

**THE DETERMINATION AND DISCLOSURE OF THE
CONTRIBUTION OF TURNOVER RENT TO LESSOR REVENUE IN
THE SOUTH AFRICAN RETAIL PROPERTY SECTOR**

by

Leopold Ferreira Kruger

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Supervisor: Prof H.C. Wingard
Co-supervisor: Mr J.A.C. Bosman

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DECLARATION

STUDENT: LEOPOLD FERREIRA KRUGER
STUDENT NR: 50800957
TITLE: THE DETERMINATION AND DISCLOSURE OF THE
CONTRIBUTION OF TURNOVER RENT TO LESSOR
REVENUE IN THE SOUTH AFRICAN RETAIL PROPERTY
SECTOR

I, the undersigned, declare that the above-mentioned dissertation is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.



Signed

17 May 2016

Date

ABSTRACT

THE DETERMINATION AND DISCLOSURE OF THE CONTRIBUTION OF TURNOVER RENT TO LESSOR REVENUE IN THE SOUTH AFRICAN RETAIL PROPERTY SECTOR

The research intends to assess the availability of information to determine the contribution of turnover rent to lessor revenue as the publicly available information on building performance, and in specific turnover rent, is not adequate to answer the research problem. Academic, legal and accounting sources are consulted and referenced as background on turnover rent. Limitations applicable to the study is noted.

A content analysis of published financial statements analyses the application of the prevailing accounting standards in the real estate sector and assesses to what extent information is available to determine the contribution of turnover rent to lessor revenue. Disclosure was found to be inconsistent and inadequate to calculate the contribution to lessor revenue and to assess individual building performance.

With relevant building performance data of a large retail centre sourced from an asset manager, the contribution of turnover rent to lessor revenue was calculated for a period of eight years as part of a retail centre case study. With information available, but not disclosed, it is recommended that the IASB considers additional disclosure for listed real estate entities to enable stakeholders to assess individual building performance. Further recommendations are made in this study.

The building performance indicators were further compared to relevant economic indicators. The results of this analysis indicates an indirect correlation between the prime interest rate and three building performance indicators being lessee turnover, total rent collected and centre footcount. This confirms the strong reliance of the South African retail sector on credit sales.

KEY TERMS

Disclosure of contingent rent
Landlord
Lease agreement
Lessee
Lessor
Optimisation of rent
Prime interest rate
Property management
Rental income
Retail centre
Retail trade
Revenue
Turnover
Turnover rent

Notes:

- i) the terms "lessee" and "tenant" are used alternatively, the latter only when quoted*
- ii) the terms "lessor" and "landlord" are used alternatively, the latter only when quoted*

ABBREVIATIONS

CPI : Consumer Price Index

ED : Exposure Draft

(The author for all references to ED in this study should be assumed to be the International Accounting Standards Board (IASB))

GDP : Gross Domestic Product

GLA : Gross lettable area

IAS : International Accounting Standards

(The author for all references to IAS in this study should be assumed to be the IASB as published in 2014)

IASB : International Accounting Standards Board

IFRS : International Financial Reporting Standards

(The author for all references to IFRS in this study should be assumed to be the IASB as published in 2014)

JSE : Johannesburg Stock Exchange

KPI : Key Performance Indicator

REIT : Real Estate Investment Trust

SAICA : South African Institute of Chartered Accountants

SAPOA : South African Property Owners Association

SME : Small and Medium-sized Enterprises

VAT : Value Added Tax

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND TO THE STUDY

The increased rental growth percentage of 7.2% (IPD, 2015) was the biggest driver of returns in retail property in 2014 in South Africa. Through additional collection terms in lease agreements, subject to the conditions of the Law of contracts (Christie & Bradfield, 2011), lessors of retail properties include turnover rent as part of the proposed income structure (Hill, 2010). Together with relevant supporting clauses in these lease agreements, the lessor will seek to recover rent above the agreed basic rent, based on the lessees' actual performance or turnover. This implies that if lessee sales should increase in the future, then lessor income would increase (Hendershott, 2002:513). The study by Hendershott (2002) indicates that the basic rent is the lowest point of expected revenue for the lessor.

The concept of turnover rent is important to lessors for a number of reasons. Firstly, according to Hill (2010), the concept provides flexibility for both the lessor and the lessee, which may provide an opportunity for an otherwise cautious lessee. It further provides an opportunity for the lessor to keep track of the lessee's turnover and immediately share in an increase in the lessee's performance above expectations, instead of waiting for a rent review to increase the rent based on this increased performance.

According to Hill (2010), the main disadvantages are that the lessor cannot count on, or budget for, rent payable with any certainty and the credibility of reported turnover information by the lessee. Centralised point of sale systems can be implemented in retail shopping centres where lessees upload turnover information on a daily basis. The lessee is obliged to produce a turnover certificate at the end of the accounting period (Hill, 2010), which can provide better insight into the

turnover of lessees.

One way lessors can combat rising rentals is the use of turnover rent lease agreements (Yeo, 1999:26), where rentals would be more competitive in the market place since basic rent is set at a lower level. A study conducted in Sweden indicates that “[t]he fair approach to setting the principal lease turnover clauses such as base rent, sales breakpoint above which the percentage rent is activated is important for a successful shopping centre tenant management system and establishing the transparent and long-term relationships between tenants and landlords.” (Klyatska, 2007:6).

Setting turnover rents and known turnover figures have further benefits to the lessor. According to The Australian Property Institute in a study conducted by the Productivity Commission (2008:132), the following:

“The provision of turnover details to the lessor of a shopping centre is not only used for the calculation of rent but more importantly, for the sake of monitoring shopping centre performance. It enables the shopping centre manager to optimise the shopping centre mix which is to the benefit of all tenants. It may highlight instances where a particular section of a centre is adversely affected by certain actions of the manager or conversely demonstrate where particular strategies are successful. It is therefore essential that lessors have the option of obtaining retail turnover figures whether or not a lease contains turnover rent provisions.”

In the same study, Colonial First State Property Management argues that market forces set rents:

“Tenants often express concern that owners use sales information for setting rents. The reality is that rents for a new lease are set by market forces. ... it is in the owner’s best interest to ensure that vacancies are minimised.” (Productivity Commission, 2008:132).

Since property funds are profit driven entities, it would be necessary to maximise income for the fund and ultimately the unit/shareholders in a sustainable way. Turnover rent should be mutually beneficial to both the lessor and lessee.

Lessee and lessor behaviour was mentioned in Klyatska (2007) but from a lessee perspective with an objective of “preventing [protecting] retail tenants from speculative behaviour of landlords by means of turnover lease agreements.” (Klyatska, 2007:7). Contrary to Klyatska (2007), it cannot be assumed that lessors have the necessary processes in place to manage turnover rent clauses (from negotiation to collection) in a “speculative” (Klyatska, 2007:7) or most favourable way. The study conducted by the Australian Property Institute (2008) concludes that the use of turnover rent lease agreements provides a mechanism to align lessee and lessor incentives, with the additional benefit of potentially reducing opportunistic behaviour of lessors (Productivity Commission, 2008:146). This is based on the assumption of lessee compliance and both parties’ collaboration for the benefit of both the lessee and the retail centre. The symbiotic relationship between lessor and lessee is mentioned in McAllister (1996:7), where this relationship can lead to a multi-beneficial or multi-detrimental (stagnated) situation where there is a co-dependency on performance of both parties.

There is a correlation between the level of basic rent and the set percentage for turnover rent. According to a study of a population of lease agreements in the United States, Boyle (1990) established that the basic rent is lower with a higher percentage of turnover rent. However, Wheaton (2000) established that lessees with greater drawing power pay less base rent, and tend to pay a lower percentage of turnover rent. The basic understanding of this correlation between turnover rent and basic rent by the relevant employees or representatives of the lessor, cannot be assumed. With the study conducted by Klyatska (2007) in Sweden—a developed economy—the assumption can be made that the lessee should be protected against the speculative action from the lessor only when the lessor is a specialised and skilled organisation or entity.

1.2 THE IMPLEMENTATION OF TURNOVER RENT

There is a possibility that the lessor or its property manager—taking into account the effect of certain key performance indicators (KPIs) for the property manager—does not always fully comprehend the impact of the turnover rent percentage nor its impact on total rental income, and would therefore not be implemented in an optimal way. For example, if the KPI states that lease agreements should be signed within a certain period, this will be the driving force for actions taken by the property manager. If the lessee requests a lower turnover rent percentage, this might be accepted without the necessary sensitivity analysis or review being performed on the effect that the proposed adjustment would have on the performance of the retail asset, in order to achieve the specific KPI. Therefore, the KPI is driving the action of the employee.

Fitz-Gibbon (1991:2) warns that selecting the incorrect indicator (KPI) could be damaging to a business, since there are emotional and logical reactions to indicators measured, and advises that such reactions should be considered before the KPI is set. Therefore, if the KPI is set on finalising the lease agreement and not on the content of the agreement or optimisation of rental, it can affect the performance of the retail asset negatively. Alternatively, an external broker or lease agent can be used to conclude a lease agreement. However, these agents might have conflicting loyalties (Anonymous, 2009:57). If there are no adequate preventative measures in place, the reactions on using lease agents as indicated by Fitz-Gibbon (1991:2) could prove to be valid. Measures, e.g. setting parameters, need to be set for the turnover rent percentage for negotiation purposes. This percentage will determine the moment when breakpoint is reached, at which point turnover rent is activated. The level of sales is; therefore, an important aspect in the application of the concept of turnover rent. (Refer to Chapter 2 Figure 2.1: Calculation of turnover rent.)

The current accounting standard for revenue, IAS 18 *Revenue* (IASB, 2014), does not require the separate disclosure of turnover rent for lessors. Further, IAS 17

Leases (IASB, 2014) requires the following recognition and disclosure in the financial statements of the lessor with respect to operating lease agreements:

Recognition:

Lease income from operating leases shall be recognised in income on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit is derived from the leased asset is diminished (IAS 17.50).

Disclosure:

Lessors shall disclose the following for operating leases:

- a) The future minimum lease payments under operating leases that cannot be cancelled in the aggregate and for each of the following periods:
 - (i) Not later than one year
 - (ii) later than one year and not later than 5 years
 - (iii) later than 5 years
- b) total contingent rents recognised as income in the period
- c) a general description of the lessor's leasing arrangements (IAS 17:56)

A separate disclosure of the types of rental income, for instance basic rent and turnover rent, is not required by the above recognition and disclosure criteria. The lessor cannot rely on International Financial Reporting Standards (IFRS) to require specific disclosure about turnover for a specific industry or for anchor lessees. The lessor and other stakeholders would not be aware what this contribution is, unless this function, together with incremental expenses, are specifically included in the management accounts. Consequently, costs can possibly be incurred to gain a potentially small or even a negative contribution to net profit in certain economic phases. Further decisions, e.g. new lessee placement, can be made without accurate forecast of future expected income from different types of rental.

Turnover rent data is also used in the valuation of retail buildings. Theoretically, the value of the retail centre is based on the present value of the current and future lease obligations (Eppli and Benjamin, 1994:23). This study will not focus on the valuation model of a retail building as Hendershott and Ward (2003) have already researched this concept, amongst others. The emphasis of this study will be on the contribution made by turnover rent to lessor revenue by the different industries (merchant categories) lessees operate in, over a period of time. Retail sales in South Africa declined from 2006–2009 and started increasing again in the years thereafter (Ernst and Young, 2012:47). The impact of the economic trends on the collection of turnover rent will be assessed with this study conducted from 2007–2014 representing a contraction phase as well as a growth phase in retail industries.

1.3 PROBLEM STATEMENT

Neither the current level of available information, nor the current IFRS disclosure requirements provides sufficient and useful information to perform an analysis of turnover rent.

1.4 RESEARCH OBJECTIVES

1.4.1 Primary objective

Primarily, this research intends to assess the availability of relevant information in order to determine the contribution of turnover rent to lessor revenue through a growth and a contraction phase in the South African economy.

