural outgrowth of the interpretivist paradigm.

The methodology used for the semi-structured interview process involves a form of triangulation. Denzin (1989) refers to methodological triangulation as the combination of two or more research strategies in the study of the same empirical unit. It is the belief of the researcher that the views of the real estate companies; the investment bankers, who have subject matter knowledge in the structure of the debt for these real estate companies; and the Bond Exchange, which facilitates the issue of listed debt, should be included within the research report. Each of these three different parties will aid in identifying, from their perspective, the factors which influence the use of listed debt for real estate listed companies. Each of these three research strategies will yield a different picture and slice of reality (Lincoln and Guba, 1985). The draft questions for the interview process are included in Appendix 1.

4.3 The sample

The sample drawn will include ten representatives from listed real estate companies, ten representatives from the banking sector, and one representative from the BESA.

The real estate companies included in the sample will all have their headquarters based in Johannesburg for ease of conducting the research. This convenience sampling is not expected to affect the research data. In addition, only real estate companies with market capitalisations exceeding R900 million will be included in this research as these companies, due to their size, may be in a better position to restructure their debt to utilise the bond exchange. The five largest banking institutions within South Africa have also been included in the sample. One representative of the BESA has been included in the sample, as there is only one bond exchange in South Africa at present.

The researcher will try to be objective in the choice of respondents for this research, as "*subjectivity can mean distortion*" (Ulin et al 2002: 30). The sample size will be made up of twenty one respondents, which are detailed in the interview schedule below:

Table 1: Interview Schedule

Interview Number	Institution	Sector	Respondent	Designation	Interview Dates
1	ABSA	Investment Bank	Jason Lamb	Commercial Property	28-Apr-06
2	ABSA	Investment Bank	Marc Hearn	Capital and Debt Markets	3-May-06
3	Investec	Investment Bank	Nick Job	Treasury & Specialised Finance	9-May-06
4	Rand Merchant Bank	Investment Bank	Barry Martin	Capital Markets	10-May-06
5	Rand Merchant Bank	Investment Bank	Simon Fifield	Property Finance	10-May-06
6	Investec Bank	Investment Bank	Bronwyn Bayvel	Property Finance	17-May-06
7	Nedbank	Investment Bank	Hendrick Ackerman	Securitisation	23-May-06
8	Nedbank	Investment Bank	Richard Hay	Securitisation	23-May-06
9	Standard Bank	Investment Bank	Johan Marnewick	Securitisation	26-May-06
10	Standard Bank	Investment Bank	Karin Joubert	Property Finance	26-May-06
11	iFour properties Ltd	Real Estate	James Nunes	Chief Executive Officer	2-May-06
12	Emira Property Fund	Real Estate	James Templeton	Chief Executive Officer	4-May-06
13	Growthpoint Properties Ltd	Real Estate	Norbert Sasse	Chief Executive Officer	5-May-06
14	Metboard Properties Ltd	Real Estate			
15	Resilient Property Income Fund Ltd	Real Estate	Jacques van Wyk	Finance Director	5-May-06
16	Diversified Properties Ltd	Real Estate	David Lewis	Chief Executive Officer	5-May-06

17	ApexHi Properties Ltd	Real Estate	Collette van Wyk	Finance Director	8-May-06
18	Redefine Income Fund ltd	Real Estate	Brian Azizollahof	Chief Executive Officer	8-May-06
19	Hyprop Investments Ltd	Real Estate			
20	Freestone Ltd	Real Estate	Mike Aitken	Chief Executive Officer	23-May-06
21	Bond Exchange of South Africa	Bond Market	Allen Jones	Listing Manager	16-May-06

4.4 Data Collection

The researcher will telephone the companies in the first week of May 2006, and try to make direct contact with the respondents. At this time, the researcher will inform the respondent of the purpose of the study and the subject to be covered. The researcher will then invite the respondent to take part in the survey, or ask to be referred to another person within the company who is suitably qualified to take part in the survey. Upon acceptance from the respondent, the researcher will confirm the date, place and time of the interview and thank the respondent.

The semi-structured interview process will take place at the respondent's offices, as this will be most convenient for the respondents and the familiarity of the location may make them feel more at ease. The researcher will take notes during the interview, and with the permission of the respondent, will audio-tape the entire interview.

The researcher will make every effort not to lead the respondent to answer the questions in a particular way, but will try to facilitate a very open discussion around the questions. "*The major disadvantage is that by his or her very presence, the researcher may alter what people say and do and how significant events unfold*" (Leedy and Ormrod, 2001: 158).

4.5 Data analysis

The technique used for the data analysis will be similar to a content analysis. Leedy and Ormrod (2001) describe a content analysis as a detailed and systematic examination of the contents of a particular body of material for the purpose of identifying themes, patterns or biases. In this case, the content analysis will be performed on the in-depth semi-structured interviews.

The data will be analysed after each interview. Firstly, the audio-tape of the interview will be listened to in its entirety. With the use of a table, the key factors from the interview will then be identified and tabulated. This will be saved on a word-document. Any important comments and quotes will also be included in the document.

The data from all the interviews will then be integrated and synthesised on to one document, and the frequency of each identifiable factor and specific theme will be tabulated. This will highlight common factors identified across all the respondents, allowing the researcher to interpret the results. No other quantitative analysis or statistical techniques will be performed on these results.

4.6 Validity and reliability of the data

"*Qualitative researchers believe that the researcher's ability to interpret and make sense of what he or she sees is critical for an understanding of any social phenomenon. In this case, the researcher is an instrument in much the same way that a sociogram, rating scale, or intelligence test is an instrument*" (Leedy and Ormrod, 2001: 147).

Leedy and Ormrod (2001) describe the validity of the measurement instrument, which in this case is the researcher, as the extent that the instrument measures what it is supposed to measure. In the case of this research, the data will only be valid provided the interview is conducted in a manner where the respondent is not influenced or led on in any way by the researcher and is free to make any comments he wishes. It is for this reason that the interview will be conducted at the premises of the respondent. It is up to the researcher to be objective in his analysis of the data, and in his interview technique. The objective is to be neutral and not to lead the respondent to answer in a specific way.

The reliability of the measurement instrument, as described by Leedy and Ormrod, (2001), is the extent to which it yields consistent results when the characteristic being measured has not changed. The researcher will try to maintain consistency in approach by utilising the same interview questions and technique for all the respondents. By operating in a systematic manner, the interviewee will attempt to ensure that the data will be reliable.

5. ANALYSIS OF RESULTS

5.1 Introduction

This chapter identifies the key themes stemming from the semi-structured interview process. The researcher seeks to identify the factors which influence the use of listed debt as a source of finance for the listed property sector on the JSE. The literature review developed propositions against which the research is being conducted. The researcher will analyse the responses of the interviewees in an attempt to qualify the accuracy of those propositions.

5.2 Interviews

A total of 15 interviews were conducted. There were eight interviews of ten respondents, representing the five largest banking institutions in South Africa. There were six interviews of nine respondents representing ten listed real estate companies in South Africa, and finally there was one interview of a representative of the Bond Exchange of South Africa (BESA).

