Research Report

Tax Legislation and Unlisted Real Estate Funds

Submitted for a Master of Science Degree in Building in the field of Property Development and Management at the School of Construction Economics and Management

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DECLARATION

I declare that the research project is my own work. The research project is submitted to complete the requirements for the Master of Science Degree in Building in the field of Property Development and Management at the School of Construction Economics and Management. It has not been submitted before to any other institution or university for a similar qualification. I further declare that I was given authorization by a panel from the ethics research committee of the School of Construction Economics and Management to carry out this research.

Signed:

31 October 2016

ABSTRACT

On the 4th of July 2013, the South African National Treasury introduced the Taxation Laws Amendment Bill. The purpose of the amendment bill was to introduce new anti-avoidance rules into the Income Tax Act No. 58 of 1962 (the Act) in order to reduce the formation of equity instruments that are falsely masked as debt instruments. The amendment bill contains sections 8F and 8FA which have unintended consequences for the real estate industry, more specifically for the unlisted real estate sector. The application of sections 8F and 8FA of the Taxation Laws Amendment Act, has been suggested to have a negative impact on the returns of unlisted real estate funds. The legislation appears to provide tax relief to real estate investment trusts (REITs) and this is perceived as grossly biased and discriminatory against unlisted real estate funds.

The Investment Property Databank (IPD) South Africa estimates the unlisted real estate market in South Africa makes up 46% of the property market. When pension funds and banks, short term and long term insurers, private investors and government are included, the unlisted real estate market is possibly larger than the listed real estate market. Despite the numerous listings of real estate investment trusts South Africa has seen over the last ten years, the listed real estate market is still in its infancy stage and accounts for a very small percentage of the property market in South Africa. This indicates the important role unlisted real estate funds play in the South African property market.

The purpose of this study is to find out whether the application of the tax legislation has had any effect on the performance of South African unlisted real estate funds. This study evaluates the investment performance of the unlisted real estate funds and real estate investment trusts (REITS) through the implementation of descriptive statistics, and the event study methodology to indicate whether there is a significant relationship in the returns of unlisted real estate funds and tax legislation.

The study finds that tax legislation imposed on South African unlisted real estate funds has had no significant impact on the return performance of unlisted real estate funds. The study also finds that the returns of unlisted real estate funds are very competitive with the listed real estate returns listed on the Johannesburg Stock Exchange.

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CHAPTER 1: INTRODUCTION OF STUDY

1.1 Introduction

On the 4th of July 2013, the South African National Treasury introduced the Taxation Laws Amendment Bill. The purpose of the amendment bill was to introduce new anti-avoidance rules into the Income Tax Act No. 58 of 1962 (the Act) in order to reduce the formation of equity instruments that are falsely masked as debt instruments. The amendment bill contains sections 8F and 8FA which have unintended consequences for the real estate industry, more specifically for the unlisted real estate sector. Section 8F covers the set of anti-avoidance rules which focuses on the characteristics relating to the instrument itself and section 8FA covers the set of anti-avoidance rules which focuses on the nature of the yield of the instrument. The effective date of the anti-avoidance rules in section 8F and section 8FA was on the 1st April 2014.

The taxation amendment bill has special significance for the unlisted real estate fund sector as the bill states that a linked unit, which comprises of a share and a debenture, in a company held by a long-term insurer, a pension fund, a provident fund, a REIT, or a short-term insurer, will be excluded from the definition of a "hybrid equity instrument" if the long-term insurer, pension fund, provident fund, REIT or short-term insurer, inter alia, holds at least 20% of the linked units in that company. Accordingly, any interest paid in respect of linked units held by the above-mentioned entities will be excluded from the application of the anti-avoidance rules. Property entities that are partially owned by pensions fund or insurers and do not meet the 20% shareholding requirement will be excluded from claiming the exemption as the entity must hold at least 20% of the linked units in that company. Unlisted real estate funds believe that sections 8F and section 8FA of the amendment bill to be discriminatory as unlisted real estate funds obtain relief, only if the funds have pension funds, short or long term- insurers who hold a minimum of 20% interest in the company.

The application of sections 8F and 8FA of the Taxation Laws Amendment Act, has been suggested to have a negative impact on the returns of unlisted real estate funds. The legislation appears to provide tax relief to real estate investment trusts (REITs) and this is perceived as grossly biased and discriminatory against unlisted real estate funds (Barnard, 2014). Unlisted

real estate funds in South Africa play an essential catalyst for the development of new listed funds, increased competition, governance and diversification of property industry players and when the unlisted real estate market size is reduced due to the reduced returns, all the benefits that the unlisted real estate funds offer to the overall property market will also reduce (Barnard, 2014).

In order to analyse the impact of sections 8F and 8FA of the Taxation Laws Amendment Act, this study attempts to measure the response of unlisted real estate investors to the introduction of sections 8F and 8FA on the 1st of April 2014. The study hypothesises that the introduction and application of sections 8F and 8FA has had a negative impact on unlisted real estate funds returns. This study will utilize an event study methodology. The objective of an event study methodology is to assess whether there has been abnormal returns made by investors due to the announcement of an event. The abnormal return, whether significantly higher or lower than normal, is the difference between the normal return which would have been realised in the absence of the event and the actual realised return which takes into account the presence of the event (Kishore and Demas, 2011). This study is significant as it provides further insight on the South African unlisted real estate sector and the drivers that contribute to the performance of returns in this real estate sector. Recent South African studies have been more focused on the listed real estate sector with little research being done on the unlisted real estate sector.

South Africa has a highly sophisticated and developed real estate market where South Africa is the only African country that appears on the FTSE EPRA/NAREIT and the S&P Global REIT index. As at June 2015, South African listed real estate companies ranked 11th out of a total of 38 countries represented on the FTSE EPRA/NAREIT global index (Akinsomi *et al*, 2016). This index tracks the performance of global listed real estate companies. On the S&P Global REIT index, the 13 South African REITS measured in the index had a combined total market cap of USD21.45Billion and as a result, South African REITS ranked 9th out of a total of 23 countries represented in this index (Akinsomi *et al*, 2016). This highlights the importance and significance of the South African real estate market in the African and global real estate market. The unlisted real estate market in South Africa is also a large market, with the Public Investment Corporation's (PIC) unlisted real estate portfolio at USD5Billion (Lowies *et al*, 2016).The Investment Property Databank IPD South Africa estimates that 54% of South Africa's real estate market is listed on the Johannesburg Stock Exchange. This means that a significant 46% of the real estate market in South Africa remains unlisted. When pension funds

and banks, short term and long term insurers, private investors and government are included, the unlisted real estate market is possibly larger than the listed sector (Barnard, 2014).

Real estate investment trusts (REITs) and unlisted real estate funds are real estate investment vehicles which offer institutional and individual investors an opportunity to invest into real estate, directly or indirectly, by purchasing shares in real estate funds. The investment from institutions and individuals in turn also provides the real estate funds the required equity to build new properties. The new properties are subsequently rented out or sold upon completion of construction. The rental or sales income received from the properties are then distributed to the shareholders in the form of dividends. There has been an enormous growth worldwide in the size and number of real estate funds in both listed and unlisted formats due to the strong performance of the real estate market (Baum and Farrelly, 2009). However over the past few years, investors have increased their investment commitments in unlisted real estate funds due to the ease of being exposed to property both in domestic and international markets and for their diversification benefits (Tomperi, 2010). Unlisted real estate funds have the desirable feature of being highly correlated to the property market, thereby providing a means to gain exposure to the direct property market. Investing specifically in unlisted real estate funds is considered to be more appealing due to the transparency and accessible nature of unlisted funds. Listed real estate funds are often considered to be more volatile in nature therefore investing in unlisted real estate funds reduces the risks that are often associated with investing in listed funds (Baum and Farrelly, 2009).

