BEST PRACTICE RECOMMENDATIONS

1ST EDITION | JANUARY 2016

Contents

1. **SA REIT best practice committee** 4

2. **Foreword** 5

3. **General guidelines** 6

4. **Specific sector matters** 8

4.1 Revenue 8

4.2 Distributable earnings and dividend declared 9

4.3 Antecedent dividends 10

4.4 Number of shares in issue for dividend per share 11

4.5 Dividend declaration 12

5. **Ratios** 13

5.1 Cost-to-income ratio 13

5.1.1 Method of calculation 13

5.1.2 Two cost-to-income ratios 14

5.2 Loan-to-value ratio 14

6. **Accounting and financial reporting matters** 15

6.1 Investment property – fair value 15

6.2 Initial direct costs – leases 16

6.3 Development projects: 16

6.3.1 Borrowing costs 16

6.3.2 Loss of income 17

6.4 Taxation 17

6.4.1 Deferred capital gains taxation 17

6.4.2 Other deferred taxation 17

6.5 Investments in listed property or REIT securities 18

6.5.1 Valuation 18

6.5.2 Dividends received 18

6.6 Co-owned properties 19

6.7 Business combinations 20

6.8 Debt 21

6.8.1 Structuring fees 21

6.8.2 Breakage costs and gains 22

6.9 Transaction costs 23

7. **Abbreviations** 24

1. SA REIT best practice committee

Committee members:

Laurence Cohen, Hyprop (Chairman)

Nick Hanekom, Resilient

Gerald Völkel, Growthpoint

Invitees:

Heather de Jongh, KPMG

Gawie Kolbé, KPMG

Patrick Kleb, Deloitte

Trevor Derwin, Deloitte

For any questions or feedback on the BPR, please contact:

Laurence Cohen, Chairman, SA REIT Best Practice Committee or Gawie Kolbé, KPMG

SA REIT Association

www.sareit.com

contact@sareit.com

Tel + 27 11 783 2201

2. Foreward

The South African Real Estate Investment Trust Association (SA REIT) is a representative umbrella body comprised of voluntary members of South African listed REIT companies and trusts. SA REIT was established from the pre-existing Property Loan Stock Association (PLSA) and Association of Property Unit Trusts (APUT), when REIT legislation was introduced in South Africa in 2013.

One of the SA REIT's goals is to help strengthen the profile of SA's REIT sector by making the financial statements of public real estate entities in South Africa clearer, more transparent and comparable across the sector. This will improve the sector's reception among stakeholders. We hope the best practice recommendations (BPR) represent a significant first step in this direction.

The first edition of the SA REIT BPR is the culmination of discussions and meetings between members of the SA REIT's Accounting and JSE Committee (the Committee) and members of the association.

Recommendations and guidelines have been provided in the context of International Financial Reporting Standards (IFRS), JSE Limited's Listing Requirements, commonly-used financial and operating ratios, and the treatment of specific accounting and financial reporting matters in the SA REIT sector.

The BPR is an evolving document. The Committee will continue to track sector-specific developments, and update this document as changes in standards, requirements or legislation call for certain issues to be revisited. We encourage feedback from our members and other stakeholders to ensure the recommendations remain relevant and representative of the views of the SA REIT membership.

The Committee is confident the recommendations provide a good starting point to standardise and to bring a greater level of consistency in reporting among South African REITs. We believe it will move the sector forward in the areas of disclosure and governance, and positively influence how the sector is assessed and viewed by relevant stakeholders.

3. General guidelines

Compliance with best practices

SA REIT encourages full compliance with the best practice recommendations set out in this document. However, it acknowledges that in certain circumstances legal, regulatory or other restrictions may make compliance with some recommendations in this document impractical.

South African Real Estate Investment Trusts (REITs) do not have to comply with one or more of the SA REIT best practice recommendations in the following circumstances:

- When a recommendation is prohibited by a REIT's legal, regulatory or other requirements.
- When a recommendation relates to an amount or item that is immaterial.
- When compliance with a recommendation would lead to substantial additional costs in gathering information.

The recommendations included in this BPR document are for SA REIT reporting and disclosure purposes. Their overriding objective is to achieve transparent, consistent and meaningful disclosure across the SA REIT sector.