All the respondents listed in Table 1 in the Interview Schedule were contacted and interviewed. The researcher was informed that Metboard Properties Limited was going to be acquired by Growthpoint Properties Limited during the course of this year. Both of these companies are managed by the Investec Property Group. As a result, the researcher inferred that the factors influencing the use of bonds or listed debt for Growthpoint would be similar for Metboard. Similarly, the Redefine Income Fund Limited, was identified to be the largest single shareholder in Hyprop Investments Limited. As a result, the researcher inferred that the factors influencing the use of bonds or listed debt for Redefine would be similar for Hyprop.

All of the interviews were transcribed into word format. The responses from the interviewees were content-analysed in tabular form. This empirical data from all the respondents has converged significantly and themes have emerged. In this chapter, the themes from the empirical data will be used to confirm or reject the propositions which stemmed from the literature review.

5.3 Bonds, a cheaper source of debt finance

When questioned on what factors would influence the use of listed debt for the listed property sector, the initial responses were almost unanimous. *"The biggest single driver is price"* (Respondent). "*Clearly the most significant factor is price. It's all a question of where we can get the cheapest source of funding*" (Respondent). This was the first theme which emerged from the data. All the respondents felt that the main factor which would influence the use of listed debt as a source of finance was whether it provided access to cheaper funds.

The reason for this is simple. "*The debt funding costs is usually one of the biggest expense items in these companies"* (Respondent). *"Typically the largest expense for listed real estate companies is the interest paid on their debt"* (Respondent). *"It is property yield less cash going out. The largest outflow is interest expenses. These companies are all geared. You reduce the interest expense which directly correlates to increased earnings to unit holders"* (Respondent).

In the Introduction to this research, the researcher highlighted that the use of listed debt will reduce the cost of debt and hence reduce the WACC. This would increase the company's valuation.

Interestingly, one respondent, who was the chief executive officer of a property unit trust (PUT), indicated that *"at the moment, equity is cheaper than debt. Our units are currently trading at a forward yield of around 7.5% with bond yield trading* *at a forward rate of 7.4% plus a margin on that. Debt funding is now coming in more expensive than equity."*

All of the listed property companies do however have some level of debt or gearing. All the respondents concurred that traditional bank funding through typical vanilla debt was currently one of the more expensive sources of funding available to the listed property sector. Presently, *"the banks will normally lend to listed companies at margins at the three-month Jibar plus 1.20% to 1.80%. Through commercial mortgage backed securitisations, this rate could be reduced to Jibar plus 0.35 to 1.00%"* (Respondent).

There are cost implications to bond issues and other considerations which will be discussed later. From the empirical data, the researcher found that in 14 of the 15 interviews, the respondents found that the bond exchange was a cheaper source of finance than traditional bank loans. One respondent indicated that equity was currently cheaper than debt. As a result, Proposition 1 is overwhelmingly correct.

5.4 Competition between banks and the bond market

In the literature review, the researcher indicated that the attitude of the banking sector would affect the extent to which the listed property companies utilised the bond exchange as a source of finance. The banking sector may reduce their lending rates to a degree which makes it less feasible for a company to use the bond exchange, or alternatively, the banking sector may become an active participant in the process (Hawkins, 2001).

The results from the empirical data were very interesting. In 2001, the listed property companies had only one real source of debt to meet their funding needs and this was through traditional bank loans. As one listed property sector respondent put it: *"Previously we had only one source of debt funding; we had to go to the five major banks. They were powerful; perhaps cartel is the wrong word.*

They used this power to say that for the privilege of doing business with us, you can borrow at an LTV of 50%, with covenants in place such as interest cover, and for this privilege we will charge you between 200 and 225 basis points above Jibar. This was clearly expensive and on top of that they charged massive fees to arrange this. What securitisation brought to the table was a reduction in that margin."

Effectively, with the emergence of funding through the bond market securitisations, there are now a number of sources of debt for the listed property sector. *"We did not want to depend on banks for all the financing needs. The bond market in South Africa is massive and we wanted an extra source of funds"* (Respondent). This increase in competition resulted in the banks having to reduce their lending rates. *"The introduction of CMBS in South Africa has forced them to look a lot harder at the rates they had been charging before. Now banks have a lot more competition on their doorstep, it has forced them to look more creatively at the situation"* (Respondent).

In South Africa, it was the listed property sector which initially drove the process to move away from traditional bank funding. *"Banks were more than happy to provide funding. It used to be high margin with relatively low risk. That is why the banks did not drive the process at all. The large property companies forced the banks to facilitate the process. That's how CMBS started here. The commercial banks changed their balance sheet spreads when they realised that the game was over and they actually just lowered the rate they were giving on balance sheet lending"* (Respondent).

All the bank respondents confirmed that there had been a reduction in their margin for bank debt to the listed property sector. *"The feedback is that there will always be a need for traditional bank funding. The wheel started to turn and now banks are throwing money at these funds at very competitive rates. Margin compression has come where margins have fallen to 130 basis points"* (Respondent).

The listed property respondents confirmed that they were now obtaining significantly lower funding rates from the banks. As one respondent put it, *"From our association with the FirstRand Group, we benefit from a low cost of funding. Margins have now come down significantly from Jibar plus 1.90% to Jibar plus 1.30%. We had benefited from that relationship."* The relationship with the banks is still a key element in the decision to use bonds. The banks have actively reduced their rates, and this will certainly be a determining factor for listed property companies to consider.

The banks have however also become active participants in the process. *"There's more diversity of products for clients. Even through CMBS there is still a relationship with the client where they will require specialist services. You will probably see that the debt capital market divisions in most banks will be working closely with the property finance areas and the property finance will have some role to play in the CMBS transaction"* (Respondent). *"Generally what happened was the CMBS was handled by the property finance division in conjunction with the structured finance division in the banks. There were therefore fees going all over the place"* (Respondent).

The banks will now actively try to market securitisation products to their clients who qualify for them. If a full securitisation is feasible, then the bank may offer to structure a CMBS product. Alternatively, banks have their own conduit structures in place which offers a good alternative. *"CMBS immediately got all the banks thinking about what the implications are for their books. All the banks now had to contend with losing new and existing business and they created structures which are called conduits. It's a semi-securitisation type of structure. It is not balance sheet funding for them and they don't have all the same costs. So from having one source of debt 18 months ago, we today have five sources of debt"* (Respondent).

The empirical data from the bank and listed property respondents clearly indicates that while the banking sector has reduced lending rates in line with the increase in competition, they have also become an active participant in the process of listed property companies using the bond market. As a result, Proposition 2 is also correct. The level of competition between the traditional banking sector and the bond market will influence the decision for real estate companies to issue bonds.

This level of competition is set to increase. As the BESA respondent highlighted, new legislation for the banks will soon require them to price risk more efficiently. *"In South Africa, the banks have grown their balance sheets. What they haven't shown is the quality they've grown with. Under Basil 2 the banks are going to have to price risk more efficiently, and with that it will force the banks to securitise"* (Respondent).

5.5 The corporate bond market

Both propositions 3 and 6 referred to aspects relating to the Bond Exchange of South Africa (BESA). In the literature review, the researcher indicated that the high yield market of the BESA was less developed when compared with the situation in the United States. As a result, listed property companies may not consider this a viable alternative to raise funding (Duca, 2001). Would there be an appetite in South Africa for paper issued by the listed property sector? The second key theme from the literature review was that if real estate companies found the listing requirements and regulations of the BESA to be too onerous, they may choose to utilise bank loans instead (Hakansson, 1998).