REIT legislation was introduced in South Africa primarily to regulate and improve the South African property market to an internationally competitive level (Lowies *et al*, 2016). REIT legislation was also introduced to generate a more unified tax treatment for listed real estate companies (Lowies *et al*, 2016). This has seen the listed property market grow exponentially from a market that was valued at R138.548 billion in 2006 to over R244.916 billion in 2012 (Akinsomi *et al*, 2016). The exponential growth of the listed property market is credited to a surplus of new listings of real estate funds, as well as the incredible returns achieved during the biggest property boom South Africa has ever experienced (Kulcsar, 2011). In contrast the European listed market size is valued at €450 092 million, with the Asian listed market size valued at €618 383 million and the North American listed market size valued at €524 895 million (Baum, 2008). Small unlisted real estate funds in South Africa, are estimated to be between the range of R25 billion and R50 billion if all the unlisted real estate held by pension funds and institutional organizations are not included in this amount (Barnard, 2014). In

contrast the European unlisted market size is valued at €500 562 million, with the Asian market valued at €179 458 million and the estimated value of the North American unlisted market size is €498 991 million (Baum, 2008). It is interesting to note that in the European market the unlisted real estate market is larger than the listed real estate by €50 470 million whereas in the Asian and North American markets, it is the listed real market that is larger than the unlisted real estate market. In an attempt to improve the knowledge base on the impact of tax legislation on the performance of unlisted real estate funds, the study aims to answer a key research question:

Have sections 8F and 8FA had a negative impact on unlisted real estate funds returns?

The study also seeks to answer the following questions in an attempt to answer the key research question:

1. How important are unlisted real estate funds to the real estate market in South Africa?
2. What are the consequences sections 8F and 8FA of the Taxation Laws Amendment Act, 31 of 2013 on real estate market?
3. What are the performance drivers of unlisted real estate funds

The purpose of the study is to find out the extent to which the application of sections 8F and 8FA tax legislation contributes to the performance of unlisted real estate funds. This will be done by cross-examining and evaluating both; the literature and studies that have been carried out with regards the performance of unlisted real estate funds with special reference to sections 8F and 8FA of Taxation Laws Amendment Bill in South Africa and the effect the legislation has on the performance of unlisted real estate funds. This research is important as it provides insight into the South African unlisted real sector which play an essential role in the South African real estate market and because there is limited research done on unlisted real estate funds in South Africa

The study will focus only on research conducted globally and locally on unlisted real estate funds. This study will try to find a link between the tax legislation and the performance of unlisted real estate funds. Real Estate Investment Trusts will be discussed in the study to highlight the influence REIT's have on Unlisted Real Estate Funds. More specifically, the study will look at section 8F and 8FA of Taxation Laws Amendment Bill which is assumed to have direct influence on the performance of unlisted real estate funds. The delineations of

the study are South Africa, unlisted real estate funds and sections 8F and 8FA of the Taxation Laws Amendment Act, 31 of 2013.

The research objectives for the study are:

1. To examine unlisted real estate funds and evaluate the importance of unlisted real estate funds in the real estate market
2. To examine sections 8F and 8FA of the Taxation Laws Amendment Act, 31 of 2013 and the application consequences the legislation has on unlisted real estate funds.
3. To identify the suitable measurement scales for the performance of unlisted real estate funds.
4. To examine the effect of sections 8F and 8FA of the Taxation Laws Amendment Act, 31 of 2013 has on the performance of unlisted real estate funds.

The aim of the study is to highlight the importance of unlisted real estate funds in the South African real estate sector. To achieve the aim of this study, the study first reviews the literature on the effect of government policies on the performance of real estate funds. The study will then collect data and an event study methodology will be utilized to assess whether there has been any abnormal gains, higher or lower than normal, made by unlisted real estate funds since the introduction and application of the tax legislation in April 2014. The study will finally present the conclusions of the study.

Chapter 1 has introduced the purpose and the background of the study. The next chapter will critically review the literature around unlisted real estate funds and the tax legislation that effects the funds. The literature review will also review literature regarding the performance of the funds.

CHAPTER 2: LITERATURE REVIEW

The literature review will first extensively review the new Taxation Laws Amendment Bill which has special significance to the unlisted real estate sector. The literature review will then review unlisted real estate funds and the performance of unlisted real estate funds. The literature review will finally attempt to discuss the link between the section 8F and 8FA of the tax legislation and the performance of unlisted real estate funds. As much as possible, the research aims to focus on studies conducted in the South African real estate market context.

2.1 Background

Real estate is important for a sophisticated and developed economy. Real estate provides residential security and a working environment for individuals as well as serving as an investment vehicle for individual and institutional investors (Baum, 2008). Construction of real estate is financed through equity and debt capital. This requires the presence of investment from entrepreneurs and the banking community to provide the necessary equity and debt capital required in order to produce new real estate (Baum, 2008).

Governments have the authority to affect change to the environment in which the private sector operates. Governments affect change in the private sector environment through levy taxes, subsidy provisions, law enforcements, competition regulation and environmental policies. These changes often cause reactions in financial markets. If the changes are anticipated, the reaction is weak however if the changes are sudden, this causes strong reactions (Pastor and Veronesi, 2011). The implementation of tax changes has profoundly different effects, and measuring these effects is very difficult (Romer and Romer, 2010).

Previous studies that have been conducted have examined the effect of government policies on returns and the general conclusion by researchers is that government policies implemented by the government have an effect on returns. A study done by Akinsomi *et al* (2016) took to investigate the performance of Broad Based Black Empowerment (BBBEE) compliant real estate firms on the Johannesburg Stock Exchange (JSE). The results of the study showed that BBBEE compliant firms tend to have better returns in comparison to non-BBBEE firms (Akinsomi *et al*, 2016). West and Worthington (2006) found that inflation and interest rates

were an influential risk factor in the performance of listed and unlisted property returns. The study found that a negative relationship existed between these variables and the returns of both listed and unlisted property (West and Worthington, 2006). West and Worthington (2006) also found that the listed property market is better able to absorb the shocks, such as inflation and interest rates, than the unlisted property market. In a research study performed by Rigobon and Sack (2002) to estimate the response of asset prices to monetary policy, the results revealed that an increase in short-term interest rates has a negative impact on stock prices. The financial markets are influenced greatly by monetary policy consequently having the knowledge of the sensitivity of asset prices to monetary policy is important as it allows institutions and individuals in making effective investment decisions (Rigobon and Sack, 2002).

Abdo and Fisher (2007), conducted a research study seeking to find empirical evidence that good corporate governance will result in better financial performance of companies listed on the Johannesburg Stock Exchange (JSE). The results indicated that there was in fact a positive relationship between corporate governance and the performance of JSE listed companies. The share price returns of the companies under review showed a positive correlation to corporate governance (Abdo and Fisher, 2007). The impact of government intervention in financial markets was examined by Hetzel (2009) to find out whether or not government intervention provided stabilization or destabilization in financial markets. Hetzel (2009) concluded that government intervention in financial markets is a natural response to look for culprits in financial markets.

Pastor and Veronesi (2011) developed a simple asset pricing model to determine the effects in changes in government policy on stock prices. The model predicts that stock returns should on average be negative when announcements on policy changes are made. The model also predicts that, should the uncertainty about the policy changes be large, then the negative returns will consequently also be large. A research study with particular relevance to this current study done by Sialm (2009) on tax changes and asset pricing showed there is an economically and statistically significant relation between before-tax abnormal asset and effective tax rates. The aim of the study was to investigate whether changes in investment tax rates had any impact on US equity prices. While numerous studies have been conducted on the performance of listed real estate returns and the factors that influence the performance of real estate returns in South Africa, there is very limited research done on unlisted real estate returns. This study has the intention of contributing more knowledge on the subject of unlisted real estate funds in South Africa and their importance to the overall South African real estate market.

2.2 Tax Legislation: Section 8F and 8FA

On the 4th of July 2013, the South African National Treasury issued the Taxation Laws Amendment Bill to regulate the hybrid debt instruments more closely. The purpose of the amendment bill was to introduce new anti-avoidance rules into the Income Tax Act No. 58 of 1962 (the Act) in order to reduce the formation of equity instruments that are artificially disguised as debt instruments. The effective date of the anti-avoidance rules in section 8F and section 8FA was on the 1st April 2014. The amendment bill contains section 8F, which centres on the nature or features of the debt instrument itself, and 8FA which centres on the yield of a debt instrument.