Consistent compliance with IFRS is of paramount importance to maintain the integrity of reporting in the SA REIT sector. Therefore, in all instances, recommendations made in the BPR are in accordance with IFRS, except where a particular recommendation deals specifically with distributable earnings of the REIT. The BPR does not in any way attempt to interpret any IFRS. However, in instances, where IFRS permits optionality or more than one treatment, the BPR may provide guidance as to which IFRS treatment to follow.

Distributable earnings

Some of the issues and recommendations in the BPR impact the distributable earnings of the REIT (as opposed to the IFRS financial statements). In most instances, where a particular recommendation has an impact on distributable earnings, the BPR is prescriptive as to the recommended reporting, in order to ensure comparability between REITs.

In instances where the BPR is silent as to a recommended treatment for the determination of distributable earnings, then the determination of distributable earnings follows the IFRS treatment.

One of the objectives of the BPR is to calculate an amount available for distribution on a comparable basis between REITs. The actual amount declared as a dividend is a matter for the board of each REIT.

What are the benefits to compliance?

SA REIT views the primary benefit for compliance with best practices as increased transparency, greater comparability and uniformity of reporting of relevant information across the South African REIT sector.

This supports improved public and investor confidence in the industry and stronger working relationships with regulators.

4. Specific sector matters

4.1 Revenue

Issue	Municipal cost recoveries (ie recoveries of electricity, water, rates etc.) are not accounted for consistently across the sector. Some REITs account for municipal cost recoveries on a gross basis by including them with revenue. Others account for municipal cost recoveries on a net basis by including them with property expenses, as a reduction to total property expenses.
Discussion	The correct treatment in terms of IFRS will depend on whether the REIT is acting as agent or principal when collecting municipal recoveries from tenants. If the REIT acts as agent, then municipal recoveries should be treated on a net basis and included as a set-off against municipal costs, and any under- or over-recovery included with total municipal expenses. If a REIT acts as principal, then municipal recoveries should be accounted for on a gross basis and included with total revenue. The following factors indicate that, in most instances , the REIT will act as principal for the collection of municipal cost recoveries from tenants: • Tenants contract with the landlord, not with council. The landlord bears the primary responsibility to provide services to the tenant, including water, electricity, sewage, etc. • The landlord bears the credit risk for the collection of the municipal cost recoveries from the tenants • The landlord has to bear the cost and pay the municipal expenses, whether or not the corresponding recoveries are collected from the tenants. • In some instances the landlord has some degree of latitude to determine pricing, for example by buying electricity from council at a bulk wholesale rate and on-selling to the tenant at a retail rate.
Recommendation	Revenue should be determined in line with IFRS (IAS 18). The treatment of municipal cost recoveries should be evaluated against the principal vs agent principle. The substance of the arrangement, namely the lease agreement with the tenant, will therefore have to be considered in determining the appropriate treatment. The REIT should provide an explanation of its approach to determine revenue and whether it treats cost recoveries on a gross or net basis. Unless it can be shown by reference to the lease agreement that a REIT is acting as agent for the collection of municipal cost recoveries from tenants, municipal cost recoveries should be accounted for on a gross basis and included with total revenue for the period.

	Note that the default treatment recommended here which is to include municipal cost recoveries with total revenue, will require an adjustment to the total revenue and total property expense figures when calculating the net property cost-to-income ratio and the net total cost-to-income ratio, as recommended in 5.1 below. This is since the default recommendation for the treatment of municipal cost recoveries in revenue is a gross basis, while the recommendation for cost-to-income ratios is a net basis.

4.2 Distributable earnings and dividend declared

Issue	While listed property entities in South Africa have historically presented a reconciliation between distributable earnings and accounting (IFRS) earnings, the method used to determine distributable earnings is not consistently applied across the sector.
Discussion	A consistent methodology to calculate distributable earnings is essential for the SA REIT sector to ensure comparability across the sector. This also reduces the likelihood of 'tainted' earnings, where REITs may use non-traditional sources of income, such as non-rental income, trading income and fee income or capital profits, to adjust reported distributable earnings.
Recommendation	REITs should disclose a reconciliation between distributable earnings calculated in terms of the BPR and IFRS net income. If distributable earnings are not the same as the dividend declared, then a reconciliation between distributable earnings and the dividend declared should also be disclosed (together 'the reconciliations'). Distributable earnings and dividend per share are amongst the primary measures used for reporting the results of REITs in South Africa. Therefore, the reconciliations should be included in the segment report in terms of IFRS 8 paragraph 25: "The amount of each segment item reported shall be the measure reported to the chief operating decision maker for the purposes of making decisions about allocating resources to the segment and assessing its performance." For example, distributable earnings calculated in terms of the BPR may be determined as follows: Revenue (1) Less: Straight-line rental income accrual (included in revenue) Less: Property expenses (2) Less: Other operating expenses (3) Less: Net interest (4) Plus: Distributions from equity accounted investees Plus: Dividends received or receivable (refer 6.5.2 below) Plus: Transaction costs expensed (5) (refer 6.9 below)