1.4.2 Secondary objectives

The following secondary objectives are relevant to this study:

- To establish the extent of financial and performance information available from the annual financial statements of Real Estate Investment Trusts

(REITs) and real estate funds owning retail buildings

- To calculate and analyse the contribution of turnover rent to lessor revenue in a selected retail building
- To express this contribution as a percentage of revenue for this specific building from each major contributing merchant category
- To compare this contribution over a period of time (economic contraction and growth), *i.e.* 2007–2014 to relevant economic indicators to establish if a correlation exists in merchant categories that made high contributions to turnover, or not

1.5 IMPORTANCE OF THE STUDY

The contribution by non-residential real estate to the Gross Domestic Product (GDP) in South Africa was approximately R81 billion or 2.4% of GDP (SAPOA, 2014:2). At the end of 2013, non-residential real estate supports 212,000 permanent employees or 1.5% of all employment in the country (SAPOA, 2014).

The real estate market and general business economy are closely related and influence each other (Onwumere, 2011). Trends in the economy may arise from– or be caused by–changes in the real estate sector (Onwumere, 2011:1).

Owners or lessees occupy properties. The entities in which these properties are held range from individuals to legal entities such as trusts, companies or special purpose entities which in turn may or may not be held by a listed or unlisted property fund or REIT. In turn, these institutions are all governed by the Companies Act, 2008 (Act 71 of 2008). Turnover rent, being variable, is indicative of levels of trading of the lessee on the one side and market powers of base rent on the other side. It may therefore indicate performance of both these factors, being negotiation and setting of base rent (building performance) and also levels of trading of the lessee (lessee performance). The benefit of this dual quality is described by Howard (2014:275) as follows: “Turnover information shared between tenants and centres means that problems can be mutually identified – the

need to improve a mall or change some feature. Both parties can see the evidence and work together on a solution.”

There is a current need to conduct the research, for the following reasons:

- Turnover rent has become an increasingly complex field in terms of accounting, legal requirements, and practicality to enforce.
- There is a constant increase in costs of turnover rent administration and collection due to inflation as well as the increase in skill set necessary to determine, calculate, and collect turnover rent.
- Increase in training costs of property managers due to the skill set differential.
- Increase in business consultants’ activity in this area (for instance investigations for misrepresentation of turnover by the lessee).
- Increase in costs of system development to support the administration of turnover rent mainly due to the different models of calculating turnover rent.
- Outsource possibilities are starting to surface where the property management company would outsource the turnover rent function due to the above reasons. This in itself would require a cost/benefit analysis before execution, and is another indication of the complexity of the field.

The conclusions of this research should provide beneficial input, such as:

- More accurate forecasting and budgeting of turnover rent income
- optimisation of rent through the proper setting of parameters for negotiating turnover rent clauses in drafting lease agreements and the benefit of having examples of turnover rent percentages per merchant category
- simplification of building valuations where turnover rent options are included
- more achievable and beneficial targets (KPIs) could be set for collection of turnover rent in order to optimise revenue for the lessor
- enable the lessor to identify opportunities to engage with lessees in order to stimulate sales to reach and exceed breakpoint turnover

- simplification of the budget and forecasting calculations
- positive contribution to asset management decision making (e.g. in the case of acquisitions)

1.6 DELINEATION AND LIMITATIONS

This retail centre case study, that forms part of this study, will be conducted on a retail property in South Africa. This property is owned by a property fund and is managed by a property manager as a full outsource function. In order to compile a statistical analysis, data relating to the specific retail building will be sourced from the property manager. The name and location of the building or its lessees will not be disclosed due to the confidential nature of the information that is subject to a legal arrangement. The relevant merchant categories will be indicated. This study relies on the availability of data from the asset manager.

The Research Ethics Review Committee of the College of Accounting Sciences has granted ethical clearance for this study. Refer to the Ethical Clearance Certificate in 'Appendix 2' to this study.

1.7 RESEARCH DESIGN

A literature review will be performed which will include relevant legal background, prevailing financial disclosure standards and academic articles relevant to this study. The research will include a content analysis as well as a retail centre case study.

1.7.1 Content analysis

A sample of six sets of annual financial statements of listed REITs or other listed owners of retail investment property will be analysed for the adherence and application of the relevant financial reporting standards. The adequacy and availability of turnover rent data and information in these annual financial

statements will be assessed with relevant conclusions.

1.7.2 Retail centre case study

Data for the case study will be collected relevant to the income of the selected retail building. Economic indicators will be sourced from public resources, e.g. The South African Reserve Bank. A trend analysis will be prepared from this data to establish if there is a notable trend between the contribution of turnover rent to revenue during certain economic and market conditions by each major retail merchant category. The total contribution of turnover rent will be calculated from 2007–2014.

1.8 DEFINITIONS OF TERMS AND CONCEPTS

Contribution margin:

“Net Sales minus the variable product costs and the variable period expenses. The Contribution Margin Ratio is the Contribution Margin as a percentage of Net Sales.” (Averkamp, 2012).

Key performance indicator:

“Goals or targets that measure how well an organisation is doing on achieving its overall operational objectives or critical success factors for a particular project. Key Performance Indicators (KPI) must be objectively defined in order to provide a quantifiable and measurable indication of the organisation’s progress towards achieving its goals.” (Bucki, 2012).

Revenue:

“The gross inflow of economic benefits during the period arising in the course of ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity partners.” (IAS 18:7).

Trading density:

“Average trading density is total sales from retail operations in the financial year divided by the average trading space.” (Holdsport Ltd., 2012:72).

1.9 CHAPTER OVERVIEW

The remainder of this dissertation is set out in chapters as outlined below.

Chapter 2: Literature Review: Relevant Legislation and Accounting Standards

The relevant legal background will be reviewed and relevant sections will be summarised where it is applicable to the retail real estate industry and related to revenue. The following legal scripts will be referred to:

- Companies Act, 2008 (Act 71 of 2008)
- Companies Regulations, 2011
- Wille’s Principles of South African Law (Wille, Du Bois, Francois; 2007)
- Law of contracts
- Law of property

Relevant financial reporting standards will be reviewed and relevant sections and requirements for the retail real estate industry will be discussed where it relates to the disclosure and determination of turnover rent. Relevant academic articles will be included as part of this analysis and discussion. A review of the following accounting standards will be conducted:

- IAS 17 *Leases*
- ED/2013/6 *Exposure Draft Leases*
- IAS 18 *Revenue*
- IAS 39 *Financial Instruments: Recognition and Measurement*
- IFRS 8 *Segment Reporting*

- IAS 40 *Investment Property*
- IFRS 13 *Fair Value*
- IFRS 9 *Financial Instruments*
- IAS 32 *Financial Instruments: Measurement*
- IFRS 15 *Revenue from Contracts with Customers*

Chapter 3: Research design

This chapter includes the proposed choice of research methods. It focuses on the two phases, being a content analysis and a case study. The chapter explains the need for both phases as the most beneficial research methods to address the research objectives. Relevant academic support will be provided to support the chosen methods.

Chapter 4: Content analysis: Review of Annual Financial Statements

A review of the annual financial statements of five listed REITs will be conducted for the applicable years of this study, as well as that of a listed insurance company owning large retail properties. Particular focus will be placed on the disclosure of revenue and other amounts and facts related specifically to turnover rent and adherence to and application of the relevant accounting standards in this regard. Further mention will be made of the fair value valuation and related disclosure.

Chapter 5: Retail centre case study

One building will be selected but the identity of the owner and property manager will be anonymous based on a confidentiality agreement. Merchant categories relating to the data will be disclosed, but lessee names will be anonymous. The following sets of data will be collected for years ending December 2007–2014:

- Tenant trade data
- merchant category data
- centre management data
- industry data
- economic indicators

Trends over the period will be identified. The end result will be the value that turnover rent contributed to the lessor's revenue over the period from January 2007–December 2014 with related economic impact, comparisons and trend analysis.

Chapter 6: Summary, conclusion and recommendations

The summary and conclusion will include an answer to the research problem statement and feedback on the research objectives set. Further research required will be highlighted as a final remark.

CHAPTER 2

LITERATURE REVIEW – RELEVANT LEGISLATION AND ACCOUNTING STANDARDS

2.1 INTRODUCTION

The previous chapter indicated that this study would endeavour to assess the availability of relevant information to determine the contribution of turnover rent to lessor revenue. Turnover rent collection, among others, is regarded as an indicator of retail building performance, building management efficiency, and lessee performance. Therefore, it is important to disclose turnover rent to the reader of financial statements. In the absence of this disclosure, it would be expected that alternative building performance criteria would be a disclosure requirement.

This chapter will make reference to relevant legal requirements and regulations. Further, a comparison is drawn between the definition of revenue according to the accounting standards, and turnover according to a retail lease agreement that contains a turnover rent clause. An analysis of the relevant accounting standards will be performed. The chapter will conclude with comments on the adequacy of the requirements of the accounting standards with regards to turnover rent determination and disclosure.

2.2 RELEVANT LEGAL REFERENCES

This study partially relies on the availability of disclosed information in the financial statements of legal entities. Relevant legal requirements are analysed to determine which accounting standards should be applied by companies owning investment property. The relevant accounting standards dictate the financial disclosure in the annual financial statements, and therefore the extent to which turnover rent information would be disclosed and available for analysis. Relevant

contract law and law of property are analysed since there are contractual arrangements between lessor and lessee stipulating turnover rent determination and payment, among other rights and obligations for both parties. Academic studies are further included where applicable to support legal and financial disclosure requirements.

2.2.1 Companies Act, 2008 (Act 71 of 2008)

The Companies Act, 2008 (Act 71 of 2008) prescribes the relevant financial reporting standards to be used for preparation of annual financial statements of different legal entities. The Act lays out these requirements in Part C Section 29: Financial Statements.

Section 29(1) (a) to (c) reads as follows:

“If a company provides any financial statements, including any annual financial statements, to any person for any reason, those statements must:

- satisfy the financial reporting standards as to form and content if any such standards are prescribed;
- present fairly the state of affairs and business of the company and explain the transactions and financial position of the business of the company; and
- show the company’s assets, liabilities and equity as well as its income and expenses and any other prescribed information.” (RSA, 2008:29)

With the above as foundation, the relevant prescribed accounting standards are indicated below for different legal entities in South Africa. The relevant accounting standards related to entities that own retail buildings as investment property, will be further analysed.

2.2.2 Companies Regulations, 2011

Regulation 27 of the Companies Regulations, 2011 sets out the details of which financial reporting statements are relevant, and would need to be applied by different entities, as follows:

- A company's financial statements may be compiled internally or independently.
- For all purposes of this regulation and regulations 28 and 29, a company's financial statements must be regarded as having been compiled internally, unless they have been 'independently compiled and reported', as defined in regulation 26(1)(e).
- Nothing in this regulation precludes a company:
 - a) That is required to prepare its financial statements to the standards of IFRS for SMEs, from preparing its financial statements to the standards of IFRS instead; or
 - b) that is not subject to any prescribed standards, from preparing its financial statements to the standards of either IFRS or IFRS for SMEs or SA GAAP
- For any particular company, any financial statements contemplated in Regulation 28 or 29 of the Companies Regulations, 2011 must comply with the applicable standards for that category of company (RSA, 2011:27).

2.2.2.1 State-owned and profit companies

The following categories of entities, among other, own retail property in the Republic of South Africa. The relevant financial reporting standards are indicated below and quoted from Regulation 27 of the Companies Regulations, 2011. Examples of South African entities that own retail buildings in the country are indicated in brackets and do not form part of the regulation.

Table 2.1: Relevant financial reporting standards

Category of companies	Financial reporting standard
State-owned companies (e.g. Public Investment Corporation and Transnet)	IFRS, but in the case of any conflict with any requirement in terms of the Public Finance Management Act, the latter prevails
Public companies listed on an exchange (e.g. Growthpoint)	IFRS
Public companies not listed on an Exchange (e.g. Pareto)	One of: <ul style="list-style-type: none"> • IFRS • IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SMEs
Profit companies, other than state-owned or public companies, whose public interest score for the particular financial year is at least 350	One of: <ul style="list-style-type: none"> • IFRS • IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SMEs
Profit companies, other than state-owned or public companies: <ul style="list-style-type: none"> • whose public interest score for the particular financial year is at least 100 but less than 350; or • whose public interest score for the particular financial year is less than 100, and whose statements are independently compiled 	One of: <ul style="list-style-type: none"> • IFRS • IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SMEs • SA GAAP
Profit companies, other than state-owned or public companies, whose public interest score for the particular financial year is less than 100, and whose statements are internally compiled.	The financial reporting standards as determined by the company for as long as no financial reporting standard is prescribed.