A hybrid debt instrument is a loan agreement which is being treated as an equity agreement (Jackson *et al*, 2015). The previous section 8F stated that a debt instrument was a hybrid instrument if, the debt was convertible or exchangeable for shares at the instance of the issuing company or the holder of the debt instrument, within three years from the date it was issued. The debt changed into equity due to the convertibility characteristic. The new section 8F of the Act has a much broader definition and contains a criteria which has to be satisfied in order for debt instrument to be classified as a hybrid debt instrument (Makola and Areias, 2013). The new section 8F of the bill defines a hybrid debt instrument as follows:

- The company, in that year of assessment, is entitled to convert or exchange that amount for shares in that company or in any other company that forms part of the same group of companies as that company; or
- The obligation to pay an amount in respect of that instrument is conditional upon the company being technically solvent or
- The company owes the amount to a person in relation to the company, including a 20% shareholder, and the company is not obliged to redeem the instrument within 30 years from the date of issue of the instrument, unless the instrument is payable on demand.

If the debt instrument satisfies the criteria and is deemed to be a hybrid debt instrument, then any interest incurred by the company is not deductible and the company will be liable for dividends tax on the interest. This is defined as dividend *in specie* (Makola and Areias, 2013).

Section 8FA is concerned with the amounts paid in relation to an instrument, regardless of whether the instrument is deemed to be a hybrid debt instrument or not. The section looks at the type of interest paid on any interest bearing debt and the interest is categorised as hybrid interest. If the interest is categorised as a hybrid interest, then the interest is deemed to be dividend *in specie* and is not deductible in the hands of the company. The recipient of the interest will be deemed to have received a dividend *in specie* and the company will be liable for dividends tax (Jackson et al, 2015).

The introduction of the new sections 8F and 8FA has special significance for unlisted real estate funds as the bill states that a linked unit (shares and debentures) in a company held by a long-term insurer, a pension fund, a provident fund, a REIT, or a short-term insurer, will be excluded from the definition of a "hybrid equity instrument" if the long-term insurer, pension fund, provident fund, REIT or short-term insurer, inter alia, does not hold at least 20% of the linked units in that company (Barnard, 2014). Accordingly, any interest paid in respect of linked units held by the above-mentioned entities will be excluded from the application of the anti-avoidance rules. Therefore, property entities that are partially owned by pension funds or insurers and do not meet the 20% shareholding requirement will be excluded from claiming the exemption (Makola and Areias, 2013). Unlisted real estate funds believe that sections 8F and 8FA, of the amendment bill, to be discriminatory as unlisted real estate funds obtain relief, only if the funds have pension funds, short or long term insurers who hold a minimum of 20% interest in the company (Barnard, 2014).

Property taxes are an important fiscal instrument for a developing country. Property taxes are financial burdens imposed by a government on property developers, owners or occupants. Property taxes are generally charged to raise income for government, to fund infrastructure for a development or community and for land use planning (Chan and Chen, 2011). These taxes are known as infrastructure contributions in Australia, infrastructure charges in the UK and development impact fees in the USA. Taxes are charged at three levels of government: national; provincial and local level. Taxes that are levied at the national level are taxes affecting property development and these include income tax, capital gains tax (CGT) and goods and services tax (GST). These taxes are applied throughout the country. Land tax and stamp duties are charged by the provinces and at local level taxes are imposed by local councils to provide and maintain infrastructure (Chan and Chen, 2011).

South African REITs have a lot of tax advantages more especially capital gains tax where REITs are exempt from paying capital gains tax where tax is levied on the capital gain made on of any asset however unlisted real estate funds do not share the same tax advantage. The tax advantages means an unlisted real estate fund is more likely to sell assets or portfolios to listed groups rather than to other unlisted real estate funds as listed real estate funds may be willing to pay more for a portfolio due to the REIT tax advantages as well as its ability to raise capital more easily (Lowies *et al*, 2016). In a study performed by Kishore and Demas (2011) where an examination of the wealth effect of REIT shares due to the introduction of SARBANES Oxley Act was carried out showed that the SARBANES Oxley Act had affected REIT shareholder wealth. The SARBANES Oxley Act 2002 required all publicly listed companies to meet a significant increased compliance requirement. (Kishore and Demas, 2001). Howe and Jain (2004) also examined the effect is the introduction of the REIT Modernisation Act (RMA) of 1999 on REIT shareholder wealth and the study found that the REIT Modernisation Act has a positive effect on the REIT shareholders wealth.

2.3 Unlisted Real Estate Funds in South Africa

An unlisted real estate fund is a private investment vehicle which comprises of direct property with the aim of providing direct property total returns (Farrelly and Matysiak, 2012). Corgel and Gibson (2008) described unlisted real estate funds as a form of "unlisted REITs" because investors adhere to all the rules of listed real estate funds except for not listing the shares on the stock exchanges. Therefore it can be reasoned that unlisted real estate funds are property investment structures that function the same as listed real estate investment trusts without the risks associated with being listed on the stock exchanges.

There are two main forms of unlisted real estate funds, primarily balanced funds and specialist's funds (Farrelly and Matysiak, 2012). Balanced funds are real estate funds that are diversified through exposure across property type and geography. Specialists' funds are real estate funds which are focussed more on the property type. In order to assist investors in evaluating the characteristics of real estate funds the real estate industry has adopted the core, value-added and opportunity fund style classifications. Core funds are funds with low or no gearing. Core funds operate within a well-defined geography with the aim of delivering

benchmark market returns. Value-added funds offer more value through re-letting empty and refurbishment work. Opportunity funds are higher risk funds with high levels of gearing which offer greater returns. These funds operate within a broadly defined geography (Baum, Fear and Colley, 2012). Financial leverage and development activity are some of the factors that determine the style of an unlisted real estate fund. Developed markets such as Europe, North America and Australia have a tendency to prefer core funds whereas opportunistic funds are mostly preferred in most developing markets (Baum, Fear and Colley, 2012).

Unlisted real estate funds usually have an investment strategy defining the parameters in which the fund will invest in. These parameters include the geographic scope of the fund; the sector in which the fund has interest in and the desired rate of return (Tomperi, 2008). Unlisted real estate funds typically have a fundraising period where the investor signs a subscription document committing to invest a specific sum of money in the fund. The sponsoring organisation performs all the duties and responsibilities required to manage the fund and in making investment decisions. In doing so, the sponsoring organisation acts as the main partner of the fund while investors become partners with limited liability (Tomperi, 2010). Corgel and Gibson (2008) state that the shares of private equity real estate funds are sold at a fixed price throughout the holding period of the investor, this is a key characteristic of unlisted real estate funds that distinguishes unlisted real estate funds from listed real estate funds.

Unlisted real estate funds have become the preferred real estate investment vehicle for institutional investors due to the diversification benefits and the exposure to property domestically and internationally (Farrelly and Matysiak, 2012). Marcato and Tira (2010) similarly reinforce that institutions and individuals prefer unlisted real estate funds because of diversification benefits, low transaction costs and liquidity of shares. Investors consider the fixity of the shares to be a great benefit of unlisted real estate funds as the volatility of the listed real estate funds is undesirable and provides less security (Corgel and Gibson, 2008). The Investment Property Databank (IPD) South Africa estimates the unlisted real estate market in South Africa makes up 46% of the property market. When pension funds and banks, short term and long term insurers, private investors and government are included, the unlisted real estate market is possibly larger than the listed real estate market (Barnard, 2014). Despite the numerous listings of real estate investment trusts South Africa has seen over the last ten years, the listed property market is still in its infancy stage and accounts for a very small percentage of property in South Africa (Rambhai, 2015). This indicates that unlisted real estate funds play

a vital role in the South African property market. Unlisted funds play a vital role in the development of new listed funds as well as increasing the competition and diversification of investors in the South African property market (Barnard, 2014).

According to a conference paper written by Rambhai (2015), during the period of 1985 and 1995, life insurance companies and pension funds invested 10 to 15% of total assets invested in South African unlisted real estate. The South African real estate market was severely affected due to high interest rates when the short term interest rates rose to 25% and the long term interest rates rose to 20%. Investors further had difficulty in exiting the market due to the lack of liquidity of real estate. The South African listed real estate had yields of 18.2% which was more attractive than the yields from unlisted real estate. This was the beginning of an incredible period for real estate returns.