	Plus: Antecedent dividends (refer 4.3 below) Less: Current normal taxation Less: Non-controlling interest of the above Equals: Distributable earnings Notes: (1) Revenue comprises rental income from the investment property portfolio, distributions from the listed property or REIT securities portfolio and municipal cost recoveries. (2) Property expenses include municipal expenses or service charges. (3) Other operating expenses include head office or fund management costs. (4) Net interest includes interest paid, reduced by interest received. (5) This assumes the transaction costs were expensed as part of 'Other operating expenses' above. The above calculation reflects a typical distributable earnings calculation that would be applicable to most REITs, however the actual calculation will differ from the above in accordance with the varying circumstances affecting each individual REIT. Ordinarily, distributable earnings would exclude all those IFRS items that are traditionally not distributed, such as capital profits/losses from the disposal of investment property and fair value adjustments. If it is decided to distribute any capital items, then this fact should be disclosed, so that the market can make its own assessment of the impact that such distributions may have on the rating and outlook for the reporting REIT.

4.3 Antecedent dividends

Issue	If a REIT issues new shares at a point in time, other than at the beginning of a distribution period, the next distribution will include an element of 'antecedent' dividends. This is due to the dividend being paid on the total number of shares in issue, including the recent new issue, for the full period. In the past, some REITs determined the amount of income attributable to the newly issued shares from the last reporting date to the issue date, and accounted for this as income.
Discussion	Accounting for antecedent dividends as income is not in accordance with IFRS, neither in terms of IAS 8 – Revenue, nor in terms of the IFRS Framework for Financial Reporting.
Recommendation	The antecedent dividends form part of the cash inflow on the issue of new equity and should be recognised as such, ie as a credit to stated capital. Antecedent dividends should not be accounted for as income in the IFRS compliant statement of comprehensive income.

	Distributable earnings Not distributing the antecedent portion will result in existing shareholders being diluted, due to the payment of a dividend based on a greater number of shares in issue, without having had the benefit of the cash flow from the new issues of shares (or the risks and rewards of ownership of any investment property purchased with the issue of new shares) in the financial period to which the dividend relates. To counter this effect, the REIT may elect to add the antecedent dividend when determining its distributable earnings, thereby INCLUDING the antecedent dividend in distributable earnings. If the REIT elects to include antecedent dividends in its distributable earnings, then such treatment must be clearly disclosed, by explicit reference thereto in the reconciliation from distributable earnings to IFRS net income (refer 4.2 above).

4.4 Number of shares in issue for dividend per share

Issue	The number of shares used to determine the dividend per share for the period is often not the same as the number of shares used to determine earnings or headline earnings per share in terms of IFRS.
Discussion	This may be pertinent when there is a fresh issue of new equity during a period, resulting in an increase in the number of shares in issue. A REIT's dividend per share is usually based on the actual number of shares in issue, while the number of shares in issue for earnings and headline earnings per share are usually weighted, based on time apportionment principles, as required by IFRS. If the number of shares used to determine dividend per share is not disclosed, then users of the financial statements cannot easily reconcile the dividend per share for the period.
Recommendation	The number of shares in issue used to determine dividend per share should be disclosed.

4.5 Dividend Declaration

Issue	Real estate entities traditionally accrued for their own distributions at year end, creating a liability for the distribution payment on the statement of financial position. This became common practice, since the former PLSs historically paid debenture interest, which accrues on a daily basis. Furthermore, the distributable earnings formulae in the debenture trust deeds of the former PLSs usually provided for the distribution of 100% of distributable earnings, creating a definite liability to make a distribution at year-end.
Discussion	In terms of IAS 10 (Events after the Reporting Period) and IAS 32 (Financial Instruments: Presentation), a dividend may only be accounted for when the right to entitlement has been fixed. This is the date when the dividend/distribution is declared, which usually falls after the financial period.
Recommendation	REIT dividends/distributions should be accounted for when declared, which is when the right to entitlement has been determined. In most instances, a REIT's distribution is declared, and the right to entitlement determined, after its period-end. This would mean that REIT distributions should no longer be accrued in the statement of financial position. Rather they must be accounted for in the period declared. This treatment is in accordance with IAS 10 (Events After the Reporting Period), and IAS 32 (Financial Instruments Presentation). First time adoption of this treatment will result in an increase in NAV by the amount of the current period distribution. To address this, and to ensure comparability, the prior period NAV should be restated, together with an explanation for the change / restatement.