Source: Regulation 27, Companies Regulations: 2011

Since this study focuses on public companies, IFRS will be analysed for the determination and disclosure of turnover rent. Further legal requirements relating to lease agreements and property will be analysed in the next section.

2.2.3 Law of contracts and the implications for turnover rent

The lease agreement between the lessee and the lessor is a binding legal contract. A lease requires no formalities other than agreement on the essential terms of the lease (Wille, *et al*; 2007:908), which contract defines the key rights and obligations that each party has in terms of the agreement. The dynamics of a lease agreement is further described as: “A lease, or contract of letting and hiring of movable and immovable property is formed by the agreement of the parties on the following three points:

That one party is:

- To let or to give the other the use
- of ascertained property
- at a fixed or fixable rent.” (Wille, *et al*; 2007:907)

The monthly basic rent is “fixed rent” as anticipated by Wille, *et al* (2007:907) and turnover rent is an example of a “fixable rent” that would appear in the lease and would add to the rights and obligations that are applicable to each party.

In general, the primary obligation of the lessee is to ensure that rentals are paid. The lessee is further required to take proper care of the leased premises whilst using it for the purpose for which it was let (Wille, *et al*; 2007:917).

According to Wille, *et al* (2007:917) the lessor has the following obligations (which again create corresponding rights for the lessee):

- Delivery of occupation: The lessor must deliver to the lessee the occupation of the property let at the time agreed upon.

- Guarantee of quiet enjoyment: Undisturbed use and enjoyment of the property for the purpose for which it was let.
- Delivery in proper condition and maintenance: Unless otherwise agreed, the lessor must deliver and maintain the property in a condition reasonably fit for the purposes for which it was let.
- Payment of taxes: The lessor must pay all rates and taxes levied for the property.

The lessor has a right to receive rental under a lease agreement. It is under these most general rights and obligations of a lease that turnover rent would fall. If the conditions to pay turnover rent are met, the lessee has the obligation to pay turnover rent in line with the primary obligation to ensure that rentals are paid for the use of the premises based on the conditions in the lease agreements and as agreed to by both parties (both lessor and lessee) or their representatives. If the turnover rent conditions are met (as governed by the lease agreement), the lessor then has the right to receive turnover rent in line with their primary right to receive rentals. Refer to the example calculation of turnover rent (Table 2.2).

There may be additional legal requirements stipulated, e.g. the requirement that the lessee should provide the lessor with a turnover certificate at the end of each agreed upon period (Hill, 2010). These additional legal requirements would then be enforceable in terms of common law principles. In case of non-performance, common law principles would also determine the remedies that are available to each party in the event of breach of contract as well as possible defences (Wille, *et al*; 2007:738).

2.2.4 Law of property

The law of property governs legal title and ownership of property. The lessor, being the title holder of the property, can contract based on this ownership, e.g. to lease out the premises or dispose of the asset.

According to Wille, *et al* (2007) the key principle around law of property relating to leases is that the leases (at least the leases that are the focus of this study) would not pass legal title. Land can only be conveyed from one person to another by means of a deed of transfer executed or attested by the Registrar (RSA, 1937:16). This means that the lessee would not be considered the legal owner of these stores inside the retail building. The legal ownership remains with the lessor. The lessee's right to use implies only the right to gather and enjoy the fruits of the property and not the right to take any of the substance of the property. This indicates that legal title remains with the lessor, who has full rights of the property, provided they do not conflict with the rights given to the lessee for the period of the lease (Wille, *et al*; 2007:907).

Humbach (1983:1217) indicates that the unique intertwined legal relationship between a lessor and lessee is twofold. Firstly, a right based on contract (the lease agreement) and secondly a right based on estate or ownership. Humbach (1983:1217) also indicates that a lease is in fact a conveyance transaction, where the lessee receives an ownership interest in the premises, albeit a temporary one (Humbach, 1983:1218). He further indicates the rights and obligations of each party in this relationship based on the right of ownership part of the arrangement as being a peaceful possession on the side of the lessee and a right to receive rent on the side of the lessor (Humbach 1983: 1219).

Wille, *et al* (2007) do not contradict the principles of Humbach (1983) as Humbach (1983) does not state that title will pass to the lessee. Humbach (1983:1218) alludes to a temporary co-ownership principle as one part of a dual relationship between the lessee and the lessor. The other part of the relationship is based on the rights and obligations included in the contractual arrangement, *i.e.* the lease agreement. Wille, *et al* (2007) and Humbach (1983), fundamentally agree on these rights and obligations as stipulated in the lease agreement.

2.3 ACCOUNTING STANDARDS

The following accounting standards and exposure drafts are applicable in the determination and disclosure of turnover rent earned by listed companies who own investment property and are discussed in the sections that follow:

- IAS 18 *Revenue*
- IAS 17 *Leases*
- IFRS 8 *Segment Reporting*
- IAS 40 *Investment Property*
- IAS 39 *Financial Instruments: Recognition and Measurement*, IFRS 9 *Financial Instruments* and IAS 32 *Financial Instruments: Measurement*
- IFRS 15 *Revenue from Contracts with Customers*
- ED 2013/6

2.3.1 IAS 18 Revenue

IAS 18.07 (IASB, 2014) defines revenue as “...the gross inflow of economic benefits during the period arising in the course of ordinary activities of an entity when those inflows result in increases in equity other than increases relating to contributions from equity participants.”

IAS 18.08 (IASB, 2014) indicates that revenue includes only the gross inflows of economic benefits received and receivable by the entity on its own account. Amounts collected on behalf of third parties such as sales taxes, goods, services taxes and value added taxes are not economic benefits that flow to the entity and do not result in increases in equity. Therefore, these are excluded from the definition of revenue. In an agency relationship (e.g. a property management company), the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity.

The amounts collected on behalf of the lessor are not revenue for the property manager; instead, revenue is the amount of the commission earned for the

collection of the principal amount. For the purposes of this study, the gross income (before deducting commission but after deducting VAT) will be used for the retail centre case study in Chapter 5 where building performance is analysed.

The content and stipulations in IAS 18 do not deal with the measurement of revenue arising from lease agreements. This is dealt with in IAS 17 *Leases*. The disclosure requirements of both IAS 17 and IAS 18 are applicable to any entity that generates revenue from lease agreements. IFRS 15 *Revenue from Contracts with Customers* (IASB, 2014) applies to all contracts except for leases within the scope of IAS 17. Therefore, IFRS 15 will not be discussed in this study.

2.3.2 Definitions of turnover and turnover rent

If a lease agreement is subject to turnover rent, it should stipulate the basis for calculation and payment of such turnover rent, and the lessee has certain obligations relating to this. These rights and obligations were discussed earlier in this chapter. This section will explore the definition of turnover rent in practice.

An example of a retail lease agreement was obtained from a South African asset manager for comparing turnover to revenue. The name of the asset manager remains anonymous due to a confidentiality agreement. In the lease agreement, “turnover”, from which turnover rent should be calculated, is defined as follows:

“The aggregate amount of actual selling prices (including any deposits and instalments) of all goods sold, and the charges for all services rendered or performed and rentals received for goods let by the lessee in, at, on or from the premises whether made in cash and/or credit or otherwise and include (but without limiting the generality of foregoing) all sales, leases and services:

- The orders for which originate at or are received or accepted or recorded by the Tenant in the premises but delivery or performance thereof is made from or at any place other than the premises, or vice versa;

- Made or rendered by means of mechanical or other vending devices in the premises;
- Made or rendered as a result of transactions originating upon the premises;
- Which the lessee would, in the normal or customary course of his business, credit or attribute to the Tenant's business upon the premises or part or parts thereof and all monies or other things of value received by the lessee from the Tenant's business in or on the premises and sales not included in the foregoing but made or performed in such manner as to deprive the lessor of the benefit thereof.

The following shall be excluded from turnover:

- Value Added Tax;
- In respect of sales on terms, such interest finance charges, and/or accommodation charges made that are separately disclosed to the customer and paid by the customer over the cash selling price of the goods sold;
- The transfer or exchange of goods between the Tenant and any of its branches, subsidiaries, associates, fellow subsidiaries, and/or holding company where such transfers or exchanges are made solely for the convenient operation of the Tenant's business and not for the purpose of sales which have been made at, in or from the premises, nor for the purpose of depriving the Landlord of the benefit of sales that otherwise would have been made at, in or from the premises; and
- Returns to manufacturers, wholesalers or suppliers; and
- Sales of fixtures after use thereof in the conduct of the Tenant's business in the premises; and
- Any amount received by the Tenant for the sale of stock in trade to a cedent of the lease where the cession of the lease to such cedent has been approved by the Landlord, and there shall be deducted from turnover, cash or credit refunds made upon transactions included with turnover, not exceeding the selling price of goods returned by the purchaser and accepted by the Tenant.

Should the Tenant operate or participate in any customer loyalty program, whether with the Landlord's consent or otherwise, it is specifically agreed that the cash-back rewards, points or other form of credits given to customers shall not be deducted from the Tenant's turnover."

According to this lease agreement, turnover rent should be calculated as follows:

"By multiplying the annual turnover of the lessee for the year preceding each anniversary of the commencement date of the lease by the percentage stated in section 6 of the schedule, and, if the resultant amount is greater than the basic rental, excluding any VAT content payable for the said year, then such excess plus VAT thereon is to be paid to the lessor as turnover rent."

The following example, on how to calculate turnover rent, is included for explanatory purposes:

Table 2.2: Turnover rent calculation

Annual turnover (Rand)	50,000,000
Store size (in square metres)	1,500
Basic rent per annum (Rand)	4,000,000
Turnover rent percentage	10%
Amount calculated (Annual turnover times Turnover rent percentage)	5,000,000
Turnover rent is the excess above basic rental and payable on an annual basis	1,000,000
Total rent paid and payable for the year	5,000,000
Breakpoint turnover	40,000,000
Further relevant ratios:	
Rent to sales ratio (total rent divided by sales)	8%
Trading density (Rand per annum)	33,333.33

Source: Own

The following graph explains the above example graphically:



Figure 2.1: Turnover rent calculation – a graphical depiction

Source: Own

The graph illustrates that total rental increases above the fixed rent after breakpoint turnover is reached. At the point of increase, the rent to sales ratio and the turnover rent percentage would be the same, being ten percent in this example.

2.3.2.1 A comparison between revenue (from a financial reporting perspective) and turnover (as defined in the example retail lease agreement)

When comparing revenue to turnover from a lessee point of view, it is important to identify the different purposes that each definition was intended for. The IAS 18 (IASB, 2014) definition of revenue is “...to determine the amount that will be presented in the financial statements for the financial year.” The lease agreement

definition of turnover is to determine the level of trading in a retail store, with the possible aim to include all activities resulting from presence in the centre in a period (lease period or financial period whichever is stipulated as a lease requirement), and ultimately to match the turnover rent income to the success of the retail centre in terms of footcount and consequential direct trade. This would serve as an optimisation of income for both lessor and lessee.

The turnover definition (from the example lease agreement) focuses on where the transaction would originate (where the order is processed or recorded); whereas the revenue definition (from IAS18) focuses on when the actual goods are transferred or the service is rendered (transfer of risks and rewards). This difference would result in amounts being included in turnover for the purposes of determining turnover rent but would not be presented in the annual financial statements as revenue. This will result in different treatment of transactions recorded by a lessee for revenue and for turnover purposes. The two different definitions will result in different answers due to the inclusions and exclusions specified in the definition of turnover as defined in the lease agreement. There will also be a difference in recognising the revenue from turnover rent to the lessor as opposed to the receipt of basic rent (refer section below on IAS 17).