The interest rates fell from 25% to 9%, real estate yields compressed from 18.2% to 5.5%, gearing was introduced at 30 to 40% and better returns were being delivered. The 21.5% return that the property sector has delivered over the past 10 is a phenomenon that will not repeat again (Rambhai, 2015). The unlisted real estate market is predicted to be the best performing asset class over the coming years on a risk adjusted basis. Unlisted real estate investments have higher yields than the listed real estate market. As investors do not trade in and out stock in unlisted real estate markets, the market experiences low volatility (Rambhai, 2015).

2.4 Performance of Unlisted Real Estate Funds

A range of measurement scales are used to measure the performance of unlisted real estate funds. This chapter of the literature review will examine the different measurement scales other studies have applied in measuring the performance of unlisted real estate funds.

In a study done by Tomperi (2010) on the performance of unlisted real estate funds, the study adopted the internal rate of return (IRR) as the standard to measure the unlisted funds' performance and was the key indicator in the study. The study used IRR as the standard measure as IRR takes into account the timing of the cash flows and values shorter investment periods over longer holding periods assuming equal exit values. Multiple regression analyses were executed to analyse the impact of fund size and sequence number on fund performance and Tomperi (2010) found that the size of the fund is positively correlated to internal rate of

return, while the sequence number is negatively correlated to the internal rate of return. Van Den Heuvel and Morawski (2014) also observed the characteristics that influence the performance of unlisted funds specifically total returns; fund volume; leverage; liquidity; management costs; geographical allocation and sector allocation. A panel regression analysis was performed on the selected sample of funds, where a combination of the investment style; size of the fund and the overall economy are identified as the key performance drivers and impact the total returns of unlisted funds (van den Heuvel and Morawski, 2014).

The geographical and property sector allocations were perceived to be of importance for real estate investments as were gearing and distribution yields however the results from the study were inconclusive on whether or not geographical allocation and sector allocation do have an actual influence on the performance of funds (van den Heuvel and Morawski, 2014). Lin and Yung (2004) establish that the size of fund net asset has a significant impact on the total returns. This implies that larger non-listed funds have better returns than smaller non-listed funds. A possible explanation for this is that large funds have better research and have more resources to employ better fund managers, over and above the economies of scale. Leverage was also found to positively influence the performance of fund returns and revealed that liquidity had no significant influence on the performance of unlisted funds (van den Heuvel and Morawski, 2014). Management costs were found to have a severely negative impact on the on the performance of funds however there is little evidence that expense ratio, management tenure have any concrete effect on the returns of a real estate fund (Lin and Yung, 2004).

An essential factor that needs to be addressed when analysing the performance of a real estate fund is whether the returns of the funds have been driven through beta (risk taking activities) or alpha (manager performance). Many fund managers receive a performance fee based on the returns achieved by the funds therefore it is imperative for investors to determine whether fund managers have received performance fees based on the risks taken by mangers in generating the returns or whether the mangers have been rewarded for continuously delivering higher returns taking account of risk (Baum, Fear and Colley, 2012). Baum and Farrelly (2009), found no evidence that managers can persistently generate alpha (manager performance), however evidence is found that beta (risk taking activities) is the main performance drivers. In a study done by Kishore and Demas (2011), an event study approach was used to examine the wealth effect of REIT shares due to the introduction of the SARBANES Oxley Act by assessing whether there has been any abnormal returns,

significantly higher or lower than normal, made by the shareholders due to the implementation of the SARBANES Oxley Act.

This study recognizes that there are a numerous factors that influence the performance of unlisted real estate funds. However due to the new tax legislation that was introduced in South Africa and the role the legislation plays in unlisted real estate funds, this study seeks to find out whether the tax legislation has had any impact on the performance on unlisted real estate funds.

In order to analyse the impact of the tax legislation on the performance of unlisted real estate funds, this study will adopt the similar framework that was used by Kishore and Demas (2011) where an event study was used to assess whether there was any abnormal returns made after the implementation if the SARBANES Act. The abnormal return is the difference between the normal return, which would have been realized in the absence of the Act, and the actual return, which is the return that is realized after the Act is implemented.

2.5 Discussion and Analysis

The literature review has showed how unlisted real estate funds in South Africa play an important role in the South African infrastructure and therefore are necessary for the property market and the economy as a whole.

The introduction of the real estate investment trusts (REITs) in South Africa has seen a considerable number of unlisted real estate funds listing on the Johannesburg Stock due to the many benefits listing on the stock exchange provides, in particular tax benefits. The perception of real estate investment trusts being regarded as more important than unlisted real estate funds is further reinforced by the introduction of the new Taxation Laws Amendment Bill (DTLAB). The amendment bill is believed to be discriminatory as unlisted real estate funds obtain relief, only if the funds have pension funds, short or long term insurers who hold a minimum of 20% interest in the company.

Real estate investment trusts (REITs) are a widely welcomed structure in the South African real estate market. However unlisted real estate funds also play an important role in the South African Real Estate and precaution should be taken in not alienating these funds. The

literature review has studied the literature on unlisted real estate funds and the performance of real estate funds. A review was also done on section 8F of the Income Tax Act No. 58 of 1962 to explain the relationship between the legislation and the performance of unlisted real estate funds. Chapter 3 will discuss the procedure in which the study will answer the research question that is posed in chapter 1.

CHAPTER 3: RESEARCH DESIGN AND METHODOLOGY

This chapter of the study contains clear objectives for the study and describes the method in which data was collected. Ethical issues and the constraints that was encountered in the collection of the data will also be discussed in this chapter.

3.1 Research Philosophy

Epistemology provides a philosophical background for deciding what kinds of knowledge are legitimate and adequate. An interrelationship exists between the theoretical position adopted by the researcher, the methodology and methods used, and the researcher's view of the epistemology. Having an epistemological perspective is important as it helps to clarify the structure of the research such as the type of data that will be gathered, from where, and how the data will be interpreted. Choosing a research philosophy will also help the researcher to recognize which designs will work and which will not, for a given set of objectives (Gray, 2011). There are three types of epistemological perspectives that a researcher can adopt: objectivism, constructivism and subjectivism.

The objectivist epistemology holds that there is an objective reality 'out there' therefore research is about discovering this objective truth and researchers should attempt to not include their own feelings and values. The constructivism epistemology holds the view that truth and meaning do not exist in some external world, but are created by the subject's interactions with the world. And finally, subjectivism epistemology holds the view that meaning does not emerge from the interplay between the subject and the outside world, but is imposed on the object by the subject (Gray, 2011). This study has taken on the objectivist epistemology and the theoretical perspective closely linked to objectivism is positivism which argues that reality exists external to the researcher and must be investigated through the rigorous process of scientific inquiry. Positivism argues that the social world exists externally to the researcher, and that its properties can be measured directly through observation (Gray, 2011). Only phenomena that can be observed will lead to the production of credible data (Saunders et al, 2012). To collect data, existing theory may be used to develop hypotheses. These hypotheses will be tested. The results will either confirm or prove

false the hypotheses leading to further development of theory and further research (Saunders et al, 2012). The argument for positivism philosophy argues that reality consists of what can be seen, smelt, touched and heard. Positivists claim that true belief is grounded in what can be perceived and that what is perceived is derived from a value-free, independent reality (Ryan et al, 2002). The philosophy also argues that the study should be based upon scientific observation as opposed to philosophical speculation (Gray, 2011).

When undertaking research the important question arises of whether the researcher should begin with theory, or the theory itself should result from the research? This is done through inductive or deductive reasoning. The deductive approach tests a hypothesis, following which the theory is confirmed, refuted or modified. This is done through testing ideas through empirical observation or experimentation (Saunders et al, 2012). For the inductive approach, data is collected, after which the data is analysed to see if any patterns emerge that suggest relationships between variables. This study has conducted a research study that combines both the deduction and induction research approaches. There is extensive literature on unlisted real estate funds and the performance of unlisted real estate funds consequently a theoretical framework can be defined and a hypothesis leads to a deduction research approach (Saunders et al, 2012). However there is limited research on the new taxation laws and consequently, limited research on the relationship between tax legislation and the performance of unlisted real estate funds. It is therefore more suitable for an inductive research approach to be used by generating data and analysing and reflecting upon what theoretical themes the data is suggesting. Through the inductive research approach, plans are made for data collection, after which the data is analysed to see if any patterns emerge that suggest relationships between the variables. From these observations it may be possible to construct generalizations, relationships and even theories (Gray, 2011).