Out of the 15 interviews, 13 commented on the bond exchange. This was mostly after a prompt from the researcher. From these 13 interviews, three broad themes emerged.

Firstly, the listing requirements of the bond exchange were found to be very efficient and not onerous at all. *"A high volume of transactions are now conducted through the bond exchange. All their processes are fairly stream-lined. They have fine tuned themselves"* (Respondent). "*There are disclosure requirements, but those are to my mind, a crystallisation of common sense requirements. We have not come across any requirements that have been unduly onerous. It is in everyone's interests that the market is as transparent as possible"* (Respondent).

Secondly, the empirical data suggested that there was indeed an appetite for the bond issues of the listed property sector. The paper was largely targeted towards the institutional investors. Typically, the company representatives who intended to use the BESA would conduct a road show prior to the listing, to attract institutional investors. *"Bonds are typically bought by institutional investors, which are governed by regulations on how to invest. It is only very safe investments that can be invested in. The bond has to have a certain rating. The perception is that the bond is tradable. We use the bond exchange largely because it's a requirement of many of the mandates"* (Respondent).

The bond issues are largely designed by the investment banks to cater to the requirements of the intuitional investors. *"The Bond Exchange is out there, but not important. This did not affect the decision to issue bonds. I went on a road show and had to talk like a parrot to the institutional investors about the issue. The bonds were oversubscribed and according to my knowledge, traded very thinly"* (Respondent).

Once the listed property bonds have been issued, there is hardly any secondary trade on that paper. "*The institutional investors will hold on to it. These instruments (securitisation issues) are thinly traded, unlike government bonds."* (Respondent) *"It brings some market discipline to the transaction. It increases the tradability of the debt that is issued. At this stage there's not a huge secondary market for debt in South Africa"* (Respondent).

The final theme to emerge was that there was a lot of prestige associated with making a public listing with the BESA. There was some marketing in this, and it raised the overall profile of the company. *"Most CMBS are listed on the bond exchange. This enhances the prestige of the issue"* (Respondent). *"The BESA is the shop window for investors. We wanted as broad market exposure as we could. We wanted a bigger target audience"* (Respondent).

The empirical data clearly suggests that there is an appetite for bonds issued by the listed property sector. Their paper is bought mainly by institutional investors and thereafter it is very thinly traded. Twelve of the 15 interviews concurred with this view. The other three made no comment and therefore did not refute this view. As a result, Proposition 3 is inaccurate. The corporate bond market is not perceived to be at an early stage in its development, and there is certainly an appetite for the bonds of the listed property sector. This view is best encapsulated by the BESA respondent: *"For our size, we are one of the most liquid markets in the world. Corporates make up 23% of issues."*

The empirical evidence also clearly suggests that the listing requirements of the BESA are very streamlined, and not onerous at all. Thirteen of the 15 interviews concurred with this view. The other two did not mention this factor and therefore did not refute this view. As a result, Proposition 6 is also inaccurate. The listing requirements of the BESA are very efficient.

5.6 The bond rating

The literature review highlighted that listed companies which had a higher rating, had a lower cost of funding (Diamond, 1991). Proposition 4 stemmed from this theme and stated that a high bond rating will reduce the cost of funding of the debt issue.

The results from the empirical data indicated that 11 out of 15 interviewees mentioned this as a factor that influences the use of bonds for the listed property sector. This theme was not mentioned in four of the interviews and was therefore not refuted by them.

There were two main themes which came out of the empirical data. Firstly, if a company does not get a rating from a rating agency, then the rating of the overall company will be given to the bond issue. This infers that a bond issue can have a different rating from that of the company. As one bank respondent put it, *"If a company offered an unsecured bond, it would receive the rating of the company. If you give some security to the bond-holder over the bond, it's called a covered bond. The difference with a securitisation primarily is that it provides a SPV which provides liquidity. You've got liquidity breaking the nexus between the default of the corporate and the default of the bond. That's how you can get AAA bonds from BBB entity, since the two have nothing to do with each other".*

The second theme to emerge was that the bond rating was indeed a very important factor. *"The rating agencies are there to assist you in developing the market. They are more there from an investor perspective"* (Respondent). In effect they performed a cost function in the bond issue. *"The bond rating is not everything, but more or less everything. The higher the rating and the more debt you can issue at that rating, the more attractive the transaction is for you. The rating determines who you can sell the bond to and what the eventual price will be"* (Respondent). *"Ratings are key in securitisations. It can really reduce the fund rate. For AAA rated issues, the cost of funding can be as low as Jibar plus 30 basis points. AA can be anything from Jibar plus 60. BBB would probably be Jibar plus 180. So it's all really a function of the rating"* (Respondent).

The fact that an unsecured bond issue will receive the rating of the company, is very important. As one bank respondent put it, *"These listed property companies are typically rated investment grade. You could theoretically get a company rated*

BBB accessing the bond market for cheaper funding costs." This however would not happen in reality. Investment grade corporate bond issues would probably cost the company Jibar plus 180 basis points. At this rate, bank funding, which costs Jibar plus 130 to 190 basis points, would certainly be cheaper for the listed companies.

Through the securitisation process, which is alluded to in greater detail in the next part, companies are able to increase their bond issue ratings. This rating reduces the cost of the bond. *"The rating agencies are an integral part of the process. The rating directly affects pricing. The higher the rating, the lower the risk will be. Therefore the issue will be cheaper"* (Respondent).

From the empirical evidence, which was supported by all 11 respondents who mentioned this theme as a factor which would influence the use of listed debt as a source of finance, Proposition 4 is certainly accurate. A high bond rating will certainly reduce the cost of funding the debt issue.

5.7 The development of the securitisation market

From some of the quotes of respondents already listed, it is clear that most of the respondents use the words 'securitisation' and 'bond issues' in the same sentence, sometimes interchangeably.

The literature review highlights the fact that securitisations, or more specifically 'commercial mortgage backed securitisations' (CMBS) is a credible means for property listed companies to access the public debt markets (Schwarcz, 2000). In a South African context, iFour, Vukile and Growthpoint have all used CMBS to raise funds through the BESA. In May 2006, Freestone has planned to join their ranks with a R500 million issue. Proposition 5 stems from this theme and states that the recent emergence of the CMBS market in South Africa provides a new channel for real estate companies to obtain cheaper debt through the use of bonds.

Out of the 15 interviews conducted, 14 spoke of the development of the securitisation and CMBS markets in South Africa. Only 1 interviewee, who was a chief executive officer of a property unit trust (PUT), did not mention this theme as a factor influencing the use of bonds as a source of finance.

This was to be expected. As a respondent commented, *"We are a PUT and are therefore limited in gearing by the Collective Investment Schemes Control Act to 30%. At this stage, our debt is between 20% and 25%."* PUTs are trusts which are more highly regulated than property loan stocks (PLSs) by the Collective Investment Schemes Control Act (Act 45 of 2002). *"We are a PUT, and having 30% gearing is a limiting factor on the use of debt"* (Respondent). The literature review also indicated that CMBS transactions were usually facilitated through a special purpose vehicle (SPV). Due to the current legislation, *"PUTs will never be able to do a securitisation. They can't get that type of gearing and they can't move their properties out of the trust, and therefore you can't strip the assets out"* (Respondent). As a result, PUTs will not be able to do a CMBS transaction at this stage.