Based on these differences there might be an opportunity, in terms of operational efficiency, to align the definition of turnover in the lease agreement to that of revenue in the accounting standards. There will be less opportunity for manipulation, and the need for separate revenue certificates will be eliminated as the audited financial statements could be submitted as proof of turnover. The example lease agreement used in this study requires that an audited certificate be submitted to the lessor, stating the amount of turnover for the preceding lease period. It is a requirement that the certificate be submitted 60 days after the period end (lease period or financial period, whichever is stipulated as a lease requirement). It should; however, be noted that this specific sharing of information between the lessor and lessees is important for management of the centre. Howard (2011:279) indicates that store managers will be surprised to know that

retail centre management has access to—and has analysed—turnover per store, centre, industry, and trends relevant to the specific retail asset, which could be beneficial for both the lessor and the lessee.

Another key difference is that when calculating turnover, it requires that any interest charged to customers above the cash-selling price is not included, but would be considered revenue for financial reporting purposes in the records of the lessee. In this case, it is required to show the split between sales revenue and interest revenue in terms of IAS 18. It must be noted that this appears to apply to the definition of turnover only when this interest is explicitly disclosed to the customer, and not a deemed amount of interest due to delayed payment terms.

The following table summarises the elements in the definition of turnover and provides a perspective of what would be included or excluded from the revenue and turnover of the lessee respectively. It was compiled using information in the lease agreement relating to the definition of turnover, and by applying the requirements of IAS 18 for lessees (relating to retail stores).

Table 2.3: Inclusions in and exclusions from revenue and turnover

Description	Revenue	Turnover
Orders received	Excluded	Included
Orders accepted	Excluded	Included
Orders recorded	Excluded	Included
Goods sold during the period	Included	Included
Vending machine sales during the period (immediate delivery)	Included	Included
Further sales in another entity due to transaction originating on the premises	Excluded	Included
Credit sales (goods delivered, payment delayed)	Included	Included

Description	Revenue	Turnover
Other monies received on the premises for goods sold in previous period	Excluded	Included
VAT	Excluded	Excluded
Interest and finance charges	Included	Excluded
Inter branch transfers	Excluded	Excluded
Returns to manufacturers (with sales reversal)	Excluded	Excluded
Sale of fixtures (assets)	Excluded	Excluded
Loyalty discount deduction	Excluded	Included
On-line sales collected/exchanged at the premises but sold from a different entity	Excluded	Included

Source: Own

The above examples explain the differences between revenue as defined in IAS 18, and the definition of turnover in a typical retail lease agreement. The purpose of this study is not to explore the differences, or the effect of the differences, on the lessee and lessor. It is noted for explanatory purposes and to highlight possible opportunities for future alignment between the two definitions to facilitate operational efficiency.

2.3.3 IAS 17 Leases

The lessor's lease income from operating leases should be recognised in income on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished (IAS 17.50). IAS 17 (IASB, 2014) further stipulates how contingent rentals should be treated (IAS 17.4). Contingent rent is defined as the portion of the lease payments that are not fixed in amount but is based on the future amount of a factor which changes other than with the passage of time

(IAS 17.4). Contingent rents recognised in the period should be disclosed (IAS 17.56).

Turnover rent is classified as contingent rent as it changes based on the sales (or other factor required by the lease agreement, for instance gross profit or occupancy rates) of the lessee in a certain period (lease period or financial period whichever is stipulated as a lease requirement). This is supported by the IASB (2008:2) who defined contingent rent as lease payments that increase or decrease because of changing factors subsequent to commencement date of the lease. An example of contingent rent being retail property rent based on performance of the lessee provided further clarity (IASB, 2008:4).

The requirements may not result in the contingent rental receivable being included in the straight-line lease income. As a result, turnover rent will be disclosed as part of lease income, and disclosed separately in a note to the financial statements.

Lessees should recognise lease payments as an expense in the statement of profit or loss and other comprehensive income over the lease term on a straight-line basis, unless another systematic basis is more representative of the time pattern of the user's benefit (IAS17.33). Lessees should, at least, disclose the basis on which contingent rent payable was determined (IAS 17.35(d)(i)). The standard only requires lessors to disclose the total contingent rents recognised as income, and does not seem to have the same requirement to disclose how contingent rental is determined (IAS 17.56(b)). The IASB considered additional disclosure requirements relating to contingent rent payments, being as follows:

- A description of contingent rent provisions in a lease with expected timing of outflows of economic benefits
- contingent rent expense in previous periods
- an estimate of future contingent rent payments with estimation assumptions (IASB, 2008:11)

If implemented, these requirements may pave the way for lessors to disclose the corresponding contingent rent income with related assumptions. The link to building performance will become clearer as it might be regarded as an expectation of collecting this assumed contingent rent income in the next period.

2.3.4 IFRS 8 Segment Reporting

If it can be determined that a specific building meets the definition of an operating segment, the entity should disclose information relating specifically to that building in its capacity as an operating segment from the perspective of the entity that holds title for it.

According to IFRS 8 (IASB, 2014), an operating segment is a component of an entity:

- That engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity)
- whose operating results are regularly reviewed by the entity's chief operating decision maker to decide on resources to be allocated to the segment and assess its performance
- for which discrete financial information is available (IFRS 8.5)

Based on the above definition, it seems possible that large buildings which form part of a portfolio could be considered operating segments for the purposes of IFRS 8. Before these segments are presented separately, they need to meet the criteria that they can be reported upon. This requires that the segment meets the preceding three criteria and must meet any one of the following quantitative criteria:

- The revenue of the building, including sales to external customers and intersegment sales or transfers, is ten percent or more of the combined revenue, internal and external, of all operating segments

- the absolute reported amount of profit or loss of the building is ten percent or more of the greater, in absolute amount of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss
- the assets of the building are ten percent or more of the combined assets of all operating segments (IFRS 8.13)

It is not compulsory to meet the above quantitative criteria if management believes that information about the segment would be useful to users of the financial statements (IFRS 8.13). Certain information of each building may be considered prejudicial to the lessor, it may therefore elect not to disclose the information in segments if the criteria above are not met, which may explain why buildings are not always presented separately as operating segments. Operating segments may be aggregated with other segments if the segments have similar economic characteristics, but do not meet the quantitative thresholds (IFRS 8.12). For example, retail centres can be reported separately to industrial buildings held in the same fund. [Refer in this regard to the content analysis of the annual financial statements in Chapter 4].

IFRS 8 allows for some flexibility in disclosure, a concern highlighted by Crawford, Extance, Helliard and Power (2012). Lessors of many of the large retail centres in South Africa would have substantial asset values and revenue per annum, and therefore it is likely that a single building's contributions to those funds would be less than ten percent, and would therefore not be considered a reportable segment. They may; however, elect to disclose certain assets only, even if assets do not meet the ten percent criteria. Crawford, *et al* (2012:6) further established that companies took the opportunity provided by this flexibility, for instance, not to disclose segmental information on capital expenditure, liabilities and the total carrying amount of assets by location of the assets.

According to IFRS 8.21, there are three types of disclosure that would be relevant if it is determined that a building is to be an operating segment. Firstly, general

information, and secondly, information about profit or loss, assets and liabilities, and thirdly, reconciliations need to be disclosed.

The following general information has to be disclosed (IFRS 8.22):

- Factors used to identify the entity's reportable segments, including the basis for organisation (e.g., whether management has chosen to organise the entity around differences in products and services, geographical areas, regulatory environments, or a combination of factors; and whether operating segments have been aggregated)
- types of products and services from which each reportable segment derives its revenue

"The information about profit or loss, assets and liabilities that is necessary to disclose includes the requirement that the entity reports a measure of profit or loss for each reportable segment, and report a measure of total assets and liabilities for each reportable segment, if such amounts are regularly provided to the chief operating decision maker." (IFRS 8.23).

- There is an additional requirement to disclose all of the following if the specified amounts are included in the measure of profit or loss, reviewed by the chief operating decision maker:
 - Revenues from external customers
 - revenues from transactions with other operating segments of the same entity
 - interest revenue
 - interest expense
 - depreciation and amortisation
 - material items of income and expenses disclosed in accordance with IAS 1.97
 - the entity's interest in the profit or loss of associates and joint ventures accounted for by the equity method

- income tax expense or income
- material non-cash items other than depreciation and amortisation
- the entity would also be required to disclose reconciliations of all of the following:
 - The total of the reportable segments' revenues to the entity's revenue
 - the total of the reportable segments' measures of profit or loss to the entity's profit or loss before tax expense and discontinued operations
 - the total of the reportable segments' assets to the entity's assets
 - the total of the reportable segments' liabilities to the entity's liabilities if segment liabilities are regularly provided to the chief operating decision maker
 - the total of the reportable segments' amounts for every other material item of information disclosed to the corresponding amount for the entity (IFRS 8.23)

The requirements to satisfy IFRS 8 are onerous. If entities were to provide the level of detail required, many entities could be prejudicing themselves, as part of the disclosures required would potentially reveal vital trade secrets. The trend seems to be to provide the bare minimum required by IFRS 8. It should be noted; however, that the current standard allows for voluntary disclosure that may be arbitrary in nature.

2.3.5 IAS 40 *Investment Property* and IFRS 13 *Fair Value Measurement*

Investment property is defined as property (land or a building, or part of a building, or both) held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes or sale in the ordinary course of business (IAS 40.5). Based on this definition, and the examples of investment property included in IAS 40 (IASB, 2014), buildings owned by property funds would be classified as investment property (IAS 40.8).

Investment property may either be measured at fair value through profit/loss or at

cost (IAS 40.30). This is an accounting policy choice, and once made, must be applied throughout the entity's investment property. The most prevalent choice is to measure investment property at fair value. [Refer in this regard to the sample of annual financial statements analysed in Chapter 4]. This requires that investment property be measured at fair value with any fair value gains/losses being recognised in profit or loss (IAS 40.35). This measure of fair value needs to be determined according to the requirements of IFRS 13 (IASB, 2014).

IFRS 13.8 defines fair value as the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. Another key point to take into account is that fair value is a market-based measurement and not an entity specific measurement (IFRS 13.9). When using fair value measurement, the entity needs to use the assumptions that market participants would use when pricing the asset.

IFRS 13.10 outlines the overall fair value measurement approach. This approach requires the entity to determine all of the following:

- The particular asset or liability that is the subject of the measurement
- for a non-financial asset, the valuation premise that is appropriate for the measurement (consistent with its highest and best use)
- the principal (or most advantageous) market for the asset or liability
- the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability, and the level of the fair value hierarchy within which the inputs are categorised

Therefore, in order to measure a retail centre at fair value, the following needs to be determined:

- The specific retail asset that needs to be valued
- when determining the valuation premise that is appropriate, it would need to

be determined what would result in the highest and best use of the asset. If the highest and best use comes as a result of use in combination with other assets as a group or on a stand-alone basis, the asset will have to be valued based on that premise

- the entity would need to determine what the principal market for the retail asset is
- when determining the valuation technique used to determine fair value, the entity shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs

This requires using as many inputs as possible that are considered Level 1 inputs in the fair value hierarchy:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the date that the asset needs to be measured at fair value
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly
- Level 3 inputs are unobservable inputs for the asset

The income approach is the valuation technique that the entity would apply all these inputs to (IFRS 13.B10). This converts future amounts (e.g. cash flows and in the case of a retail centre the expected rental income) to a single current (discounted) amount. This includes present value techniques and potentially option pricing models.

To measure a retail asset at fair value using a present value technique, the entity links future amounts (in this case expected future rental) to a present amount, using a discount rate. All of the following would be taken into account by using this technique (IFRS 13.B13):

- An estimation of future cash flows for the asset or liability being measured
- expectations about possible variations in the amount and timing of the cash

flows representing the uncertainty inherent in the cash flows

- the time value of money, represented by the rate on risk-free monetary assets with maturity dates or durations that coincide with the period covered by the cash flows
- the price for bearing the uncertainty inherent in the cash flows (*i.e.* a risk premium)
- other factors that market participants would take into account in the circumstances

Turnover rent would be a factor in determining the fair value of retail assets, as turnover rent will make up a portion of the cash flows expected to be earned from retail assets. In order to determine the fair value correctly, and to ensure that the effect on the statement of financial position is correct, estimates of turnover rent would be needed. Howard (2011) refers to the problems with valuation of a retail shopping centre, and indicates that valuers may find it difficult to estimate retail turnover, and that unconventional approaches cause uncertainty. Howard (2011) cites this as a reason why the value of a shopping centre as an asset may be affected by estimates. These estimates could be based on economic or retail trade forecasts, but should ideally be based on specific lessee or industry trade forecasts, or at least based on past trade trends of each lessee. The budgets of the particular retail centres could be used in this regard, but certain longer term assumptions should be made to accurately reflect the turnover (and turnover rent) forecast. According to McAllister (1996:22) expected turnover-related income is likely to vary annually due to the complex interaction of macro-economic trends, local economic and property market conditions, the trading performance of the lessee, and the nature of the retail asset. Valuers are trusted as experts (Ilsjan & Kask, 2005:79). There is an indication that the client who requested the valuation cares more about the outcome than the methodology or base data, and is usually management rather than the accountant, auditor or specialist (Ilsjan & Kask, 2005:79).