5. Ratios

This section outlines recommendations for providing consistent presentation and disclosures of relevant ratios in the SA REIT sector. This will ensure information and definitions are clearly presented, enhancing comparability and consistency across the sector.

5.1 Cost-to-income ratio

5.1.1 Method of calculation

Issue	Cost-to-income ratios in the SA REIT sector have historically been disclosed on a gross and a net basis. On a gross basis, utility (or service charge) recoveries are included with revenue (in the denominator), while utility expenses are included with property expenses (in the numerator). On a net basis, utility expenses are deducted from utility recoveries, with only the net amount included in total property expenses. Any over- or under-recovery is included in the numerator, in total property expenses. A cost-to-income ratio calculated on a gross basis results in a higher ratio (usually above 30%) than that calculated on a net basis (usually below 20%). Furthermore, real estate entities have not always disclosed which method (ie gross or net) used to calculate the cost-to-income ratio.
Discussion	The use of inconsistent methods to calculate cost-to-income ratios reduces the comparability of reported information across the sector. The absence of clear disclosure as to which method is used (gross or net) to determine the cost-to-income ratio compromises the quality of reported information. Disclosure of a cost-to-income ratio on a net basis is arguably more meaningful, since the majority of utility costs are recovered from tenants through utility recoveries.
Recommendation	SA REITs should calculate and disclose a cost-to-income ratio on a net basis. Utility cost recoveries and expenses should be included in the numerator, with total property expenses. Over recoveries, if any, should also be included with total property expenses. The entity should disclose the method used to determine the cost-to-income ratio. It can do so by referring to the ratio as the 'net cost-to-income' ratio. Entities that historically disclosed the cost-to-income ratio on a gross basis should change to a net basis, briefly outlining the reason for the change. Alignment with industry best practice may be provided as a reason for a change from a gross to a net cost-to-income ratio. Prior period (comparative) ratios should be restated.

5.1.2 Two cost-to-income ratios

Issue	Not all REITs disclose a property cost-to-income ratio and a total cost-to-income ratio. Those that only disclose one or the other, frequently do not make it clear whether they are reporting a property cost-to-income ratio or a total cost-to-income ratio.
Discussion	Disclosure of both a property cost-to-income ratio and a total cost-to-income ratio is useful for users of REIT financial statements. Comparison of the two ratios assists the user in understanding the impact of non-property expenses (such as fund management or head office costs), and indirect property income (such as income from investments in REIT securities), on the ratio.
Recommendation	SA REITs should disclose a property cost-to-income ratio and a total cost-to-income ratio. The property cost-to-income ratio should reflect total property expenses (including net utility costs), as a percentage of total revenue from the direct property portfolio, excluding the straight line rental income accrual. The total cost-to-income ratio should reflect total property expenses (including net utility costs), plus total 'other' operating expenses such as fund management or head office costs, as a percentage of total revenue, excluding the straight line rental income accrual.

5.2 Loan-to-value ratio

Issue	There is inconsistency across the sector with respect to the calculation of the loan-to-value (LTV) ratio. Also, the method or formula applied to determine the loan-to-value ratio is rarely, if ever, disclosed.
Discussion	A consistent method for determining the loan-to-value ratio will enhance comparability across the sector. Disclosure of the method or formula used to determine loan-to-value will enhance transparency and encourage consistency across the sector.
Recommendation	SA REIT should disclose the method used to determine its loan-to-value ratio. The loan-to-value ratio should equate to net debt divided by the entity's share of total property assets. Net debt equals nominal interest bearing debt (excluding all derivatives), reduced by cash or cash equivalents.

	Property assets includes the sum of investment property, listed property or REIT securities and investments in associates and joint ventures. Property assets also include any property assets held for sale and loans receivable.