The empirical data from the other 14 interviews raised some fascinating themes, which are detailed next.

Firstly, through the use of securitisation, it is possible to reduce the costs of funding. *"The fundamental difference is that with a securitisation, you can tranche up the various papers that you issue, and get a higher rating. The other way, if you do not have the size, is to do it through an asset-backed commercial paper conduit, which all the banks have"* (Respondent). This has already been alluded to in Proposition 1. The costs of funding through a securitisation can be significantly lower than traditional bank funding. In terms of cost, conduit funding falls between traditional bank funding and CMBS.

Secondly, securitisation allows the listed property companies to diversify their funding sources away from traditional bank debt. *"It also diversifies funding sources. Banks may reach a point where they are full up on credit and do not have the appetite to lend to a company. This may be because they already have a large exposure. Securitisation allows real estate companies to access the bond market as opposed to the debt market."* This will allow a bank to maintain their relationship with a client, rather than their going to a competing bank for funding needs.

The final theme to emerge was that the securitisation market in South Africa is expected to grow. *"CMBS is great for the funding market because it gives you an alternative. It creates competition. It opens a whole new way of thinking, which we are very excited about. Now we see the likes of Old Mutual entering the property finance market. It's a market that we're starting to understand much better. It's a very attractive market for us to look at in the future"* (Respondent).

In 14 of the 15 interviews, the research data clearly indicates that CMBS is certainly a new alternative for debt funding for the listed property sector. One interviewee did not take this view when he inferred that PUTs will not be able to use CMBS under the current legislation. There are currently six PUTs listed on the JSE, in the Real Estate Sector (Appendix 3). The use of securitisation is certainly an option for the balance of the listed companies. The empirical data therefore supports Proposition 5 where the emergence of the CMBS market in South Africa provides a new channel for real estate companies to obtain debt through the use of bonds.

Perhaps this view is best summarised by a quote from the BESA respondent: *"We see the market and securitisation growing. The beauty of securitisation is that you* *can take 10,000 homes or mortgages, repackage them, and if one goes belly up, it doesn't contaminate the issue."*

5.8 High upfront costs

The literature review reveals that compared with traditional bank loans, the issue of bonds allow companies to borrow money over longer horizons, but high upfront costs make this instrument more attractive for companies that need to finance larger volumes (Wacshiczek, 2004). Proposition 7 stems from this and states that high upfront costs make the use of bonds more attractive for companies that need to finance larger volumes.

From the empirical data of the 15 interviews conducted, 14 of the respondents mentioned costs as a factor which influences the use of listed debt as a source of finance for the listed real estate sector. There were two distinct themes however, which emerged from this.

Firstly, there were significant costs involved in structuring a securitisation. *"Arrangers like myself charge not insignificant sums of money to arrange these deals. This may be amortised over the 5 years of the bond, but may make it too expensive for smaller issues"* (Respondent).

It was possible to amortise these costs over the issue of the bond, which was typically five years. Due to the size of this cost burden, only issues of a certain size made this transaction viable. *"The costs involved in these securitisations include arranging the issue, rating agency fees, implementation, legal fees and setting up a special purpose vehicle such as a conduit structure. The issue will only be worthwhile for securitisations for issues in excess of R500 million – R700 million. Vukile were able to reduce their cost of debt from approximately 11.32% to 10% after their securitisation programme. This is after including all the up front fees. Their AAA rated issue was at a cost of Jibar plus 0.28%"* (Respondent).

There was consensus from some of the respondents that the arranging fees had been reduced since the first bond issue was completed by iFour in 2004. All the major banks now have the expertise in place to do a CMBS transaction. The initial CMBS issues were all around R800 million. Freestone however will be making an issue of R500 million. *"The actual physical cost of the bond you're funding will be around 40 basis points. The difference between 40 and taking you up to 100 is the cost of doing the stuff: banks, rating agencies, lawyers. The up-front costs have become a lot less. We're doing Freestone at R500 million"* (Respondent).

The second theme to emerge was that the costs were not necessarily a determining factor. One banker stated that *"Costs are generally negotiated, and it all depends on what the various parties are willing to do the deal for. It is possible to do this type of transaction for next to nothing. It all depends on what sort of package the client can negotiate with the banks."* According to this banker, the upfront fees were negotiable. This view was reinforced by another respondent who highlighted that they *'usually build these into the margin and they are insignificant when you look at how low your cost of funding is, compared to what you would be paying otherwise".*

One of the listed property respondents who had already made a bond issue through CMBS stated that *"we were unique in that at the time of listing, a SPV was put in place which held properties. This reduced the initial costs of the securitisation, which was done with Absa. It was our intention at the time of listing to raise funds through the bond exchange by securitisation".* This statement indicated that with the correct structures in place initially, the upfront costs could be reduced.

This second theme acknowledged that there were upfront fees attached to the issue of CMBS. The respondents however did not consider this an over-riding factor influencing the decision to utilise listed debt as a source of finance. They believed that there were means to get around this.

The results from the overall empirical data indicate that in 11 interviews, the respondents supported the first theme. They concurred that the upfront costs were significant, and that only an initial issue of at least R500 million would be viable. In the other three interviews, this was not directly refuted, but the respondents did not make this theme a determining factor in the use of listed debt. Finally, one interviewee did not mention this theme. The data therefore clearly supports the first theme to which the majority of respondents alluded. As a result, Proposition 7 can be deemed to be accurate. High upfront costs make the use of bonds more attractive for companies which need to finance larger volumes.

5.9 Lack of flexibility

In the literature review, it was highlighted that bonds were perceived to be inflexible when compared with traditional bank loans, and that it was virtually impossible to change a contract once a bond had been issued, as there are normally a large number of creditors (Wacshiczek, 2004). Proposition 8 stemmed from this theme and stated that bonds were perceived to lack the same flexibility that traditional bank loans offer.

From the empirical evidence of the 15 interviews, three did not mention this as a factor which influences the decision to use bonds as a source of finance. Out of the 12 outstanding interviews, four themes emerged.

Firstly, during a securitisation process, a number of properties belonging to the listed property company would be transferred or ring-fenced into a bankruptcy remote structure or SPV. This was done to enhance the rating of the properties in order to reduce the cost of funding. In order to obtain a higher rating, strict covenants are put in place, such as having to substitute like with like properties into the SPV. Many respondents felt that this was a limiting factor and flexibility was reduced. *"Another factor to consider is flexibility. Bank funding is much more flexible than securitisation. There can be some flexibility in a securitisation, but not to the same level as bank funding. There will be limitations to the replacement of properties that have been securitised. The covenants will be different from bank funding covenants. The LTV's will probably be lower than bank funding. Flexibility is definitely an issue, and securitisations are typically best suited for a company that's got a large portfolio where there's not too much activity, such as trading, in their portfolio"* (Respondent).