2.3.6 IAS 39 *Financial Instruments: Recognition and Measurement*, IFRS 9 *Financial Instruments* and IAS 32 *Financial Instruments: Measurement*

The interaction between IAS 32 (IASB, 2014) and IAS 39 (IASB, 2014) dictates that IAS 32 be looked at first to determine if a lease contract gives rise to a financial instrument, then to apply IFRS 9 (IASB, 2104) for initial recognition and measurement, and then, if objective evidence of an impairment appears, IAS 39 will be used. IFRS 9 is slowly replacing IAS 39. IAS 39 applies to financial instruments for subsequent measurement (impairment) and hedge accounting, and IFRS 9 applies to financial instruments for initial recognition and measurement. IAS 32 dictates the presentation of financial instruments.

In terms of IAS 32.11, a financial instrument is any contract that gives rise to a financial asset of one entity, and a financial liability or equity instrument of another entity. A financial asset is defined as any asset that is one of the following:

- Cash
- an equity instrument of another entity
- a contractual right
 - to receive cash or another financial asset from another entity
 - to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity
- a contract that will or may be settled in the entity's own equity instruments (IAS 32.11)

Turnover rent clauses only result in a right to receive cash when the clause is activated, providing the lessee earns enough turnover to reach breakpoint turnover that activates the clause. This amounts to a contingent settlement provision, and as the lessee does not have the unconditional right to avoid delivering cash, they will be required to account for it as a financial liability which will result in the lessor recognising a financial asset.

In terms of IFRS 9, turnover rent clauses will be considered embedded derivatives. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable provided in the case of a non-financial variable, the variable is not specific to a party to the contract. Turnover rent is based on turnover of the retail store, as indicated in Table 2.2. The contractual cash flows will change according to the total turnover achieved in each retail store in the specified period of measurement.

IFRS 9.4.3.3 requires the embedded derivative to be separated from the host contract (the lease agreement) and accounted for as a derivative only if:

- The economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host (the lease contract)
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative
- the hybrid contract is not measured at fair value with changes in fair value recognised in profit and loss (*i.e.* a derivative that is embedded in a financial liability at fair value through profit or loss is not separated)

IFRS 9.B4.3.8(f) further indicates that an embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is:

- An inflation related index such as an index of lease payments to a Consumer Price Index (CPI) (provided that the lease is not leveraged and the index relates to inflation in the entity's own economic environment)
- contingent rentals based on related sales
- contingent rentals based on variable interest rates

Therefore, turnover rent clauses are not required to be split from the host lease contract and accounted for as a derivative in terms of IFRS 9, as they would be considered closely related to the host contract as mentioned above.

2.3.7 ED 2013/6

The reason for the IASB and the FASB publishing this revised exposure draft is to try to address some of the challenges experienced from the previous model of accounting for leases (ED 2013/6.5). The current model requires that leases be accounted for as either finance leases, or operating leases. According to Craig (2013:10) this treatment does not result in faithful representation as it results in significant assets and liabilities not being reported on the statement of financial position. This model has been criticised for failing to meet the needs of users of financial statements since they do not always provide a faithful representation of leasing transactions. The impact of the current IAS 17 is illustrated by Branswijk, Stephanie and Patricia (2011) indicating that, while the total annual leasing volume in 2008 for the top fifty countries amounts to \$644 billion, many of those lease contracts do not appear in the financial statements or balance sheet of an entity due to the categorisation as operating leases.

This exposure draft (IASB, 2013) proposes changes to both lessee and lessor accounting for lease agreements. For most leases of assets other than property (e.g. equipment, aircraft, cars, and trucks), a lessee would classify the lease as a Type A lease. It is not applicable to this study since it relates to leases other than property, and will therefore not be further explored.

For most leases of property (*i.e.* land and/or a building or part of a building and therefore applicable to this study), a lessee would classify the lease as a Type B lease and would therefore do the following:

- Recognise a right-of-use asset and a lease liability, initially measured at the present value of lease payments

- recognise a single lease cost, combining the unwinding of the discount on the lease liability with the amortisation of the right-of-use asset, on a straight-line basis

Similarly, the accounting applied by a lessor would depend on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. For practical purposes, this assessment would often depend on the nature of the underlying asset. Typical to large retail buildings, there is not one lessee leasing a significant portion of the property, but rather a mix of lessees servicing customers (shoppers). When one lessee is taking a significant portion of the premises, ED 2013/6 would have an impact on the records of the lessee and the following disclosure should be applied:

- Continue to recognise the underlying asset
- recognise lease income over the lease term, typically on a straight-line basis

When measuring assets and liabilities arising from a lease, a lessee and a lessor would exclude most variable lease payments. In addition, a lessee and a lessor would include payments to be made in optional periods, only if the lessee has a significant economic incentive to exercise an option to extend the lease, or not to exercise an option to terminate the lease.

The exposure draft is not changing how the lessor would account for the operating lease or leases that would arise from the retail centres in terms of how the investment property would be treated. The lessor shall, after identifying the lease components in a contract in accordance with ED 2013/6.20 (which requires that the separate components of the contract be accounted for), allocate the consideration in the contract using the requirements laid out in IFRS 15.70-76 (ED 2013/6.22). In essence, the requirement of these paragraphs state that for a contract with more than one performance obligation, an entity shall allocate the transaction price to each separate performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in

exchange for each separate performance obligation. For a lessor the performance obligation remains unchanged in providing the building and other services according to the lease agreement, and therefore the treatment for turnover rent would be the same as is currently according to IAS 17.

2.4 SUMMARY AND CONCLUSION

This chapter indicates the compulsory compliance to IFRS for listed real estate funds, funds that are owned by listed entities and REITs as a legal requirement. Other legal requirements relating to turnover rent are highlighted in this chapter. Due to the contract (lease agreement) that is in place between the lessor and the lessee, there is a legal obligation for the lessee to pay turnover rent to the lessor. Further legal requirements relating to turnover rent may exist in the lease agreement creating a further obligation of, for instance, sharing of information with the lessor. The availability of this information to the lessor can therefore be assumed if supply of the information was enforced. The lessor will be able to use this information to monitor lessee and building performance, but has no requirement to disclose this information to shareholders or other stakeholders.

This chapter further highlights the prevailing financial disclosure requirements relevant for retail real estate performance. Determination and disclosure of turnover rent, being indicative of both building and lessee performance receives specific focus. The chapter indicates the difference between revenue as a financial disclosure requirement (IAS 18.07) and turnover as defined in a retail lease agreement. Based thereon, there may be an opportunity for alignment with the accounting standards which may create operational efficiencies for both lessee—in terms of ease and cost of compliance—and the lessor, in terms of enforcing, interpreting and processing the information. Turnover rent as a building and lessee performance indicator was confirmed by the calculation in Table 2.2, taking into account the lessee turnover and rental (building income).

The IASB has considered additional disclosure requirements relating to contingent

rent payments by lessees, but has not implemented these. The current requirement for a general description of the basis on which contingent lease payments, and the amount for the period forms part of the current disclosure requirements of IAS 17 (IASB, 2008) are determined. These additional requirements may pave the way for lessors to have an additional requirement to disclose contingent rent income in the future. Currently, there are no additional financial disclosure requirements for the performance of individual real estate assets.

This chapter further highlights that IFRS 8 allows for flexibility in the disclosure of segment information not meeting the minimum criteria stipulated. This would allow a lessor to disclose only certain information of, for instance, better performing buildings. The lessor may also group certain information together where a well performing building disguises the performance of a poor performing building.

In the next chapter, the choice of research method and the research design will be discussed with relevant academic support. The methods and related limitations for both the content analysis of annual financial statements and the retail centre case study will be discussed. This chapter will further demonstrate the alignment to the research problem statement and the research objectives.

CHAPTER 3

RESEARCH DESIGN

3.1 INTRODUCTION

Chapter 2 focused on the current financial disclosure requirements related to retail building performance and specifically the determination and disclosure of turnover rent. Chapter 2 also provided—as explanatory background—a summary of the legal aspects related to lease agreements in retail centres, both in relevant legislation and in contractual obligations. The information required to determine turnover rent and its contribution to lessor revenue, being basic rent (income for the lessor) and lessee turnover (income for the lessee), confirms turnover rent as a building and lessee performance indicator.

Chapter 3 focuses on the proposed choice of research methods, specifically the two phases, being content analysis and a case study. It addresses the issue of availability of data and indicates the limitations of the chosen methodologies. The methods to be followed in both phases are discussed. The chapter explains the need for content analysis and a case study as the most beneficial research methods to be followed in order to address the research objectives.

3.2 RESEARCH METHODS

3.2.1 Content analysis of financial disclosure

Chapter 4 focuses on the content analysis phase of the study. A broad definition of content analysis is “...any technique for making inferences by objectively and systematically identifying specified characteristics of messages” (Holsti, 1969:14). The content analysis will address the objective to establish the extent of financial and performance information available from the annual financial statements of

REITs and real estate funds owning retail buildings. This objective supports the overall research problem statement of this study, which is to assess the availability of relevant information in order to determine the contribution of turnover rent to the lessor's revenue, measured per industry in the retail sector, through both a growth and a contraction phase in the South African economy. Content analysis enables a researcher to sort through larger volumes of data with relative ease in a systematic way (GAO, 1996). The analysis of retail properties rental is; however, hampered by a lack of data (Hui and Yau, 2006:141). Mousa and Elamir (2013:27) selected annual reports of listed entities to analyse disclosures effectively by means of a content analysis. Annual financial statements will be the source of the information required. The entire integrated report will be scrutinised for information relevant to turnover rent. The entities should be listed on the JSE and own retail buildings; however, a selection of companies will be made based on publicly available information on ownership.

In conducting a content analysis, six questions should be addressed according to Krippendorff (1980), with the related context to this study as indicated in Table 3.1 below.

Table 3.1: Critical questions of the content analysis

Question	Context of this study
1) Which data is being analysed?	1) Turnover rent disclosure
2) How is it defined?	2) Definitions, context and related financial disclosure requirements of turnover rent are included in chapters 1 and 2 of this study. Synonyms for turnover rent, e.g. variable rent or contingent rent will be included in this content analysis to identify the relevant disclosure
3) What is the population from which they are drawn?	3) Listed annual financial statements of retail property owners in South Africa
4) What is the context relative to which	4) The application of the financial

Question	Context of this study
the data will be analysed?	disclosure requirements of turnover rent as building performance criteria
5) What are the boundaries of the analysis?	5) The analysis will be limited to annual financial statements, published in line with the JSE listing requirements
6) What is the target of the inferences?	6) To establish the possible lack of disclosure of turnover rent and the availability of data to address the research problem

By addressing the above questions, specifically for the case study of this dissertation, content analysis will be performed and documented in Chapter 4.

3.2.2 Retail centre case study

Considering the various qualitative research methods of data analysis, such as surveys, economic or statistical modelling or a case study, the research problem was taken into account. According to Yin (2014:2), a case study is the appropriate method to follow if the predominant research questions are “why” and “how” questions, and lists two more factors to consider when deciding on the research method of a case study:

- The researcher should have little or no control over behavioural events
- the study should be focusing on a contemporary phenomenon (Yin, 2014:2)

A case study is defined as “...an in depth study of a particular situation rather than a sweeping statistical survey. It is a method used to narrow down a broad field of research to a more easily researchable topic.” (Shuttleworth, 2008). A further, even more relevant, definition of a case study is “...an in-depth, multifaceted investigation, using qualitative research methods, of a single phenomenon.” (Feagan, Orum & Sjoberg, 1991:2). A case study was, e.g., performed on a single shopping centre to analyse the attractiveness of the location of the retail centre

(Gorter, Nijkamp & Klamer, 2003:219).