3.2 Methodology

The research design for a study can either be qualitative, quantitative or a combination of both methods. Quantitative research is based on the measurement of quantity or amount. The result of this type of research is essentially a number or a set of numbers. Quantitative research usually begins with the collection of data based on a theory or hypothesis or experiment followed by the application of descriptive or inferential statistical methods

(Rajasekar et al, 2013). Quantitative research is conducted through methods such as questionnaires and structured interviews. The basic characteristics of quantitative research are:

- It is numerical, non-descriptive, applies statistics or mathematics and uses numbers.
- It is an iterative process whereby evidence is evaluated.
- The results are often presented in tables and graphs.
- It is conclusive.
- It investigates the what , where and when of decision making

Qualitative research explores attitudes, behaviour and experiences. This type of research is concerned with qualitative phenomenon involving quality (Rajasekar et al, 2013). Qualitative research is conducted through methods such as interviews, case studies and focus groups. The basic characteristics of qualitative research are:

- It is non-numerical, descriptive, applies reasoning and uses words.
- Its' aim is to get the meaning, feeling and describe the situation.
- Qualitative data cannot be graphed.
- It is exploratory.
- It investigates the why and how of decision making.

This study has used a quantitative research design. Quantitative research is commonly associated with the positivism philosophy. It is applicable to phenomena that can be expressed in terms of quantity (Kothari, 2004). Quantitative research examines relationship between variables and analysed with the use of statistical techniques (Saunders et al, 2012). Quantitative research generates statistics through the use of large-scale survey research, using methods such as questionnaires or structured interviews (Dawson, 2002). Where quantitative research design is generally related with a deductive approach to test theory using collected data, an inductive approach can also be used in a quantitative research design where data is used to develop theory (Saunders et al, 2012). Quantitative research is primarily linked with experimental and survey research strategies. This study will use a survey research strategy. The survey strategy allows the researcher to collect quantitative data which can be analysed using descriptive and inferential statistics. The data collected using a survey strategy can be used to suggest possible reasons for particular relationships between variables and to produce

models of these relationships (Saunders et al, 2012). The objectives of the study are summarised in Table 1 as follows:

OBJECTIVES	STRATEGY	PURPOSE
To examine unlisted real estate funds	What sectors is the real estate fund exposed to? Is the real estate fund a balanced or a specialist fund? Type of investor who invests in the fund? Does the fund receive any tax benefits from the government?	Evaluate the importance of unlisted real estate funds in the real estate market
To examine sections 8F of the Taxation Laws Amendment Act, 31 of 2013 and	Is the implementation of section 8F of Taxation Laws Amendment Bill considered to be bias and discriminatory against unlisted real estate funds?	The application consequences the legislation has on unlisted real estate funds.
To identify the suitable measurement scales for the performance of unlisted real estate funds.	How is the performance of the fund measured? What influences the performance of the fund in question?	Characteristics of an optimally performing unlisted real estate fund
To examine the effect of sections 8F of the Taxation Laws Amendment Act, 31 of 2013 has on the performance of unlisted real estate funds.	Has the implementation of section 8F of Taxation Laws Amendment Bill have any effect on the performance of the fund?	To find out if a relationship exists between the tax legislation and unlisted real estate funds

Table I: Objectives of study and strategy to achieve objectives

A time horizon also needs to be selected in order to determine whether the research will be done at a particular time studying a particular phenomenon, defined as cross-sectional time horizon, or be a representation of events over a given period studying change and development and this is defined longitudinal time horizon. This research is a cross-sectional study due to time constraints as this research is done for academic courses.

3.3 Data Sample and Collection

There are two main types of samples, probability samples and purposive samples. In probability samples all participants within the research population have a specifiable chance of being selected. This type of sample is used if the researcher wishes to explain, predict or generalise to the whole research population. Purposive samples are used if description rather than generalisation is the goal. It is not possible to specify the possibility of one participant being included in the sample in this sample type (Dawson, 2002). This study has adopted a probability sample type. The sample technique that was used is the systematic random technique due to insufficient time and money to collect data from all unlisted real estate funds in South Africa. This technique is suitable for all sample sizes, accurate and easily accessible. The study has used secondary data obtained from census; continuous and regular surveys and ad hoc surveys to obtain performance data as the necessary data cannot be directly obtained from the funds.

The empirical analysis of this study is based on a sample of South African unlisted real estate funds between the years 2003 - 2015. The study utilises secondary data to achieve its objectives. The sample covers 23 unlisted real estate funds with annual total returns for each fund listed on the Citywire online database in March 2016. The Citywire online database contains information of funds with respect to performance data, fund managers, inception years and value of the real estate funds. Additional performance data was collected from the Equinox, Morning Star, Catalyst Fund Managers and the Mcgregor websites. These websites offer information that provide potential investors with the past returns of the funds. Unlisted real estate funds are not traded on the Johannesburg Stock Exchange and this poses as a challenge in studying the performance of unlisted real estate funds due to the unavailability of data. In addition to the data collected for the 23 unlisted real estate funds, the Real Estate

Investment and Services Index is used in analysing the returns of unlisted real estate funds. The Real Estate Investment and Services Index is traded on the Johannesburg Stock Exchange and the index measures companies that invest directly or indirectly in real estate through development, investment or ownership. The index excludes real estate investment trusts and similar entities, which are classified as Real Estate Investment Trusts. The index also measures companies that provide services to real estate companies but do not own the properties themselves and includes agencies, brokers, leasing companies, management companies and advisory services. A stock index or stock market index is a measurement of the value of a section of the stock market. In order to ensure the accuracy of the data, a comparison of the information is performed.

The general rule in research is that the larger the sample the more accurate the results will be, however this study is restricted by time and money (Dawson, 2002). Daily price returns on unlisted real estate funds are used in analysing the response of the unlisted real estate returns to the introduction of section 8F and 8FA on the 1st of April 2014. Concurrent daily price returns on the Johannesburg Stock Exchange (JSE) Top 40 Index is used in estimating the market parameters. The Top 40 index is made up of the 40 biggest companies on the JSE, ranked by market capitalisation, or market cap. The market cap of a company is the total number of outstanding shares multiplied by the current share price. The Top 40 index is a fair reflection of what happens to the South African stock market as a whole, because even though it contains only 40 out of the roughly 400 shares listed on the JSE, it represents over 80% of the total market cap of all JSE listed companies.

Preceding studies that have been completed utilised a series of different methodologies in collecting and analysing the data. Studying the performance of unlisted real estate funds is a challenge as there is a lack of data available to the public as the unlisted real estate funds are private by nature. Tomperi (2010) used different model specifications to study the funds and sponsor-related factors' correlation with fund performance. The analyses performed was based on a sample of value-added and opportunistic unlisted real estate funds. In a study to examine the performance trends of listed and unlisted real estate funds in South Africa, Akinsomi *et al* (2016) and Lin and Yung (2004) employed a capital asset pricing model (CAPM) to evaluate the performance of the funds. Akinsomi *et al* (2016) also utilised the Sharpe ratio, which is the adjusted return per unit of risk, as a unit of measure for the performance. In a research study aimed at determining the impact of monetary policy on asset

prices Rigobon and Sack (2002) employed a technique called identification through heteroscedasticity. This technique depends on looking at changes in the co-movements of interest rates and asset prices when the change of one of the shocks in the system is known to shift. Similarly Sialm (2009), conducted a research study on the impact of tax changes on asset prices. Sialm (2009) studied the time-series relation between effective tax burdens on equity securities and the aggregate equity valuation levels. Sialm also investigates the cross sectional relation between risk-adjusted stock returns and tax burdens on stock portfolios based on the model of Brennan (1970).