Secondly, the initial setting up of the SPV or bankruptcy remote vehicle during the securitisation process was perceived to be administratively cumbersome. *"Administratively it is still very cumbersome to have a securitisation, than it is to have conventional debt. There are limitations in place; you can't just buy and sell into that portfolio. There are significant constraints on what you can do with that portfolio. Therefore, the properties that are in the trust are generally long term, investment type properties. There is a certain loss of flexibility and a significant increase in administration burden. We will still do it for a 40 point saving"* (Respondent).

Next, as a result of the flexibility issue and the high upfront costs issue mentioned earlier, some respondents felt that a conduit structure, which was available from the banks, was more attractive. The objective of these bank conduits is to originate assets directly into the capital markets without bringing these assets onto the bank's balance sheet. Typically, A grade properties of the listed property companies would be used in conduit funding. There is greater flexibility, but the costs are not as attractive as a complete CMBS. *"Then we came across conduit funding which met our needs and now we are not looking to raise money through CMBS. We have recently done some conduit funding of about R900 million"* (Respondent).

Finally, some respondents felt that if the SPV was set up properly initially, then adequate flexibility was provided. *"The second factor is perceived lack of flexibility. Some of the guys who are not acquainted with the latest structures feel that securitisation is less flexible than bank funding. That's not really the case. When we set up these capital market structures we set up sale limits to allow for some flexibility, so that some properties can be sold or substituted"* (Respondent).

In nine of the interviews conducted, the respondents largely agreed with the theme that flexibility was reduced by the securitisation process. One of these nine raised the issue of additional administrative burden, and another one highlighted a preference for the conduit structure. In three of the interviews, the underlying theme was that if the CMBS had been structured properly initially, flexibility was not an issue and the whole process was indeed worthwhile. The final three interview respondents did not mention the factor at all. The empirical data clearly indicates that flexibility was indeed considered to be an inhibiting factor by the majority of the interview respondents. As a result, Proposition 8 can be deemed to be correct. Bonds are perceived to lack the same flexibility that traditional bank loans offer.

5.10 Tax implications

From the literature review, it was identified that the interest portion on debt will normally result in a reduction in the nominal profit of a company. This will result in the tax shield effect where the corporate tax on the debt interest will result in a reduction in the company's cost of debt. The smaller portion of equity would also enjoy a magnified Return on Equity (ROE) (Hartley et al, 1999). Proposition 9 stemmed from this literature, where companies will need to analyse the tax implications of the use of bonds, as this will affect the cost of debt, the nominal profit of the company, and the return on equity for shareholders.

The empirical data from the interview research raised some interesting results. Of the 15 interviews conducted, the respondents in five of them made absolutely no mention of this factor, or mentioned it in a different context, which did not provide a conclusive theme. Of the ten interviews where this subject was mentioned, two themes emerged.

Firstly, there are no tax implications to consider with a bond issue. There may be capital gains tax concerns if the ownership of the properties was changing. In the case of a securitisation, this is not the case, as the properties may be transferred to a separate SPV, but the holding company remains the same listed entity. As a result, there is no real change in ownership from a tax perspective. *"There are not really any tax implications. For the property companies, instead of the loan being granted by a bank, it is now granted by an SPV. There should not be any tax implications"* (Respondent). *"When you move properties around, there may be tax implications. We generally keep the properties in the same group structure as where they came from and then we use the reorganisation provisions in the tax act which allow you to move properties from one subsidiary to another without triggering CGT. So we generally do these deals without CGT implications"* (Respondent).

The second theme to emerge was that property unit trusts (PUTs) and property loan stocks (PLSs) which are the two types of companies which make up the listed real estate sector of the JSE, are both considered to be tax neutral entities. They do not pay tax on the income they earn, and as a result, all the income is distributed to their unit holders. Distributions are therefore only taxed in the hands of the unit holders. *"Typically PUTs and PLSs are tax neutral companies"* (Respondent). *"The companies that you mentioned are all property loans stock companies. We do not pay tax in our companies. We distribute all our revenue to unit holders. There were no accounting or IFRS implications"* (Respondent).

From the empirical data, the researcher found that 10 of the respondents concurred with the first theme, that there were no tax implications. Of these 10, two raised the second point, that listed property companies were tax neutral. Since five interview respondents did not even mention this point as a factor, and therefore did not refute this factor, it is safe to conclude that Proposition 9 is inaccurate. Companies will not need to analyse the tax implications of this type of transaction unless there is a change in ownership. This is unlikely and as a result, CGT should not take effect. There is certainly no tax shield effect which will further reduce the cost of debt. PUTs and PLSs are tax neutral entities. Therefore, this is not a factor for listed real estate companies to consider when deciding to use bonds or listed debt as a source of finance.

6. CONCLUSION

6.1 Summary of key findings

This research aimed to identify the factors which influenced the decision for companies listed in the real estate sector of the JSE, to utilise listed debt as a source of finance. Three companies had issued bonds on the Commercial Property Securitisation Sector of the BESA. These included iFour, Vukile and Growthpoint. From the literature review, nine propositions were identified, which represented these factors.

The researcher conducted 15 semi-structured interviews with 19 respondents. These interviews represented the five largest banks in South Africa, ten property listed companies, and the BESA. A content analysis was conducted on the responses from the interviews, and this formed the empirical data. The themes from the empirical data were used to confirm or reject the propositions which stemmed from the literature review.

Three of the nine propositions were rejected outright. Firstly, there is certainly an appetite for bonds issued by the listed property sector. Their paper is usually bought by institutional investors, and as a result, the state of the current corporate bond market is not perceived to be a limiting factor for real estate companies to consider, when issuing bonds or listed debt. The empirical data refutes Proposition 3. Next, the empirical data clearly suggests that the BESA listing requirements are streamlined, and not onerous at all. This refutes Proposition 6. Finally, there were no tax implications which are a determining factor in the use of bonds as a source of funding. As a result, Proposition 9 was also incorrect.

The empirical data did however identify some important themes which resulted in six propositions being accepted.

Firstly, through the use of securitisation, and next conduit funding, it is possible to reduce the cost of debt finance (Proposition 1). There are high upfront costs attached to this (Proposition 7), but these costs can be amortised over the life of the issue. In addition, the bond issue should exceed a minimum of R500 million to overcome these upfront costs.

The next factor to consider is the issue of flexibility (Proposition 8). During the securitisation process, a number of properties owned by the listed property company would be transferred or ring-fenced into a bankruptcy remote vehicle or SPV. This is done to enhance the rating of the properties to reduce the cost of funding (Proposition 4). In order to obtain a higher rating, strict covenants are put in place. These may include stricter LTV ratios (loan to value), limits around trading the properties within the SPV, and there is also an administrative burden in setting up the structure. It is possible, however, to get around this issue by building some flexibility into the initial structure, and as a result, this does not have to be a limiting factor.

Finally, the empirical data suggests that a normal uncovered corporate bond may not be viable at this stage. Investment grade corporates may issue uncovered bonds at Jibar plus 180 basis points. The banking sector has reduced their lending rates considerably in the last eighteen months (Proposition 2). This has occurred because of the emergence of the securitisation market (Proposition 5) and the resulting increase in competition caused by the increase in funding sources. Three companies have successfully reduced their cost of funding through the issue of securitised / covered bonds.