6. Accounting and financial reporting matters

6.1 Investment property – Fair value

Issue	IFRS 13 addresses fair value of non-financial assets. The incorrect application and interpretation thereof can result in inconsistent valuations in the industry.
Discussion	When determining the fair value of investment property, a REIT must measure the fair value of non-financial assets (investment property), with reference to the asset's highest and best use (IFRS 13.27). Disclosures on significant unobservable inputs and sensitivity analysis of fair value Where fair value measurements of investment property are made using 'significant unobservable inputs', disclosure should be made of the valuation technique and significant unobservable inputs used (IFRS 13.93 (d)). Examples of 'significant unobservable inputs' are expected market rental growth, the expected void period at the end of a lease, occupancy rates, rent-free periods on leases and the risk-adjusted discount rate. A description of the sensitivity of the fair value of the property to changes in unobservable inputs should also be disclosed (IFRS 13.93 (h)(i)). The use of estimations and assumptions that may have a significant risk of material adjustment to the carrying amount (fair value), of investment property needs to be disclosed, (IAS 1.125) and should include a sensitivity analysis on the carrying amounts of investment properties (IAS 1.129).
Recommendation	REITs should consider the highest and best use of a property, guided by IFRS 13, to determine the fair value of investment property. This should not normally conflict with the methods usually employed

	by REIT managers and external valuers. The DCF (discounted cash flow) and other similar valuation methods usually employed by them would, in most circumstances, approximate highest and best use principles. Where estimation uncertainty has been used to determine the fair value, a description of the sensitivity of the fair value of the property to changes in 'unobservable inputs' should be disclosed. For example, the estimated fair value would increase (decrease) if, expected market rental growth were higher (lower); void periods were shorter (longer); the occupancy rate were higher (lower); rent-free periods were shorter (longer) or the risk-adjusted discount rate were lower (higher).

6.2 Initial direct costs – leases

Issue	In terms of IAS 17 (Leases), initial direct costs incurred by lessors in negotiating and arranging an operating lease shall be added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income (IAS 17.52). The provisions of IAS 17 have not been correctly and consistently applied in the property industry.
Discussion	A consistent application of the requirements in terms of IAS 17.52 would enhance comparability of the required disclosure across the sector.
Recommendation	Where incremental costs directly attributable to negotiating and arranging a lease are incurred, these should be capitalised to the leased asset and recognised as an expense over the lease term.

6.3 Development projects

6.3.1 Borrowing costs

Issue	In terms of IAS 23 (Borrowing Costs) an entity is not required to apply the standard to borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset measured at fair value (IAS 23.4).
Discussion	Since the accounting standard on borrowing costs in IAS 23 permits policy choice for the capitalisation of borrowing costs on assets measured at fair value, there may be inconsistent treatment across the sector.
Recommendation	Where development projects meet the criteria for capitalisation, borrowing costs should be capitalised.

6.3.2 Loss of income

Issue	There is no specific guidance in IFRS regarding the loss of income on development projects.
Discussion	In the case of loss of income incurred directly as a consequence of a development project, no transaction has occurred. An entity should apply the principle of 'substance over form' and, as a result, no transaction should be recognised.
Recommendation	Loss of income should not be accounted for, either in the statement of comprehensive income or through capitalisation to the cost of the project.

6.4. Taxation

6.4.1 Deferred capital gains taxation

Issue	The implementation of REIT legislation in South Africa results in a change to the taxation status of real estate entities that are constituted as REITs or that covert to REITs. SIC 25 deals with the change in taxation status of an entity, which will be the case for the new REITs.
Discussion	Under SIC 25.4, a change in the taxation status of an entity or its shareholders does not give rise to increases or decreases in amounts recognised outside profit or loss. The current and deferred taxation consequences of a change in taxation status should be included in profit or loss for the period.
Recommendation	The elimination of deferred capital gains taxation or other deferred taxation should be accounted for in profit or loss.

6.4.2 Other deferred taxation

Issue	While SA REITs are exempt from capital gains taxation, they are not exempt from income taxation. It is therefore possible for income taxation or deferred taxation to arise. Uncertainty exists in the sector as to the deferred taxation implications of the REIT tax legislation (Section 25BB of the South African Income Tax Act).
Discussion	To determine if deferred taxation should be raised, it is necessary to

	consider those items which will be deductible as part of the qualifying distribution (which result in no taxation arising overall), versus those items which will not form part of the qualifying distribution and which will be subject to taxation. The quantum of the distribution will be determined by management or the board. In instances where it is decided not to include a specific item in the distribution, taxation and/or deferred taxation may arise and should be accounted for.
Recommendation	REITs should continue to perform detailed normal and deferred taxation calculations to determine the relevant normal and deferred taxation effects.