Considering the above criteria, definitions, and example of a retail centre case study, it would be the appropriate research method, as it will address the research questions and objectives. The primary research objective was stated as a quantification of turnover rent. Following the indications of Yin (2014), the main questions applied to the topic of this research, is how turnover rent is disclosed or not disclosed, and why it is done in a certain way. One can speculate as to the reasons for the specific disclosure or the lack thereof. The more important aspect is how important turnover rent is to a retail building and how susceptible it is to changes in the economy – it is not merely a revenue stream, it speaks to performance of property management and lessee performance alike. Yin (2014:2) further highlights that the researcher should have little or no control over the behavioural events. In this case, this aspect is met with the researcher being independent from the organisation supplying the data. The last aspect Yin (2014:2) indicates was that the case study should focus on a contemporary phenomenon. The case study will be focusing on data from 2007 through 2014, thus being in line with this third aspect raised.

In order to meet the definition of a case study, an investigation should be performed in an in-depth and multifaceted nature, using qualitative methods (Feagan, *et al*; 1991). This investigation will analyse a full set of turnover data for the entire centre. All centre performance dynamics should be taken into account, including, but not limited to, the period investigated and the lessees in all merchant categories.

3.3 SOURCING AND AVAILABILITY OF DATA

3.3.1 Content analysis

Published annual financial statements from 2012 to 2014 will be used. These will be sourced from the websites of listed entities. Ownership of retail centres will be

confirmed either through the review of these annual financial statements or through other public sources, such as the South African Council for Shopping Centres annual publications. According to the JSE requirements, annual financial statements should be released to shareholders within six months after the end of the financial period (JSE, 2015). Examples will be selected in the latter part of the period under review to ascertain application of current financial disclosure requirements. Refer to section 3.5.1.1 for more detail.

3.3.2 Retail centre case study

Data will be sourced from an asset manager willing to share the relevant data to perform the case study over the period proposed in one retail centre. Ethical clearance was granted in this regard. Refer to the ethical clearance certificate included in 'Appendix 2'. The centre should be of a substantial size and should include all or most of the major retail merchant categories. The owner of the data and the name of the retail centre it relates to will not be disclosed due to confidentiality and the sensitive nature of the centre and lessee performance data.

3.4 LIMITATIONS OF THE CHOSEN METHODS

3.4.1 Results of both phases cannot be extrapolated

Results of the content analysis cannot be extrapolated over the population of companies that own retail centres. These companies are independent from each other, therefore it cannot be assumed that one company's interpretation, and application of financial disclosure is applicable to another, or that the results of the content analysis of a selection of published financial statements are applicable to all listed entities holding retail investment property.

An inherent limitation to case studies is that a narrow field is investigated and therefore, results cannot be extrapolated to an entire population (Shuttleworth, 2008). The data of a single retail centre analysed can therefore not be assumed as

applicable to all retail centres.

3.4.2 Data origin and accuracy of data not verified

Data sourced from the financial statements as part of the content analysis is audited and published. However, the data used in the retail centre case study is captured from different sources, e.g., data supplied by lessees in lease obligations, the property manager rent roll as captured by individuals working for the property manager, turnover rent calculated and captured by individuals working for the property manager. The accuracy of this data will not be verified as part of this study. A research department manages the data and the asset manager makes management and investment decisions based on this data. The lessor has therefore accepted this data and had, or has, the right, stipulated in the lease agreement, to audit this data, which is an option in the lease agreement and not compulsory. It can be exercised on a random basis or where anomalies might exist. The entity releasing the data is a listed entity and subject to external audits. Based on the above information, the data for both phases of this study will be accepted.

3.5 METHODS TO BE FOLLOWED

3.5.1 Content analysis

3.5.1.1 Selection of published annual financial statements

In Chapter 4 a selection of annual financial statements will be made. Refer in this regard to paragraph 3.3.1. These financial statements are publicly available and forms part of the integrated reports of listed entities. Purposive sampling is used to select the sample size out of a population of thirty-five JSE-listed REITs (Moneyweb, 2016). Purposive sampling is used when the sample is selected for a specific purpose and is not probability based (Leedy & Omrod, 2005:206). A sample of six companies is selected. This sample will endeavour to determine the

availability of relevant information in order to determine the contribution of turnover rent to landlord revenue. The selection will be made by following the next steps:

- Select one entity from the JSE listed property section and confirm, through review of these 2012 annual financial statements, that they do own retail real estate as investment property.
- Confirm that this entity owns more than one retail building or a building of substantial size (above 100,000 square metres) in order to analyse all requirements of the financial reporting standards, e.g. grouping of buildings in segments as required by IFRS 8.
- Perform the analysis as stipulated in paragraph 3.5.1.2.
- Should it be found that the disclosure for turnover rent and other building performance criteria are inadequate, select a further four entities from the JSE listed property section in order to assess the interpretation of the disclosure of turnover rent further.
- Confirm, by reviewing the annual financial statements of the additional four entities, that they do own retail real estate as investment property.
- Confirm that these entities own more than one retail building or a building of substantial size (above 100,000 square metres) in order to analyse all requirements of the financial reporting standards, e.g. grouping of buildings in segments as required by IFRS 8.
- Select one insurance company which owns multiple retail real estate by confirming ownership through SAPOA as the financial statements may not disclose this detail based on materiality.
- Select annual financial statements of one year for each of these additional five entities from 2013–2014 and include these in the analysis.

The selection of the financial statements occurs over the period in which the study was performed, *i.e.* from 2013–2015. The period of analysis is selected as being the most recent years that form part of the study (including the period of data in the case study) in order to take into account recent financial disclosure regulations and interpretations in line with the problem statement of the availability of relevant

information relating to turnover rent.

3.5.1.2 Analysis of the relevant disclosure of building performance

The financial disclosure of turnover rent and related building performance criteria will be measured against the current requirements of the financial disclosure standards. Where the information disclosed is less than what is prescribed, this will be indicated. Where additional disclosure is made over and above the requirements, it will be indicated. The results of this analysis will be summarised in tabular format for comparative purposes.

3.5.2 Retail centre case study

3.5.2.1 Requesting and sourcing of data

Data will be requested from the owner of the retail centre. Officially published economic data will be sourced from reputable sources, including the South African Reserve Bank and Statistics South Africa.

3.5.2.2 Establish and confirm availability and relevance of data

The relevance of the data will be established by means of the review of the data as it is extracted from the management information system. Available data will be reviewed to assess the availability, applicability and relevance of the data for this study. This would include the fields relevant for basic rent and lessee turnover in order to assess relevant centre level and merchant category level performance from 2007 through 2014. Vacancy levels will not be taken into account as an influence on other lessee rentals. The occupancy rate (the inverse of vacancy rate) has no significant influence on rent in larger diversified retail centres (Hui & Yau, 2006:144-145).

3.5.2.3 Sorting of data

Data will be sorted according to two levels. The first will be the centre level performance where it relates to turnover rent. In order to address the research question, turnover will be quantified for the centre, and secondly clarified and contextualised by analysing the largest contributing merchant categories to turnover rent. This is supported by Hui and Yau (2006:137-138) who indicated that the introduction of a greater variety of shops attracts higher overall rental income, hence confirming the importance of the variety of merchant categories in a large retail centre. At the second level of sorted data, this specific variety will be sorted in descending value from highest to lowest contributors to base rent and turnover rent specifically and analysed accordingly.

3.5.2.4 Prepare pivot tables of relevant data fields

Pivot tables will be used to analyse the summary of the data. A pivot is an experimental application for exploring large data sets with smooth visual interactions (Microsoft, 2010). All relevant fields will be included in the pivot, e.g., relevant centre level, merchant category level performance data, and economic data over the entire period of investigation, namely 2007–2014.

3.5.2.5 Perform data analysis and depict in graphical format

The following graphical depictions will be used to visually portray the results of the analysis: Bar charts, line graphs, and pie charts. Visual tools can play a significant part in the analysis of data (Bazeley and Jackson, 2013:217). Visual summary of data in charts graphs and diagrams assist in the identification of patterns, trends and relationships in the data (Bazeley and Jackson, 2013:217). In analysing real estate price indices, Hui and Yau (2006:140) effectively utilised line graphs to depict trends in the indices over a period of nine years. Their study used regression analysis to determine the impact of various attributes in terms of a retail facility's physical characteristics, and market positions and location on the

annualised per-area net rental income. Regression analysis would not be the appropriate method for this study. While rental will be analysed as part of this study, a trend analysis will be used to address the research problem. Line graphs will be used for the trend analysis.

Economic trends will be compared to the centre and merchant category performance of the largest turnover rent contributors in the centre. Gyourko and Linneman (1988) assessed the effectiveness of REITs as inflation hedges. Returns on a wide variety of residential and non-residential real estate were investigated. REITs appeared to be negatively correlated to inflation (Gyourko and Linneman, 1988). In this study CPI will be included and compared to the retail centre and merchant category performance, as well as prime interest rates and GDP numbers.

3.5.2.6 Summary of findings

The data analysis will render findings in the form of notable trends. The visual tools will be provided in 'Appendix A' to this study. Retail centre performance information available from the data will be indicated, *i.e.* information and data available over and above the data required for financial disclosure requirements.

3.6 SUMMARY AND CONCLUSIONS

This chapter indicated the two phases in the research study and why two phases are necessary to address the research objective. The main research methods were discussed with relevant motivation for the use of these methods. Both the content analysis of financial disclosure and the retail centre case study included in the next two chapters, form an important part of the overall study, since it provides additional information of the availability of relevant data, and the usability of this data to depict (and ultimately disclose) retail building performance data related to turnover rent, and other building performance aspects.

The next two chapters will be dedicated to the research methods illustrated in this chapter. The steps will be followed as indicated in paragraph 3.5 of this chapter. The findings obtained through the execution of the steps will be documented in Chapters 4 and 5, relating to the content analysis and the retail centre case study respectively.

CHAPTER 4

CONTENT ANALYSIS: REVIEW OF ANNUAL FINANCIAL STATEMENTS

4.1 INTRODUCTION

The prevailing financial disclosure requirements relevant to turnover rent (or contingent rent) generated by lessees in retail real estate were analysed in Chapter 2. Certain inadequacies were highlighted and summarised in the conclusion of the chapter. Among these is the possibility of arbitrary disclosure in terms of IFRS 8. Chapter 3 stipulated the methods to be followed for both phases of the research with the first phase of this study, namely a content analysis of the disclosure of turnover rent in annual financial statements, included in this chapter.

The content analysis in this chapter will endeavour to ascertain how the prevailing accounting standards are applied in the commercial real estate industry in South Africa. The analysis' findings of published annual financial statements of six listed retail property owners will be documented and summarised in this chapter. The application of the financial disclosure requirements relevant to the retail real estate industry will be evaluated insofar it relates to turnover rent.

4.2 SELECTION OF ANNUAL FINANCIAL STATEMENTS

In accordance with the method described in paragraph 3.5.1.1, one entity was selected from the JSE listed real estate section. It was confirmed with the review of the annual financial statements that they do own multiple retail buildings as investment property. The analysis as described in paragraph 3.5.1.2 was performed and the result of this analysis is document in the next section.

4.2.1 SA Corporate Real Estate Fund (SAC): 2012 Annual Financial Statements

SAC's accounting policy relating to revenue recognition stipulates the basis for accounting of turnover rent as follows:

“Revenue comprises gross rentals, including all recoveries from tenants. Variable operating costs are recognised on the accrual basis. Rental income and fixed operating costs are recognised on the straight line basis in accordance with IAS 17: Leases. Turnover rent income is recognised on the accrual basis and measured at fair value.” (SAC, 2013:14).

SAC applies IFRS 8 and stipulated the following segments in line with their accounting policy (SAC, 2013:30):

- Retail
- industrial
- offices
- other

SAC does not disclose further detail of their property portfolio. SAC makes specific mention of turnover rent in their accounting policy relating to revenue recognition as quoted above (SAC, 2013:14). This is in line with the requirements of IAS 18.35(a). In the note disclosure, turnover rent has been disclosed separately from rental income to determine total rent (SAC, 2013:16). This is in line with IAS 18.35b and IAS 17.56b.