6.2 Recommendations

The current market capitalisation of the Real Estate Sector of the JSE exceeds R70 billion (Appendix 3). It comes as a great surprise to the researcher that only three securitised bond issues have been completed to date. Less than R2.5 billion has been raised from these three issues. There is clearly greater opportunity for other listed real estate companies to reduce their cost of funding through CMBS, but they have chosen not to do so as yet.

This suggests that there is a subjective element in the decision-making process around this issue which need not be there. There is enough evidence available in the market, for management of the listed property sector to make informed decisions around the use of bonds or listed debt as a source of funding. The management of these listed companies should aim to maximise returns for their shareholders by utilising the cheapest source of funding for their debt.

The researcher therefore recommends that the management of the listed property sector investigate the use of securitisation or conduit funding for their portfolio of debt. The researcher further recommends that institutional investors owning large property holdings, such as pension funds, also look at the use of CMBS to substitute traditional bank debt for bond issues where possible.

6.3 Ideas for future research

The researcher has identified two further areas for future research.

Firstly, it is possible to conduct a quantitative study on all the financials of the companies listed on the real estate sector of the JSE. The objective will be to identify which companies qualify for CMBS currently or in the near future. Recommendations can then be made to them on how to reduce their funding costs.

Next, a study can be conducted on identifying new industries other than property, where securitisation can be used to reduce funding costs. It may be possible to identify the new sources of securitisation in the United States, and compare them with those available in South Africa.

7. SUMMARY OF REFERENCES

Bierman, H. (1966): 'The Bond Issue Size Decision', *The Journal of Financial and Quantitative Analysis*, Vol. 1, No. 4, pp. 1-14.

Brueggeman, W.B. & Fisher, J.D. (1993): *Real Estate Finance and Investments*, ninth edition, Homewood, Irwin, pp.438.

Davidson, A. Sanders, A. Wolf, L.L. & Ching, A. (2003): *Securitisation, Structuring and Investment Analysis,* John Wiley & Sons, Inc. pp. 410-411.

Denzin, N. K. (1989): *The Research Act,* New York, McGraw-Hill.

Diamond, D.W. (1991): 'Monitoring and Reputation: The choice between bank loans and directly placed debt', *The Journal of Political Economy*, Vol.99, No. 4, pp.689-721.

Duca, J. (2001): 'The Democratisation of America's Capital Markets', *Federal Reserve Bank of Dallas, Economic and Financial Review,* Second Quarter 2001, pp. 10-19.

Falkena, H. Davel, G. Hawkins, P. Llewellyn, D. Luus, C. Masilela, E. Parr, G. Pienaar, J. & Shaw, H (2004): 'Competition in South African Banking', *Task Group Report for The National Treasury & the South African Reserve Bank.*

Fabozzi, F.J. (2000): *Bond Markets, Analysis and Strategies*, Fourth Edition, Prentice Hall International, pp 3.

Fife, I. (2005): iFour Properties, *Financial Mail*, accessed 12 September 2005, (http://www.fm.co.za/cgi-bin/pp-print.pl).

Foo, Dr. S. T. (2000): 'Securitizing Real Estate – A Primer on the New Financial Instrument,' draft, National University of Singapore, 4 October 2000.

Firer, C. Ross, S.A., Westerfield, R.W., & Jordan, B.D (2004): *Fundamentals of Corporate Finance,* Third South African Edition, London: McGraw Hill, pp 472-84.

Graham, J. R. (2000): 'How Big Are the Tax Benefits of Debt?' *The Journal of Finance*, LV, No. 5.

Graff, R. (1992): 'Perspectives on Debt-and-Equity Decomposition for Investors and Issuers of Real Estate Securities,' *Journal of Real Estate Research*, Volume 7, Number 4, pp. 449-467.

Hakansson, N. (1998): 'The Role of a Corporate Bond Market in an Economy – and in Avoiding Crises', draft, University of California, Berkley, 1999.

Hand, J. Holthausen, R.W. & Leftwich, R. (1992): 'The Effect of Bond Rating Agency Announcements on Bond and Stock Prices' *The Journal of Finance*, Vol. 47, No. 2, pp. 733-752.

Hartley, C. Firer, C. & Ford, J. (1999): *Business Accounting and Finance for Managers,* 4th Edition, Witwatersrand University Press, pp. 184 – 190.

Hawkins, J. (2001): 'Bond markets and banks in emerging economies', (*Bank for International Settlements) BIS Papers* No. 11, pp. 42-48.

Hess, R. C. (2001): 'Converging on Maturity – Trends in CMBS Issuance' *Prudential Real Estate Investment (PREI) Research Reports* , February 2001, pp. 1-26.

Jud G.D. & Winkler D.T. (1995): ‘The Capitalization Rate of Commercial Properties and Market Returns’, *The Journal of Real Estate Research*, Volume 10, Number 5, pp. 509-18.

Leedy, P.D. & Ormrod, J.E. (2001): *Practical Research: Planning and Design.* New Jersey: Merrill Prentice Hall. pp. 98-162.

Listed Products, (2005): Bond Exchange of South Africa, accessed 12 September 2005 (http://bondex.co.za/).

Lincoln, Y. S. & Guba, E. G. (1985): *Naturalistic Inquiry,* Beverly Hills, Sage.

Lintner, J. (1965): ‘Security prices, risk, and maximum gains from diversification’, *Journal of Finance*, December, pp. 587-615.

Mackie-Mason, J. K. (1998): ‘Do Taxes affect Corporate Financing Decisions?’ *Working Paper No. 2632, National Bureau of Economic Research, pp. 1-40.*

Myers, S. C. (2001): ‘Capital Structure’ *Journal of Economic Perspectives,* Volume 15, Number 2, pp. 81-102.

Modigliani, F. & Miller, M.H. (1958): ‘The Cost of Capital, Corporation Finance and the Theory of Investment,’ *American Economic Review*, 48:3, pp.261-297.

Navarette, A. (2001): ‘The Role of the Corporate Bond Market in Mexico as a Source of Financing,’ in Conference on Financial markets in Mexico, organized by the Center for Research on Economic Development and Policy Reform at Stanford University, October 5-6, 2001, pp. 1-22.

Pagano, M. (2005): ‘The Modigliani-Miller Theorems: A Cornerstone of Finance’ *Working Paper no. 139*. Centre for Studies in Economics and Finance.

Peterson, M.A. & Rajan, R. (1994): 'The effect of credit market competition on lending relationships' *National Bureau of Economic Research,* Working Paper No. 4921.

Pratt, S. (1998): *Cost of Capital, Estimation and Applications*, Jon Wiley & Sons Inc. pp. 3-5.

Prime Overdraft Rate SA, (2005) I-Net Bridge.

Rajendra, G. (2002): 'The use of securitisation as an alternative funding tool for European corporates', *The European Restructuring and Insolvency Guide 2002-2003,* Deutche Bank AG 2002, pp. 15-21.

Ross, S. Westerfield, R.W. & Jaffe, J. (2002): *Corporate Finance,* Sixth Edition, London: McGraw Hill, pp 395-407.

Schwarcz, S. L. (2000): 'The Universal language of International Securitisation', *Duke Journal of Comp. & International Law,* pp. 285.

Sharpe, W.F. (1964): 'Capital asset prices: a theory of market equilibrium under conditions of risk', *Journal of Finance*, September, pp.425-42.