6.5 Investments in listed property or REIT securities

6.5.1 Valuation

Issue	In terms of IFRS 13 (Fair Value Measurement) when a financial asset or liability measured at fair value has a bid price and an ask price, a price between the bid-ask spread, that is most representative, should be used to measure fair value (IFRS 13.70).
Discussion	Real estate entities should determine the most representative price between the bid-ask spread to measure fair value.
Recommendation	Listed property or REIT securities should be valued at the price within the bid-ask spread that is most representative of fair value.

6.5.2 Dividends received

Issue	Dividends received from other REITs or from listed property investments are not always treated consistently across the sector. Inconsistent treatment is evident both from an accounting (IFRS) and a distributable earnings perspective.
Discussion	Dividend income from listed property or REIT securities should be recognised on the accrual basis of accounting in accordance with IAS 1 (Presentation of Financial Statements). On this basis, the dividend income should only be accrued for on the record date for the distribution. The REIT does not become entitled to the income until the record date.

Recommendation	The relevant dividend should only be recognised once the REIT is entitled to receive the dividend, which is on the record date. The dividend should not be recognised by matching an accrual of income to the period to which the investment relates. **Distributable earnings** An adjustment should be made when determining distributable earnings, to ensure that dividend income is recognised by matching the income to the period to which the investment is held. (Refer 4.2. above). When a REIT receives dividends from listed property or other REIT investments, and the dividend includes an element of 'pre-acquisition' dividends, the pre-acquisition portion of dividends received should not be included in distributable earnings. Should the non-distribution of the pre-acquisition portion of dividends received result in an income tax liability for the REIT receiving the dividend, then the REIT may include such pre-acquisition dividend in its dividend declared, provided it discloses the fact that pre-acquisition dividends have been distributed to shareholders. This will ensure investors are aware that there is an element of 'once-off benefit' in the distribution and that the enhancement in distributions may not be continuing.

6.6 Co-owned properties

Issue	The method applied to accounting for co-owned properties is not consistent across the sector.
Discussion	Where a REIT is an investor in a co-owned property, the nature of the relationship between the investors must be considered. Frequently these investments operate in accordance with an agreement that governs the co-owners' rights over the significant decisions regarding the property. If the agreement amounts to joint control, then IFRS 11 Joint Arrangements will apply. Consideration should then be given to the investor's rights to the assets and liabilities of the arrangement to determine whether it is a joint operation or a joint venture.

	Where the arrangement constitutes a joint operation, each investor's share of the assets, liabilities, income and expenses will be accounted for. If it is determined that the arrangement is a joint venture, then the investment will be equity accounted.
Recommendation	The substance of ownership arrangements should be carefully considered to determine the nature of the relationship between the investors. Based on this assessment, the appropriate accounting treatment should be applied. If joint control exists, then the co-ownership should be accounted for in terms of IFRS 11 (Joint Arrangements). If joint control cannot be established, such as where one of the co-owners effectively has control over the co-ownership, then consideration will need to be given to consolidating the co-ownership, with consequent accounting for non-controlling interests.

6.7 Business combinations

Issue	Determining whether the acquisition of a property constitutes a business combination requires careful judgement and will depend on the facts and circumstances relating to the transaction in question.
Discussion	If investment property is acquired, then a careful analysis of what is acquired is often needed to determine whether it constitutes a business. In some instances, it can be difficult to decide whether the acquired property / properties meets the definition of a business, and judgement is required. Factors that may be relevant in making the determination could include whether property management services are also acquired, the nature of those services and the level and nature of ancillary services, e.g. security, cleaning and maintenance. If it is determined that an acquisition is not a business combination, disclosure is required as to why the entity has concluded that it is not a business combination in terms of IAS 1.122.
Recommendation	Judgement should be used to determine whether the acquisition of a property constitutes a business combination. Whether the acquisition is determined to be the acquisition of an asset or a business combination, disclosure as to the reasons for the determination should be made.