Relating to the accounting policy for revenue recognition (SAC, 2013:14), investment property is measured at fair value and if information on recent prices is not available, the fair values of investment properties are determined using discounted cash flow valuation techniques. The principal assumptions involved in that valuation relates to the receipt of contracted rentals. This basis meets the

requirements of IAS 40.75 and IFRS 13.91(1).

Companies have to disclose the fair value hierarchy, *i.e.* what their Level 1, 2, and 3 inputs are when used to determine fair value if IFRS 13 is being applied. SAC has not applied the standard in their 2013 Annual Financial Statements.

4.2.2 Selection of further Annual Financial Statements

Due to the inadequate disclosure of turnover rent and building performance to address the research problem indicated in paragraph 1.3, a further four listed REITs or listed real estate entities, as well as an insurance company (being a large owner of multiple retail real estate assets) were selected to evaluate the application of disclosure requirements relating to turnover rent, as stipulated in paragraph 3.5.1.2. It was confirmed with the review of the annual financial statements and SAPOA that the selected entities own more than one retail building as investment property in South Africa. This selection is not necessarily representative of the entire population of retail buildings in South Africa, but selected to establish if adequate disclosure is available in these financial statements in line with the financial disclosure requirements. The one year selected for each entity was from 2013–2014, being the latest available financial statements during the time in which the study was performed. Refer to paragraph 3.5.1.1 for more detail. The following sections contain the findings of the analysis of these additional financial statements.

4.2.2.1 Growthpoint Properties Limited (Growthpoint): 2013 Annual Financial Statements

In the analysis of Growthpoint's 2013 Annual Financial Statements (2013:20) the following information, relating to revenue from the letting of properties, has been disclosed in line with their accounting policy for revenue recognition:

“Revenue from the letting of investment property comprises gross rental income

and recoveries of fixed operating costs net of value added tax. Rental income is recognised on a straight line basis over the term of the lease. Recoveries of costs from lessees, where the entity merely acts as an agent and makes payments of these costs on behalf of lessees are offset against the relevant costs.”

The above definition correlates to the definition of revenue as stipulated in IAS 18.7 and with IAS 17.50. There is no reference to turnover rent in the accounting policy.

In the statement of profit or loss and other comprehensive income, revenue is disclosed net of the straight-line operating lease adjustment; it must be noted that turnover rent (considered contingent rent) will not affect this straight lining adjustment. This is in line with the requirements of IAS 18.35b and IAS 17.50.

In the notes to the financial statements, total revenue has been split into the different components of revenue. Here Growthpoint discloses turnover rent separately. Amounts are disclosed without an explanation of how the amounts were derived or the timing of recognition of the amount. The question arises whether turnover rent is recognised in the period that it relates to, the period when it is quantifiable, or in the period that it was received (*i.e.* on the cash basis) since no accounting policy is provided in this regard.

Note 40 (Growthpoint, 2013:51) also discloses minimum contracted rental as required by IAS 17.56. In this note, Growthpoint is explicit in stating that the amounts they have disclosed are the amounts that would be due in terms of the contractual agreement between them and their lessees. As turnover rent forms part of the contractual obligation between lessor and lessee, it could only be assumed that it is included in this amount. It remains speculative how they calculated this amount—possibly by means of estimation—although there is no separate split for turnover rent in this note, and no further information regarding turnover rent is provided.

In Section B (Growthpoint, 2013:63-81) provides detail on the property portfolio, and the gross rental on each property is disclosed; gross rental being defined as “...being the weighted average actual gross rental, consisting of net rental, operating cost recoveries and recovery of assessment rates.” Turnover rent is not separately disclosed, and again it could only be assumed that turnover rent is included in this amount.

As required by IAS 40.33, investment property is measured at fair value. The discount rates used to determine the fair value of investment property has been based on adding a growth rate related to market transactions, according to the Accounting Policies 1.3 Investment Property (Growthpoint, 2013:18).

IFRS 8 is applied as indicated in the accounting policy 1.19 (Growthpoint, 2013: 21). The operating segments are split geographically and then the segment relating to South Africa is split into Retail, Office and Industrial as well as showing a segmental analysis for their investment in the V&A Waterfront. Although the criteria for separate disclosure of IFRS 8 are technically not met, the Waterfront is shown separately. No reason is indicated in the financial statements why this is shown separately but IFRS 8.17 does allow separate disclosure even though the minimum criteria are not met. One can only speculate as to why this was disclosed separately. It is publicly known that the specific retail asset is co-owned by another party. Growthpoint applies equity accounting for this investment and specifically mentions that it is equity accounted. It may be that separate disclosure is a requirement for the co-owner, but it is speculative.

Companies have to disclose the fair value hierarchy, *i.e.* what their level 1, 2 and 3 inputs are when used to determine fair value if IFRS 13 is being applied. Growthpoint will be applying this standard only for the year ended 30 June 2014.

4.2.2.2 Hyprop Investments Limited: 2013 Annual Financial Statements

Hyprop provides a breakdown of revenue in the Financial Director’s report

(Hyprop, 2013:22). This breakdown of revenue shows that turnover rent amounts to less than one percent of total revenue. They claim this supports the contractual and predictable nature of their revenue stream (Hyprop, 2013:22).

Hyprop's investment property is measured according to the fair value model as per their Accounting Policy 1.9 Investment and Development Property (Hyprop, 2013:65). This is in line with the requirements of IFRS 40.75.

Hyprop's revenue recognition policy, according to the Accounting Policy 1.17 Revenue, stipulates when turnover rent is accounted for, as follows:

“Property portfolio revenue comprises operating lease income and operating cost recoveries from the letting of investment properties. Operating lease income is recognised on a straight line basis over the term of the lease. Turnover rents are included in revenue when the amounts can be reliably measured.” (Hyprop, 2013:68).

This is the only specific reference to turnover rent in Hyprop's financial statements. It provides information to the recognition of turnover rent. As turnover rent can only be reliably measured after the financial year or annual lease period end of the lessee (whichever period is stipulated in the lease agreement), it can be assumed that turnover rent is actually recognised on the cash basis, or at the earliest on the accrual basis in the year after the relevant year that the turnover rent is based on, but only if it can be reliably measured. With the requirements stipulated in Chapter 2, it can be assumed that it can only be reliably measured once the auditors of lessees in Hyprop buildings have certified the turnover for the year and have provided related annual turnover certificates. This certification could be used to measure turnover rent reliably.

Hyprop's minimum lease payments receivable, according to note 31: Minimum lease payments, shows all amounts receivable relating to contractual rental income and operating expense recoveries from investment properties (Hyprop,

2013:92). This is in line with IAS 17.56. There is no separate disclosure provided for turnover rent in this note. As is the case in the Growthpoint Annual Financial Statements, one could only speculate whether turnover rent is included in this amount.

Hyprop separates turnover rent from operating income (Hyprop, 2013:87). In this note they disclose contingent rental income (turnover rent) which amounts to approximately R7 million. This does amount to less than one percent of their total revenue, like it was indicated in the Financial Director's report (Hyprop, 2013:22).

Hyprop discloses a weighted average rental per retail centre that they own (Hyprop, 2013:99). This weighted average rental includes basic rent and operating costs. This is additional detail and not specifically required by any specific accounting standard. The reason for this additional disclosure is not known.

Companies have to disclose the fair value hierarchy, *i.e.* what their Level 1, 2 and 3 inputs are when used to determine fair value if IFRS 13 is being applied. Hyprop applied IFRS 13 with all Level 3 inputs used.

4.2.2.3 Vukile Property Fund Limited (Vukile): Integrated Annual Report 2014

Vukile mentions that contingent rent forms part of revenue in the accounting policy in point 1.7: Revenue Recognition (Vukile, 2014:84). It further states that “[c]ontingent rents (turnover rent) are included in revenue when the amounts can be reliably measured.” (Vukile, 2014:84). This meets the criteria of IAS 18.35a. Vukile discloses the amount of turnover rent separately (Vukile, 2014:113). This meets the requirement of IAS 18:35b as well as IAS 17.56b.

Vukile applies IFRS 8. The Operating segment report is disclosed with IFRS 8.21a and IFRS 8.21b requirements met, but there is no reconciliation of segment amounts to the groups' numbers (Vukile, 2014:120). Vukile further discloses additional information for operating segments. The following information, not

specifically required by any accounting standard, is disclosed for each individual building owned (Vukile, 2014:120):

- The region and town where it is situated
- The gross lettable area (“GLA”)
- The purchase price
- The effective date of acquisition
- Directors’ valuation
- Property revenue
- Property expenditure
- Goodwill
- Linked debentures and premiums
- Interest bearing borrowings
- Weighted average rental per square metre
- Vacancy rate as a percentage of GLA

The note disclosure for trade debtors includes a line item named “Gross rental receivables.” (Vukile, 2014:95). It is unclear whether this amount includes amounts relating to turnover rent as there is no mention of this fact.

As required by IAS 40.33, investment property shall be measured at fair value. Vukile states that:

“Investment property is initially recorded at cost which includes transaction costs directly attributable to the acquisition thereof. The directors value all the properties bi-annually to fair market value. Approximately 50% of all properties are valued every six months on a rotational basis by qualified independent external property valuers and any differences between the respective valuations are reported in the notes to the financial statements.” (Vukile, 2014:81).

Therefore, the requirements of IAS 40.33 are met.

4.2.2.4 Redefine Properties International Limited (Redefine): Group Annual Financial Statements 2014

Redefine mentions in section 1.15.1 of the Accounting Policies, that contingent rent (turnover rent) are included in revenue when it can be reliably measured (Redefine, 2014:22). Revenue has been split into the different components of revenue on the face of the statement of profit or loss and other comprehensive income (Redefine, 2014:13), as required by IAS 18.35b. Turnover rent has not been disclosed separately as part of these components. There is no disclosure explaining the breakdown on the face of the statement of profit or loss and other comprehensive income. No further disclosure has been made for contingent rent.

Redefine states that investment property is carried at fair value (Redefine, 2014:20), which meets the requirements of IAS 40.75a and IAS 40.75b. Turnover rent and the treatment thereof for valuation purposes are not disclosed.

Redefine applies IFRS 8. The local segment is broken down into subsectors of retail, office and industrial, as well as Fountainhead (a business combination). Turnover rent of specific segments and of the business combination is not separately disclosed.

With the limited disclosure of turnover rent by Redefine, it is expected that trade debtors would not include a disclosure for turnover rent. This was indeed the case.

The question arises why no disclosure was made in the Redefine financial statements for turnover rent, when there is an accounting policy for contingent rent. One can speculate that it was omitted on the basis of materiality. It is unclear why there was no disclosure for turnover rent.

4.2.2.5 Old Mutual Life Assurance Company (South Africa) Limited (Old Mutual) 2014

Old Mutual did not include much information about any rental income from investment properties. Rental income is not on the face of the statement of profit or loss and other comprehensive income but is included in the note to the investment income (Old Mutual, 2015:34). Only the total amount is disclosed.

The investment property policy is not included as part of the accounting policies. However, one can see that the fair value model is used throughout the financial statements. The investment property note discloses the fair value hierarchy (Old Mutual, 2015:38).

The segmental report meets the minimum standards of IFRS 8. There is no disclosure of any individual buildings though. The requirements of IAS 17 are not met. This may be because of the limited information about investment property, rental income and any lease agreements which in turn may be due to the immateriality of these amounts in relation to the rest of the group.

4.3 SUMMARY OF CONTENT ANALYSIS OF ANNUAL FINANCIAL STATEMENTS

Based on the above content analysis the following summary highlights the inconsistencies and inadequacies in disclosure of turnover rent in the sample analysed.