To investigate the relationship between the performance of unlisted real estate funds and the tax legislation, an event study methodology is used. The event study methodology is a widely used methodology in corporate finance research as it is designed to investigate the effect of an event on a specific dependant variable. The aim of an event study methodology is to determine whether there is an abnormal stock price effect linked with an event. In an event study, the returns of a company after an event has occurred is compared with the firm's normal returns that would have occurred in the absence of the event and the difference between the two is examined and attributed to the event (Kishore and Demas, 2011). The key assumption of the event study methodology is that the market must be efficient so that the effects of the event will be reflected immediately in the stock prices of a company (Woon, u.d).

Based on the literature review of sections 8F and 8FA of the tax legislation, it is hypothesized that the application of sections 8F and 8FA of the Taxation Laws Amendment Act has had a negative impact on unlisted real estate funds returns, and the negative impact of the legislation would have taken place after the legislation became effective on the 1st of April 2014. The procedure of an event study comprises of identifying the event in question; identifying estimation, event and post event windows; estimating the parameters using data in estimation window; measuring abnormal returns in the event period and measuring the aggregate abnormal returns.

Step 1: Identifying the Event

The 1st of April 2014 is considered as the event date of the analysis of the study. The event under investigation is the application of the section 8F and 8FA tax legislation on unlisted real estate funds.

Step 2: Estimation, Event and Post Event Windows

The size of the event window is subjective as it may vary according to the market and events being examined. The estimation window must include the total share price reaction to the announcement whilst excluding price fluctuations from other announcements (MacKinlay, 1997). A post event period that is too short will not be able to show the full economic effects of the event in question while a post event period that is too long will not be accurate as it might include other events occurring in the same period (Woon, u.d). A window of 10 working days post event was determined as the event period for this study as it is believed to be enough time for most of the investors to make any decisions relating to their investments because of the introduction of sections 8F and 8FA of the Tax Amendment Act.

Step 3: Estimate Parameters using Data in Estimation Window

Next, the estimations of the normal return market parameters will have to be made in order to calculate the expected returns during the event period (Kishore and Demas, 2011). Prior daily returns to the event date are used to estimate the normal return parameters for the market model where the alpha (y-intercept) and beta (slope) of the prices (Woon, u.d). The estimation period for daily returns, range from 100 to 300 days (Kishore and Demas, 2011). For this study, 100 working days excluding weekends prior to the event was used to estimate the normal return market parameters. The 100 working days selected takes the analysis period back to the 21st of October 2013. The market model is defined as follows:

$$E(R_{it}) = a_i + B_i R_{mt}$$

Where:

$E(R_{it})$ = The expected return on security i in period t

a_i = The intercept term (alpha coefficient)

B_i = The regression slope (beta coefficient)

R_{mt} = The return on the market in period t

Step 4: Measure Abnormal Returns in the Event Window

The abnormal returns are calculated by deducting the expected returns from the actual returns to get the abnormal return on each day in the event window. The model is defined as follows:

$$AR_{it} = R_{it} - E(R_{it})$$

Where:

AR_{it} = The abnormal return for security i in period t (due to the event)

R_{it} = The actual return for security i in period t and (affected by the event)

$E(R_{it})$ = The expected return for security i in period t (not affected by the event)

Step 5: Aggregate Abnormal Returns

The abnormal returns over the entire period of time is added up to get the cumulative abnormal returns. The model is defined as follows:

$$CAR = \sum AR_{it}$$

Once all the abnormal returns and the cumulative abnormal returns are calculated a graph can be plotted of the abnormal return and cumulative abnormal return over the event window to check the effects of the event on the return.

3.4 Validity, Reliability and Transferability

As the study will use secondary data to meet its objectives, issues of validity, reliability and transferability need to be discussed. The data will be collected from Citywire and Mcgregor online database. The Citywire and Mcgregor online database contains information of funds

with respect to performance data, fund managers, inception years and value of the real estate funds. Additional performance data was collected from the Equinox and the Morning Star websites.

Golafshani (2003), defines reliability in quantitative research as results that are consistent over time and are an accurate representation of the total population under the study. If the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable. Rattray and Jones (2005), further supports this notion by also defining reliability as the repeatability, stability or internal consistency of a questionnaire. Validity determines whether the study actually measures that which it is intended to measure or how truthful the research results are (Golafshani, 2003).

The study addresses the issue of validity by ensuring that the secondary data that is collected measures what it intends to measure. To establish reliability, an assessment of the authority and reputation of the sources was performed. The online databases that have been used in this study to collect the data are investment databases that are well known and used by individuals and institutions for investment purposes. This would make the databases to be reliable and trustworthy and the data available on these databases to be credible.

3.5 Limitations

Unlisted real estate funds are private by nature and information such the performance of the fund is seldom available to the public. Unlisted real estate funds are not traded on the Johannesburg Stock Exchange and this poses as a challenge in studying the performance of unlisted real estate funds due to the unavailability of data. Other variables that influence the returns of unlisted real estate funds have not been included in this study.

3.6 Ethical Considerations

The ethical considerations that the researcher was aware of in the execution of the study is:

- The researcher has exercised integrity and objectivity during the duration of the study
- The researcher has taken responsibility when analysing the data and reporting the findings

- The researcher was aware of the University of the Witwatersrand goodwill and take every measure necessary in maintaining it.
- The researcher has been respectful and cautious with regards to the sensitive information the study requires.

This chapter has described the data, the data source and the research methodology and design implemented in the study. This chapter also addresses the ethical considerations and the limitations the study faces. Issues of validity, reliability and transferability are also discussed in this chapter. The next chapter presents the results.

CHAPTER 4: RESULTS

This chapter of the study presents the descriptive data of 23 South African unlisted fund returns over the thirteen year period starting in January 2003 to December 2015. The results from the event study methodology are then presented and discussed.

4.1 Descriptive Statistics

Table II provides the return statistics of the 23 selected unlisted real estate funds. When comparing the annual returns of unlisted real estate funds against the Real Estate Index, PUT Index, PLS Index, South African Listed Property Index (SAPY) and the Capped Property Index, it is evident that the returns of unlisted real funds in South Africa are in line with the returns of other South African property investment vehicles.

	UNLISTED REAL ESTATE FUNDS				**LISTED REAL ESTATE FUNDS**				
	N	Range	Mean	Std. Deviation	Real Estate	PUT	PLS	SA Listed Property	Capped Property
	No. of Funds	Statistic	Statistic	Statistic	Index	Index	Index	Index (SAPY)	Index
YEAR2003	3	7.94	9.93	4.027	n/a	n/a	n/a	n/a	n/a
YEAR2004	6	8.30	34.25	2.84	n/a	n/a	n/a	n/a	n/a
YEAR2005	11	15.30	41.23	5.17	n/a	n/a	n/a	n/a	n/a
YEAR2006	13	23.70	25.96	6.14	n/a	n/a	n/a	n/a	n/a
YEAR2007	13	15.30	20.08	5.44	2.05	22.68	28.78	26.52	18.23
YEAR2008	15	32.30	-5.31	7.55	-22.31	-9.70	-2.33	-4.47	-11.11
YEAR2009	16	32.40	13.98	7.59	7.10	18.69	12.61	14.07	12.80
YEAR2010	18	86.90	27.53	18.45	10.46	25.50	30.95	29.62	24.81
YEAR2011	21	13.70	7.39	2.63	5.17	12.19	7.73	8.93	6.91
YEAR2012	21	24.80	30.54	6.73	28.85	27.09	39.12	35.88	35.26
YEAR2013	21	29.20	9.83	6.18	8.78	4.44	9.49	8.39	13.76
YEAR2014	22	29.10	23.15	7.10	25.55	31.09	-5.48	26.64	26.73
YEAR2015	22	28.90	10.03	6.86	n/a	n/a	n/a	7.99	14.75

Table II: Descriptive Statistics: Unlisted Real Estate Funds, Real Estate Index, PUT Index, PLS Index, South African Listed Property Index and the Capped property Index.