6.8 Debt

6.8.1 Structuring fees

Issue	Fees incurred to raise new debt or to restructure existing debt are not treated consistently across the sector.
Discussion	The correct treatment depends on whether the debt itself is accounted for at amortised cost (the most common case) or at fair value.
Recommendation	**Debt accounted for at amortised cost** Structuring fees that are directly attributable to raising a loan facility must be capitalised to the loan. This will result in the loan being reduced to less than the legal amount due at inception. In order to ensure that the loan amortises to nil once repaid, an interest rate, or internal rate of return (IRR) must be calculated so that the capitalised structuring costs are amortised over the period of the loan. This is referred to as calculating the effective interest rate. It is not appropriate to amortise these costs on a straight-line basis over the period of the loan, unless they are clearly immaterial. The calculation takes the amount recorded initially (the loan received less the restructuring costs) and determines an interest rate (effective interest rate or IRR) that will make the future expected capital and interest payments equal to the amount recorded initially. This effective interest rate is applied to the loan in order to calculate the IFRS interest expense. The interest expense will then effectively be increased over the term of the loan by the amount of the debt structuring fees amortised. **Debt accounted for at fair value** Structuring fees relating to debt that is accounted for at fair value must be expensed in profit and loss. **Distributable earnings** In both cases (whether the debt is accounted for at amortised cost or at fair value) the determination of distributable earnings should follow the accounting treatment, and no adjustment should be made. This will mean that debt structuring fees will reduce the amount available for distribution, either up-front as incurred or over the term of the loan, as the case may be.

6.8.2 Breakage costs and gains

<table>
<tr><td>Issue</td><td>Breakage costs and gains, usually relating to fixed-rate agreements or interest rate swaps to hedge debt facilities, are not always treated consistently across the sector.</td></tr>
<tr><td>Discussion</td><td>Breakage gains/losses

These are the costs incurred renegotiating the significant terms of a financial liability or from early settling of a liability.

The treatment depends on whether the breakage gain or loss relates to a derivative or non-derivative instrument.</td></tr>
<tr><td>Recommendation</td><td>Breakage gains/losses (derivative instruments)

These gains/losses should be recognised in profit or loss, whether the financial liability is derecognised or not.

Breakage gains/losses (non-derivative instruments)

The treatment of breakage gains/losses on non-derivative financial liabilities will depend on whether the financial liability is derecognised or not. If the loan is derecognised, then breakage gains/losses will be recognised in profit or loss. If the loan is not derecognised, then the carrying amount of the liability will be adjusted by the amount of the breakage cost / gain.

Distributable earnings

The determination of distributable earnings should follow the accounting treatment, and no adjustment should be made. This will mean that for non-derivative instruments:
in instances where the loan is derecognised (there is no new balance sheet item) the breakage cost or gain will reduce/increase distributable earnings;
in instances where the loan is not derecognised, then the carrying amount of the liability will be adjusted by the amount of the breakage cost/gain and distributable earnings will accordingly not be impacted.
For derivative instruments, breakage gains / losses are recognised in profit or loss and will increase / decrease distributable earnings accordingly.</td></tr>
</table>

6.9 Transaction costs

<table>
<tr><td>Issue</td><td>Transaction costs in respect of different types of corporate activity are not treated consistently across the sector.</td></tr>
<tr><td>Discussion</td><td>The correct treatment will depend on the type of transaction and classification of the transaction for IFRS purposes</td></tr>
<tr><td>Recommendation</td><td>Transaction costs incurred in the course of:

(i) acquisition of a property or portfolio of properties classified as a business combination should be expensed in the period incurred, in accordance with IFRS 3 paragraph 53;
(ii) acquisition of a property classified as investment property should be capitalised and added to the cost of the property acquired in terms of IAS 40 paragraph 21;
(iii) any equity transaction should be accounted for as a deduction from equity in accordance with IAS 32 paragraph 35.

Any transaction costs incurred in the course of a capital restructure (for example to convert debentures to equity) must be treated in accordance with (iii) above and deducted from equity.

Distributable earnings

In all of the above cases, any transaction costs incurred, if expensed for IFRS purposes (for example as in (i) above), should be added back to determine distributable earnings (ie transaction costs of any type should be viewed as capital for distributable earnings purposes and should not reduce distributable earnings). Refer 4.2 above.</td></tr>
</table>

7. Abbreviations

Term	
APUT	Association of Property Unit Trusts
BPR	Best Practice Recommendations
IAS	International Accounting Standard
IFRS	International Financial Reporting Standards
JSE	Johannesburg Stock Exchange
PLS	Property Loan Stock
REIT	Real Estate Investment Trust
SA REIT	South African Real Estate Investment Trust
SIC	Standings Interpretations Committee