Thatcher, J. S. (1985): 'The Choice of Call Provision Terms: Evidence of the Existence of Agency Costs of Debt,' *The Journal of Finance,* Vol. XL, No. 2, P549.

Ulin, P.R. Robinson, E.T. Tolley, E.E. & McNeill, E.T. (2002): *Qualitative Methods A Field Guide for Applied research in Sexual and Reproductive Health,* Family Health International, pp. 11-33.

Wacshiczek, W. (2004): ‘The Role of Corporate Bonds for Finance in Austria’, *Monetary Policy & The Economy*, Q4 / 04, pp. 39-52.

Wilson, R.S. & Fabozzi, F.J. (1990): *The New Corporate Bond Market: A Complete and Insightful Analysis of the Latest Trends, Issues & Advances*, Probus Publishing Company, Chicago, Illinois, pp 3.

Wilson, P. Okunev, J. & Ta, G. (1996): ‘Academic Papers: Are real estate and securities markets integrated? Some Australian evidence’, *Journal of Property Valuation & Investment*, Volume 14, Number 5, pp. 7-24.

Yoshitomi, M. & Shirai, S. (2001): ‘Designing a financial market structure in post-crisis Asia – how to develop corporate bond markets’, *Asian Development Bank Institute working paper* 15, March.

8. SUMMARY OF APPENDICES

Appendix 1: Interview Questions

Appendix 2: Prime Overdraft Rate in South Africa

Appendix 3: Listed Real Estate Companies

Appendix 4: Listed Products, Bond Exchange of South Africa

Appendix 1:

Draft Interview Outline for Real Estate Companies

Factors influencing the decision to utilise listed debt as a source of finance for listed real estate companies on the JSE.

Details of the respondent

Date:
Time:
Respondent name:
Title:
Organisation:

Opening Remarks

Thank the respondent for taking the time to meet and contribute to the research report. Refer to the telephone conversation requesting the interview and provide general information of what the research is about: identifying factors which influence the decision to utilise the bond exchange as a source of finance.

Background information

Ask the respondent some factual data about their company which is readily available from public sources:

What is the company's market capitalisation?

What is the approximate value of the property portfolio?
How many properties are there?
What is the approximate value of current debt?
What is the cost of debt / interest rate paid to the banks?

Question 1

What factors influence the decision for listed real estate companies to utilise the bond exchange as a source of finance?

If 'bonds are a cheaper source of finance than bank loans' is mentioned

Prompt 7: Aren't there 'high up front costs' when issuing bonds?

If 'the current relationship with banks' is mentioned

Prompt 2: To what extent would your existing bankers assist your company in issuing bonds and restructuring your debt?

If 'the early stage of development of the bond market' is mentioned

Prompt 3: What improvements do you think can be made to the BESA?

If 'the bond rating' is mentioned

Prompt 4: Does the bond rating affect the coupon rate? Does the bond rating affect the quantity of debt issued?

If 'securitisation' is mentioned

Prompt 5: How has the CMBS market developed?

If 'listing requirements or regulations' is mentioned

Prompt 6: Do you think the listing requirements and regulatory requirements of the BESA are acceptable?

If ‘high up front costs’ are mentioned

Prompt 1: What do these costs entail? Aren’t coupon rates in the BESA lower than traditional bank lending rates?

If ‘flexibility’ is mentioned

Prompt 8: Is there an element of inflexibility associated with issuing bonds?

If ‘tax implications’ are mentioned

Prompt 9: How does this influence the cost of debt, nominal profits, and the ROE?

Question 2

Are there any other factors which influence the decision for listed real estate companies to issue bonds?

Prompt: At this stage the researcher will tell the interviewee the other factors from the literature that have not been mentioned, and ask them to rate how important they are compared to those already mentioned?

Closing remarks

Thank the respondent for taking the time to meet with you and offer him a copy of the report once it is complete.

Draft Interview Outline for Banks and the BESA

Factors influencing the decision to utilise listed debt as a source of finance for listed real estate companies on the JSE.

Details of the respondent

Date:
Time:
Respondent name:
Title:
Organisation:

Opening Remarks

Thank the respondent for taking the time to meet and contribute to the research report. Refer to the telephone conversation requesting the interview and provide general information of what the research is about: identifying factors which influence the decision to utilise the bond exchange as a source of finance.

Background information

Ask the respondent some factual data about their company which is readily available from public sources:

What services does your institution offer to listed real estate companies?

Question 1

What factors influence the decision for listed real estate companies to utilise the bond exchange as a source of finance?

If ‘bonds are a cheaper source of finance than bank loans’ is mentioned

Prompt 7: Aren’t there ‘high up front costs’ when issuing bonds?

If ‘the current relationship with banks’ is mentioned

Prompt 2: To what extent would bankers assist real estate companies in issuing bonds and restructuring their debt?

If ‘the early stage of development of the bond market’ is mentioned

Prompt 3: What improvements do you think can be made to the BESA?

If ‘the bond rating’ is mentioned

Prompt 4: Does the bond rating affect the coupon rate? Does the bond rating affect the quantity of debt issued?

If ‘securitisation’ is mentioned

Prompt 5: How has the CMBS market developed?

If ‘listing requirements or regulations’ is mentioned

Prompt 6: Do you think the listing requirements and regulatory requirements of the BESA are acceptable?

If ‘high up front costs’ are mentioned

Prompt 1: What do these costs entail? Aren’t coupon rates in the BESA lower than traditional bank lending rates?

If ‘flexibility’ is mentioned

Prompt 8: Is there an element of inflexibility associated with issuing bonds?

If ‘tax implications’ are mentioned

Prompt 9: How does this influence the cost of debt, nominal profits, and the ROE?