In 2007, the average annual return for unlisted real funds was 20.08%. This return performed considerably better than the Real Estate Index which achieved a 2.05% return in the same year, whereas the PUT, PLS, SAPY and Capped Property indices performed marginally better than the unlisted funds with returns of 22.68%, 28.78%, 26.52% and 18.23% respectively. In 2014, the PLS index achieved a -5.48% return while unlisted real estate funds had an average of 23.15% with the Real Estate index at 25.55%, the PUT index at 31.09%, the SAPY index at 26.64% and the Capped index at 13.76%. This comparison of the property returns shows that unlisted real estate funds are very competitive with other property indices in South Africa with the unlisted returns achieving approximately the same returns as the listed indices and in some cases achieving better returns.

4.2.Event Study Methodology

In order to perform the event study on unlisted real estate funds, the Real Estate Investment and Services Index was used. The Real Estate Investment and Services Index is traded on the Johannesburg Stock Exchange and the index measures companies that invest directly or indirectly in real estate through development, investment or ownership. The index excludes real estate investment trusts and similar entities, which are classified as Real Estate Investment Trusts. The index also measures companies that provide services to real estate companies but do not own the properties themselves. The event study methodology will indicate the immediate effect that the introduction of sections 8F and 8FA has on the returns.

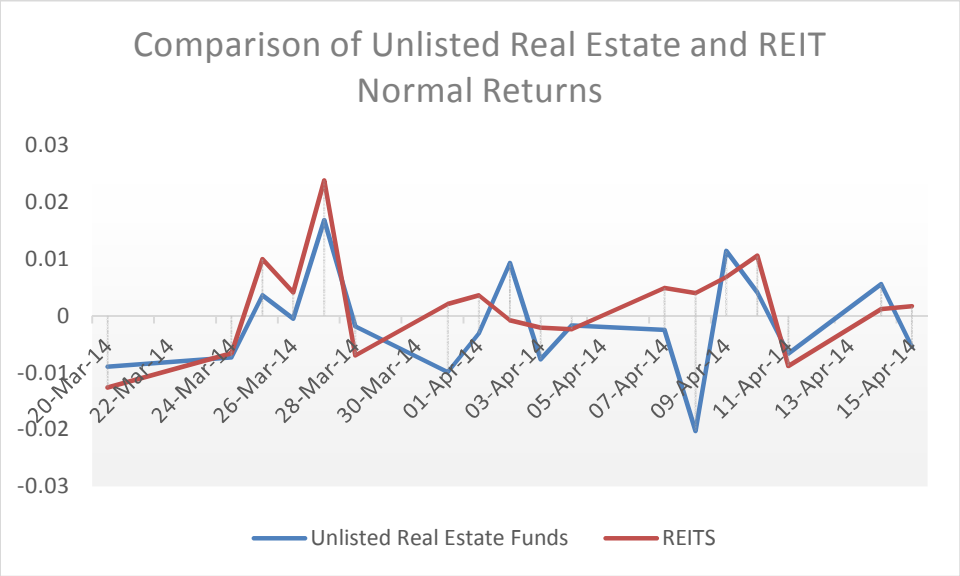

Figure 1: Comparison of Unlisted Real Estate and REIT Returns

Figure 1 compares the Unlisted Real Estate returns with the REIT returns over the event window. The comparison reveals that Unlisted Real Estate Returns track the REIT returns reasonably closely before and after the event date. The comparison also shows that during the event window Unlisted Real Estate returns were more volatile than REIT returns. The 1st of April 2014 was when sections 8F and 8FA of the Tax Amendment Act were introduced to the market and as can be seen on the graph, there was a depression in the Unlisted Real Estate returns whereas the REIT returns performed positively that day. This evidence suggests that the introduction of section 8F and 8FA has affected Unlisted Real Estate more than REITS.

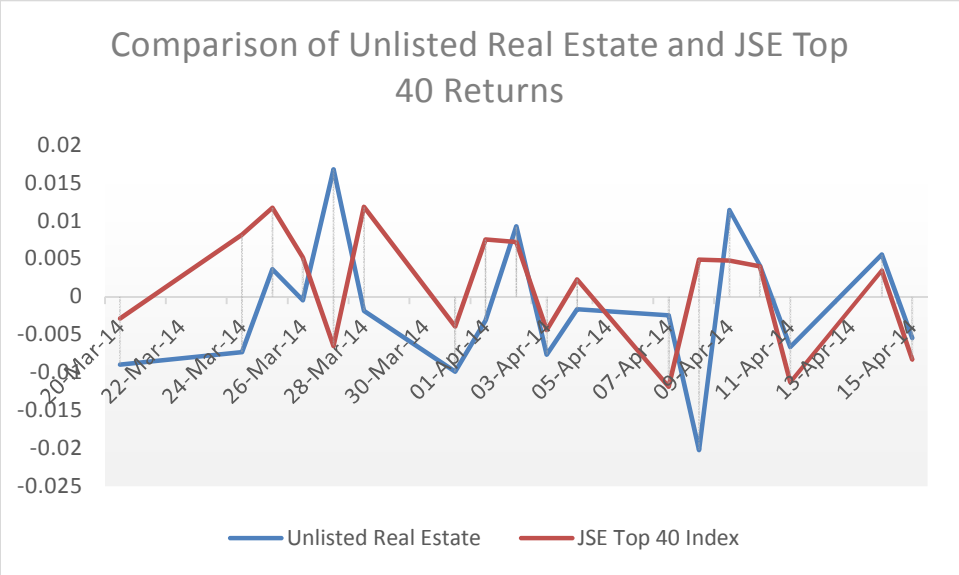

Figure 2: Comparison of Unlisted Real Estate and JSE Top 40 Returns

Figure 2 compares the Unlisted Real Estate returns with the JSE Top 40 Index returns over the event window. The JSE Top 40 Index is a good representation of the general South African market. The comparison reveals that Unlisted Real Estate tracked the JSE Top 40 relatively closely before and after the introduction of sections 8F and 8FA.

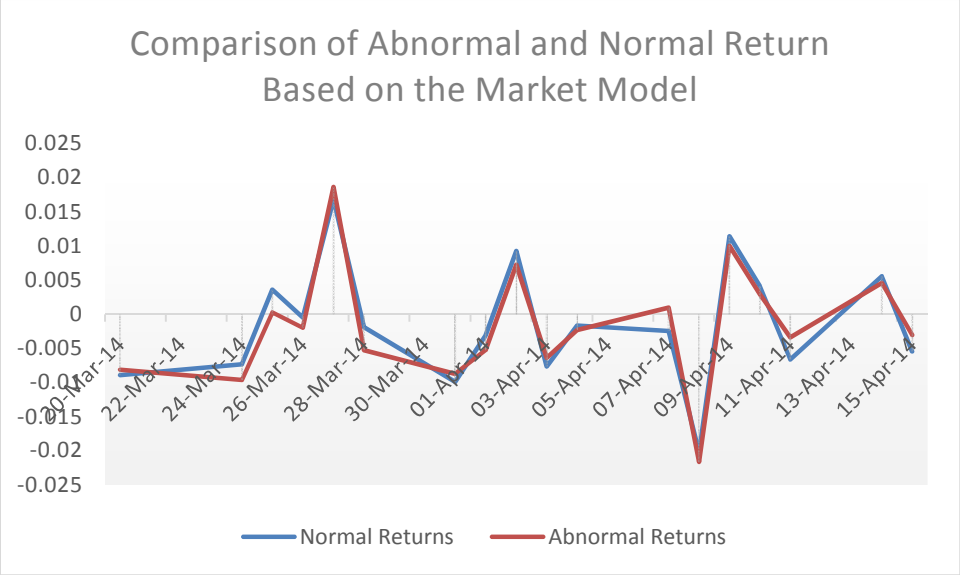

Figure 3: Comparison of Abnormal and normal returns based on the market model

The abnormal returns are the average actual realized returns of Unlisted Real Estate during the event period. Figure 3 shows that the normal and abnormal returns were volatile before and after the Tax Legislation Act. The returns dramatically reduced from the 27th of March 2014 to the 28th March 2014 and continued to reduce until the 1st of April 2014 where the returns began to increase again. The sudden sharp in the decline of returns suggests that leading up to the introduction of the Tax Legislation investors sold their investments in unlisted real estate operating funds or companies.