Question 2

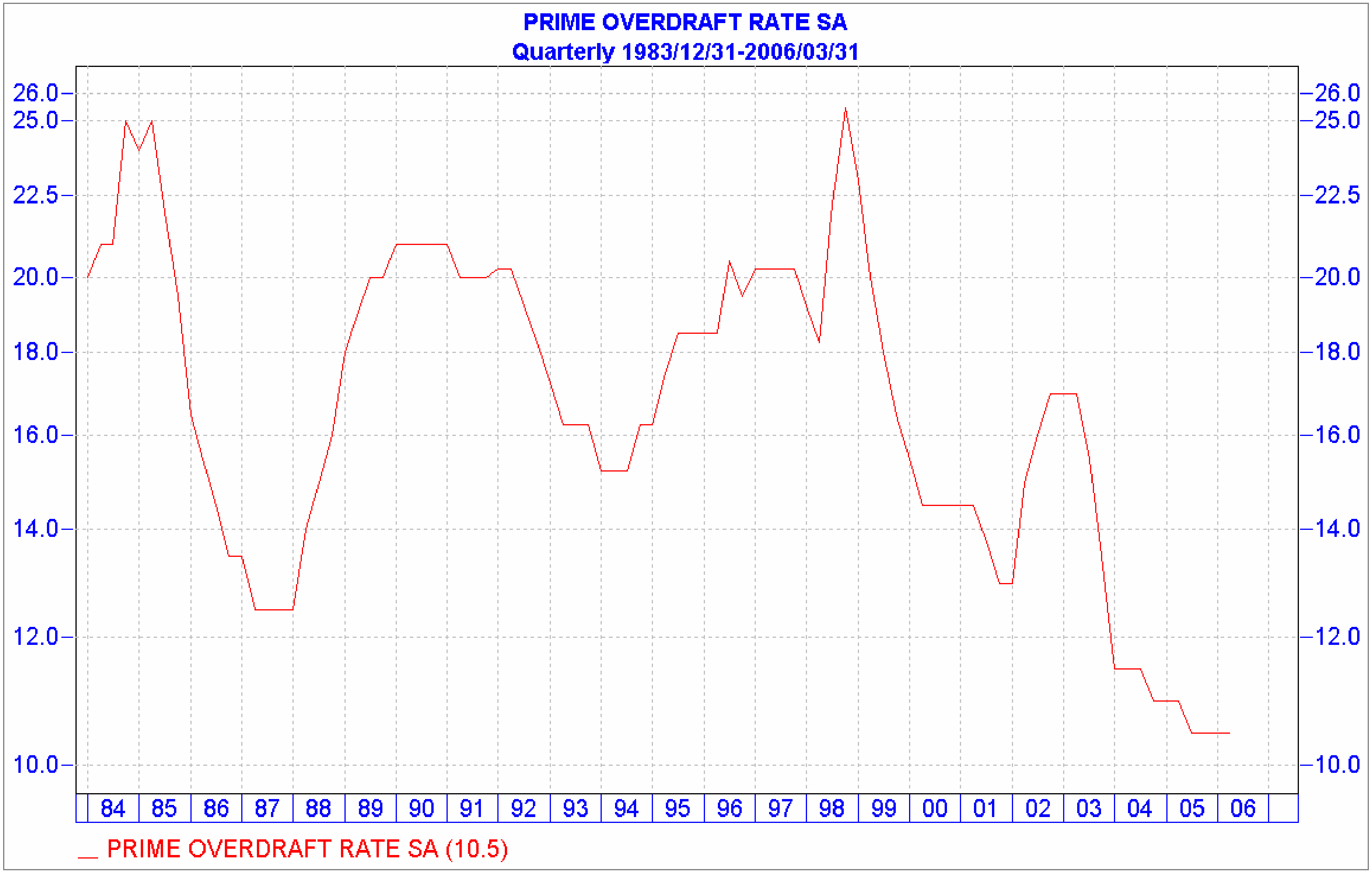
Are there any other factors which influence the decision for listed real estate companies to issue bonds?

Prompt: At this stage I will prompt the interviewee on the issues from the literature they have not been mentioned, and ask them to rate how important they are compared to those already mentioned?

Closing remarks

Thank the respondent for taking the time to meet with you and offer him a copy of the report once it is complete.

Appendix 2: Prime Overdraft Rate South Africa (Source I-Net Bridge)



Appendix 3: Listed Real Estate Companies (Source: Share Data, March 2006)

Name	Code	Year End	Next Results	Market Cap
Acc-Ross Holdings Ltd	ACC	Feb	Feb 2006 (Final)	429m
Acucap Properties Ltd	ACP	Mar	Mar 2006 (Final)	1 886m
Allan Gray Property Trust	GRY	Sep	Mar 2006 (Interim)	6 574m
Ambit Properties Ltd	ABT	Sep	Mar 2006 (Interim)	643m
ApexHi Properties Ltd	APA	Jun	Jun 2006 (Final)	7 787m
Atlas Properties Ltd	ATS	Sep	Mar 2006 (Interim)	1 021m
Calulo Property Fund Ltd	CLO	Jun	Jun 2006 (Final)	190m
Capital Property Fund Ltd	CPL	Dec	Jun 2006 (Interim)	2 090m
CBS Property Portfolio Ltd	CBS	Jan	Jan 2006 (Final)	780m
Diversified Property Fund Ltd	DIV	Jun	Jun 2006 (Final)	911m
Emira Property Fund	EMI	Jun	Jun 2006 (Final)	3 095m
Fairvest Property Holdings Ltd	FVT	Sep	Mar 2006 (Interim)	53m
Freestone Property Holdings Ltd	FSP	Jun	Jun 2006 (Final)	1 128m
Growthpoint Properties Ltd	GRT	Jun	Jun 2006 (Final)	9 306m
Hospitality Property Fund Ltd	HPA	Jun	Dec 1899 ()	478m
Hyprop Investments Ltd	HYP	Dec	Jun 2006 (Interim)	5 255m
iFour Properties Ltd	IFR	Jun	Jun 2006 (Final)	1 930m
Johnnic Holdings Ltd	JNC	Mar	Mar 2006 (Final)	1 728m
Liberty International PLC	LBT	Dec	Jun 2006 (Interim)	42 728m
Marshalls Ltd	MSS	Dec	Jun 2006 (Interim)	52m
Martprop Property Fund	MTP	Jul	Jul 2006 (Final)	2 719m
Metboard Properties Ltd	MPL	Mar	Mar 2006 (Final)	1 952m
Oasis Crescent Property Fund Ltd	OAS	Dec	Dec 1899 ()	230m
Octodec Investments Ltd	OCT	Aug	Feb 2006 (Interim)	912m
Orion Real Estate Ltd	ORE	Jun	Jun 2006 (Final)	141m
Pangbourne Properties Ltd	PAP	Jun	Jun 2006 (Final)	3 469m
Paramount Property Fund Ltd	PRA	Oct	Apr 2006 (Interim)	1 477m
Premium Properties Ltd	PMM	Feb	Feb 2006 (Final)	1 147m
Putprop Ltd	PPR	Jun	Jun 2006 (Final)	173m
Redefine Income Fund Ltd	RDF	Aug	Feb 2006 (Interim)	3 267m
Resilient Property Income Fund Ltd	RES	Dec	Jun 2006 (Interim)	2 554m
S A Retail Properties Ltd	SRL	Mar	Mar 2006 (Final)	2 159m
S&J Land Holdings Ltd	SJL	Jun	Jun 2006 (Final)	28m
Sable Holdings Ltd	SBL	Jun	Jun 2006 (Final)	152m
Siyathenga Property Fund Ltd	SYA	Jun	Jun 2006 (Final)	843m
Spearhead Property Holdings Ltd	SPE	Jun	Jun 2006 (Final)	1 264m
Sycom Property Fund	SYC	Mar	Mar 2006 (Final)	3 493m
Vukile Property Fund Ltd	VKE	Mar	Mar 2006 (Final)	2 711m

**** Companies with the trade of their shares suspended have been edited out of this list***

Appendix 4: Listed Products, Bond Exchange of South Africa

BOND EXCHANGE OF SOUTH AFRICA

Listed Products

The Bond Exchange of South Africa lists Rand denominated debt securities issued by central and local government, public enterprises and corporates. Click on the relevant section in blue to view more detail.

Click here to download an Excel sheet containing Loan Stock Listings data for the current month.

Product	Market Capitalisation
Central Government	R 411 907 823 778
Municipals	R 2 701 228 000
Parastatals / Utilities	R 42 635 812 053
Water Authorities	R 20 664 828 288
Corporates Banking Financial Services Gold Mining Transport Telecommunication	R 97 474 914 371
Dual / Inward Listing	R 40 800 000
Total	**R 575 425 406 489**