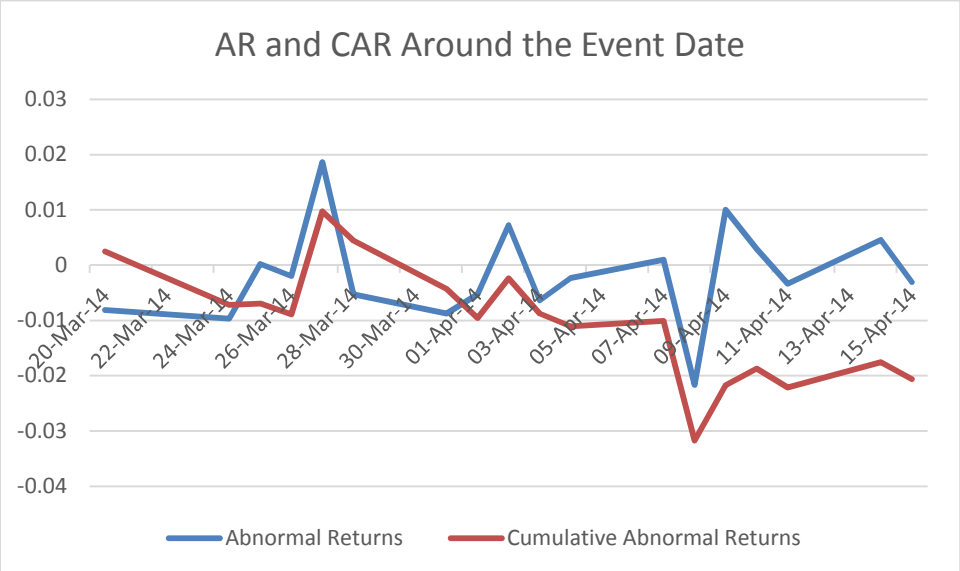

Figure 4: Abnormal Returns and Cumulative Abnormal Returns around the Event Date

The abnormal returns and cumulative abnormal returns are graphed in order to quantify the overall impact of sections 8F and 8FA on Unlisted Real Estate returns. The graph shows that the cumulative abnormal returns reduced post event, after the introduction of section 8F and 8FA, this indication suggests that the introduction of sections 8F and 8FA has affected the returns of Unlisted Real Estate Funds.

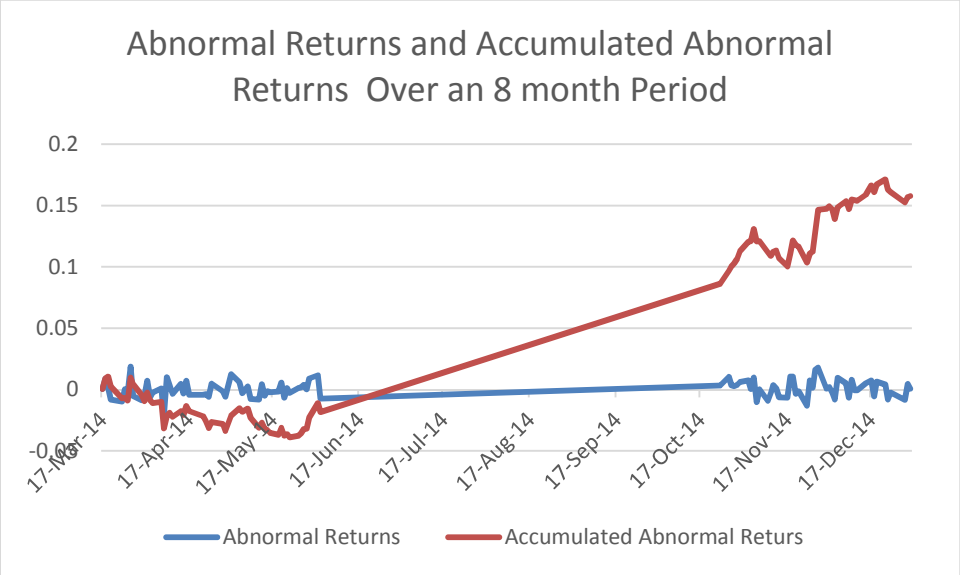

Figure 5: Abnormal returns and accumulated abnormal returns over an 8 month period

Figure 5 displays that abnormal returns and accumulated abnormal returns over an 8 month period. Over the 8 month period the abnormal returns remained stable with little sharp increases or decreases in the returns. The accumulated abnormal returns indicate an incline in the returns 8 months after the Tax Legislation was introduced into the real estate market. This evidence confirms that sections 8F and 8FA have not affected the returns of unlisted real estate funds.

CHAPTER 5: DISCUSSION AND CONCLUSION

This chapter discusses the results presented in chapter 4 and makes a conclusion on the study. This chapter will also recommend methods that future studies may use to conduct studies on this topic or similar topics.

5.1 Discussion on Findings

Based on the comparison that was performed between the average performance returns of unlisted real estate funds and the Real Estate, PUT, PLS, SA Listed Property and Capped Property indices in South Africa; it is apparent and evident that unlisted real estate funds play a vital role in the South African real estate sector. The comparison of the total average returns shows that the returns of unlisted real estate funds are very competitive with the listed real estate returns listed on the Johannesburg Stock Exchange, in that the performance of unlisted returns are in line with the listed returns and in some cases perform better than listed returns.

This comparison result strengthens Farrelly and Matysiak (2012) argument that unlisted real estate funds have become the preferred real estate investment vehicle for institutional investors due to the diversification benefits and the exposure to property domestically and internationally. Institutional and individual investors can achieve the same returns as listed real estate funds with unlisted real estate funds with without the risks associated with investing in listed real estate funds.

In order to determine whether there is a correlation between sections 8FA and 8F of the tax legislation and the performance of unlisted real estate funds, the event study methodology was performed the Real Estate Investment and Services Index is used in analysing the returns of unlisted real estate funds. The Real Estate Investment and Services Index is traded on the Johannesburg Stock Exchange and measures companies that invest directly or indirectly in real estate through development, investment or ownership. The index excludes real estate investment trusts and similar entities, which are classified as Real Estate Investment Trusts. The index also measures companies that provide services to real estate companies that do not own the properties themselves and includes agencies, brokers, leasing companies, management companies and advisory services. Sections 8F and 8FA of the tax legislation was introduced in 2014 and implemented until the end of 2015. The returns on the real estate

investment and services reduced sharply from the 27th of March 2014 to the 28th March 2014 and continued to reduce until the 1st of April 2014 where the returns began to increase again. This result could possibly indicate that there is a negative correlation between the tax legislation and the fund returns, however it should be noted that other variables that could have influenced the returns of unlisted real estate funds, during the same period, have not been included in this study. In looking at the returns of the unlisted real sector over an 8 month period, the evidence shows that sections 8F and 8FA did not have an effect on the performance of the unlisted real estate sector.

The study aimed to answer the following questions in an attempt to answer the key research question:

1. How important are unlisted real estate funds to the real estate market in South Africa?
2. What are the consequences sections 8F and 8FA of the Taxation Laws Amendment Act, 31 of 2013 on real estate market?
3. What are the performance drivers of unlisted real estate funds

All three questions were discussed in the study by means of the literature review and the empirical results presented.

5.2 Conclusion and Recommendations

This study sought to answer the main research question of whether or not the implementation of tax legislation had any influence on the performance of unlisted real estate funds in South Africa. The study aimed to answer the research question by evaluating a new tax legislation that was implemented in April 2014 and that was only applicable to unlisted real estate funds, through the use of descriptive statistics and the event study methodology. A number of studies have been done on the performance of Real Estate Investment Trusts (REITs) in South Africa since their introduction into the South African real estate market but little research has been done on the performance of unlisted real estate funds in South Africa.

Results from this study indicate that the tax legislation that is imposed on unlisted real estate funds has had no significant impact on the return performance of unlisted real estate funds.

An attempt was first made to conduct this study using questionnaires, which would have share more knowledge into the relation between tax legislation and the return performance of

unlisted real estate funds in South Africa, however due to the low response rate and a shortage of time, it was not possible. Further research should examine South African unlisted real estate funds and the variables that affect the performance of the funds through questionnaires or structured interviews for a better and more in depth understanding of South African unlisted real estate funds.

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