Table 4.1: Summary of disclosure of turnover rent in annual financial statements

Accounting standard reference/criteria	SAC (2012)	p	Growthpoint (2013)	p	Hyprop (2013)	p	Vukile (2014)	p	Redefine (2014)	p	Old Mutual (2014)	p
IAS 18 Revenue												
<u>Accounting Policy:</u> Is there a turnover rent policy?	Yes	14	No		Yes	68	Yes	84	Yes	22	No	
<u>Disclosure:</u> Is turnover rent disclosed on the face of the statement of profit or loss and other comprehensive income?	No		No		No		No		No		No	
<u>Disclosure:</u> If not, is there note disclosure for turnover rent?	Yes	16	Yes	32	No		Yes	113	No		No	
IAS 17 Leases												
<u>Accounting Policy:</u> Lease income disclosed on a straight line basis or other systematic basis?	Yes	14	Yes	20	Yes	68	Yes	86	Yes	22	No	
<u>Disclosure:</u> Are assets subject to operating leases were disclosed according to their nature?	Yes	5	Yes	25	Yes	60	Yes	72	Yes	12	No	

Accounting standard reference/criteria	SAC (2012)	p	Growthpoint (2013)	p	Hyprop (2013)	p	Vukile (2014)	p	Redefine (2014)	p	Old Mutual (2014)	p
<u>Disclosure:</u> Was there note disclosure of contingent rental income?	Yes	16	Yes	32	Yes	87	Yes	113	No		No	
IFRS 8 operating segments												
<u>Accounting Policy/Disclosure:</u> Are factors used to identify the entity's reportable segments in specific investment property, disclosed?	Yes	30	Yes	21	Yes	69	Yes	148	Yes	76	No	
<u>Disclosure:</u> Is information about profit or loss, assets and liabilities from investment property disclosed?	Yes	30	Yes	28	Yes	98	Yes	148	Yes	76	No	
<u>Disclosure:</u> Were the segment amounts reconciled to the entity's amounts?	Yes	30	Yes	28	Yes	98	Yes	148	Yes	76	Yes	23
<u>Disclosure:</u> Were the quantitative thresholds, IFRS 8:13, met for all separately disclosed real estate assets?	Yes	30	No	28	Yes	98	Yes	148	Yes	76	No	
IAS 40 investment Property												
<u>Accounting Policy:</u> Was a fair value or cost model policy disclosed?	Yes	10	Yes	18	Yes	65	Yes	81	Yes	20	No	

Accounting standard reference/criteria	SAC (2012)	p	Growthpoint (2013)	p	Hyprop (2013)	p	Vukile (2014)	p	Redefine (2014)	p	Old Mutual (2014)	p
<u>Accounting Policy/disclosure:</u> If fair value model used, are interests held under operating leases classified and accounted for as investment property?	Yes	5	Yes	25	Yes	60	Yes	73	Yes	12	No	
<u>Disclosure:</u> Is rental income disclosed in the statement of profit or loss and other comprehensive income?	Yes	6	Yes	32	Yes	61	Yes	74	Yes	13	No	
IFRS 3												
<u>Accounting Policy:</u> Was turnover rent disclosed as being included as an input in the valuation of investment property?	No		No		No		No		No		No	

The following summary highlights the inconsistencies and inadequacies in disclosure of building performance that are not required by the accounting standards.

Table 4.2: Disclosure of building performance criteria not required by current accounting standards

	SAC (2012)	p	Growthpoint (2013)	p	Hyprop (2013)	p	Vukile (2014)	p	Redefine (2014)	p	Old Mutual (2014)	p
Were buildings separately disclosed by name?	No		Yes	64	Yes	98	Yes	120	Yes	83	No	
Was each individual property's revenue disclosed	No		Yes	66	Yes	98	Yes	121	Yes	83	No	
Was turnover rent separately disclosed for each property?	No		No		No		No		No		No	
Was expenditure disclosed for each property?	No		No		Yes	98	Yes	121	No		No	
Were linked debentures and premiums disclosed for each building?	No		No		No		Yes	121	No		No	
Were interest-bearing borrowings disclosed per building?	No		No		No		Yes	121	No		No	
Were vacancies disclosed per building?	No		Yes	66	Yes	17	Yes	121	Yes	83	No	
Was footfall/count disclosed per building?	No		No		Yes	10	No		No		No	

	SAC (2012)	p	Growthpoint (2013)	p	Hyprop (2013)	p	Vukile (2014)	p	Redefine (2014)	p	Old Mutual (2014)	p
Was the percentage lessee change (churn) disclosed per building?	No		No		Yes	18	No		No		No	
Was trade density disclosed per building?	No		No		Yes	17	No		No		No	
Were details of performance information for centre management disclosed per building?	No		No		No		No		No		No	
Was how many people work in building management disclosed?	No		No		No		No		No		No	
Was total lessee turnover disclosed for the building?	No		No		Yes, can be calculated from rent to sales ratio	17	No		No		No	

4.4 RESULTS OF CONTENT ANALYSIS

The results of the above content analysis are documented in this section. A discussion on the importance of consistent and adequate disclosure of turnover rent follows the results with recommendations, and conclusion of the chapter.

Four of the six companies include an accounting policy for turnover rent in their financial statements. None of the companies discloses turnover rent on the face of the statement of profit or loss and other comprehensive income. Three of the companies disclose the amount of turnover rent for the year in a note disclosure as part of revenue. One company has an accounting policy but no further disclosure whatsoever on turnover rent. Five of the six companies, the other being the insurance company where property income may not be material, do segment reporting in accordance with IFRS 8.

Internal property management and asset management ratios, which indicate building performance, are not consistently disclosed in the annual financial statements and is not required to be disclosed. Four of the six companies disclose building revenue separately per individual building with only two of the six also disclosing expenditure per building. Only one of the six discloses linked debentures and premiums for individual buildings. Four of the six disclose vacancies per building. One of the six disclose footfall, lessee churn, and trade densities per building. From these disclosures, total lessee turnover for the building can be calculated. None of the companies discloses turnover rent collected per building. Since not all companies disclose their property portfolios and the value of individual assets, distressed assets or assets that are performing below industry standards can be hidden inside of total numbers due to the lenient segment reporting criteria of IFRS 8. It is therefore not possible to determine the contribution of turnover rent to the revenue of the building and the lessor on a consistent basis as eluded to in the research objective of this study.

The reader (*e.g.* shareholder) could be interested to know about the areas for improvement in the management of certain assets. In order to ascertain this, certain information on each building could be disclosed, which, *e.g.*, may include

the following:

- Average rent to sales per building
- quality of assets
- performance of assets
- level of lessee churn
- vacancy ratio per building
- average trading density per building

Turnover rent is not disclosed consistently. This may be based on materiality. The disclosure of turnover rent and additional information on how it was derived at (or even per asset) are indicative of building performance, and could assist stakeholders in their decision-making process. The following aspects form part of the formula for turnover rent:

- Turnover per store (store performance in other words)
- the percentage turnover rent (what the lessor is entitled to will have a direct impact on the lessor's income and building performance)
- an indicator of the dynamics between the building and the lessee, a message on the maturity of the mutually beneficial relationship between the lessor and lessee
- the ratio between basic (fixed) rent and turnover rent as an indicator of risk appetite of the lessor, since turnover rent is not certain and influenced by several economic factors. These influences are further explored in the retail centre case study in Chapter 5
- it is an indicator of how successful the calculated risk strategy was executed
- it is an indicator of how well the lessor understands his lessees' business models and performance and it ultimately indicates the level of control the lessor has over lessee compliance

No property management performance criteria are disclosed by any of the six companies. These may have included:

- Management KPIs
- risk tolerance
- execution of risk strategy
- staff complement and consistency in staff complement

It is apparent from the observations above, and from several findings of inappropriate disclosure cited by Baik, Billings & Morton (2008), that the necessary information could be withheld, and can influence the decisions of readers of the financial statements. These can relate to individual assets and the performance of these assets. Incomplete and inconsistent information in press releases could create false impressions. Therefore, it is recommended that the disclosure requirements for REITs be re-evaluated in this regard. Disclosure requirements specifically for REITs should be considered, since it could be valuable to stakeholders. This would allow for consistency in disclosure as well as increased comparativeness of the results of REITs and statuses of their assets.

Upon enquiry to the SA REIT Association, a reply was received on 1 July 2015 indicating that no best practice reporting has been released as yet for South African REITs. It is also unclear what the additional disclosure requirements would be. The SA REIT Association indicated that additional best practice disclosure is in process and should be vetted by the JSE and SAICA before release. It is further unclear whether and when these additional best practice disclosure would become compulsory to be disclosed in the annual integrated reports of SA REITs (Simelela, 2015).

4.5 SUMMARY AND CONCLUSION

Through the analysis of prevailing financial disclosure requirements performed in this chapter, it is evident that the current levels of information required do not stipulate individual asset performance to be explained to stakeholders. The risk of arbitrary disclosure therefore exists. Valuable information, such as individual

building performance, is not required by the current financial disclosure standards. Some companies choose to disclose building performance information (income, expenses, debt, vacancies, etc.), while other companies choose to disclose only some building information. Refer to Tables 4.1 and 4.2 for detail. These inconsistencies can lead to decision making which may have been different had more information been available.

The actual disclosure of the contribution of turnover rent to building revenue is particularly inadequate and inconsistent. This may be due to the materiality of the amounts involved, but the management performance embedded in the collection of turnover rent remains undisclosed in this event. Building performance should be a disclosure requirement to provide more information to the reader. With some companies already choosing to disclose certain information on building performance, there is a need to govern this information, and to provide guidance to the preparers of the financial statements to which information should be disclosed.

The factors affecting building performance, like turnover rent, should be a requirement for disclosure in the annual financial statement of REITs and other commercial property owners, since it provides further information to stakeholders on building performance and risk profile, and may influence decision making. In a paper titled, “Does more transparency go along with better governance?” Islam (2006) indicated that information is a critical ingredient in efficient and well-functioning markets. The author further indicated that more information allows for better analysis, monitoring, and evaluation of events that are important to the economic well-being of stakeholders. The author also stated that it allows decision makers to evaluate opportunities, and manage risks better. In the context of disclosure of retail real estate information for listed entities, this would be applicable specific from a building performance point of view. Performance information should be formalised and should be disclosed in a structured and guided way. The decision of shareholders may very well be affected by the ability, or inability, of a property manager to utilise opportunities, and to mitigate risks. This can ultimately lead to a change in the share price of a particular REIT.

Specifically, individual building performance should be a disclosure requirement as part of segment reporting, irrespective of materiality, as follows:

- Building income and expenses
- risk structure (exposure) relating to variable rent
- linked debentures and premiums
- average trade densities
- footcount
- lessee churn
- tenant turnover
- turnover rent and base rent ratio

Guidelines for when this information should be disclosed should be set. The percentage dependency of the company on income from investment property should be taken into account, e.g. for insurance and investment companies, when setting these guidelines.

Optional disclosure can be considered, but should then be governed to be disclosed in a standardised way that would not allow for arbitrary disclosure of well performing assets. This optional disclosure may include some or all of the following:

- Dwell time
- drive time
- conversion rates
- parking income
- property management staff complement
- detail on outsourced management contracts
- the performance management of the property manager

In this chapter, a selection of relevant published annual financial statements were analysed, and measured against the financial disclosure requirements where it relates to turnover rent, as stipulated and discussed in Chapter 2. The results indicate that disclosure of turnover rent is inconsistent among companies, and that

inadequate and inconsistent information is available to the reader of the financial statements to assess individual building performance. It is also concluded that there is a possibility for companies to provide arbitrary disclosure. The content analysis was unable to provide sufficient and consistent evidence of financial disclosure to address the problem statement of this study, namely to assess the availability of relevant information in order to determine the contribution of turnover rent to the lessor's revenue.

In the next chapter, a retail centre case study is performed to attempt to address the problem statement of this study as well as the research objectives included in Chapter 1. As indicated in Chapter 3, the case study will include an analysis of centre and merchant category performance data of one retail centre in South Africa and will attempt to determine the contribution of turnover rent to revenue for the building per merchant category through a period of economic decline and recovery.

CHAPTER 5

RETAIL CENTRE CASE STUDY

5.1 INTRODUCTION

Chapter 4 indicates that individual building performance indicators (including turnover rent) are not consistently disclosed by a sample of companies owning large shopping centres in South Africa. It is further established that the current minimum disclosure requirements are not adequate to call for disclosure of building performance criteria, at least not on an individual basis. Companies may choose to voluntarily disclose certain information in their annual financial statements that may be to their own benefit since full disclosure is not required. For example, four of the six companies included in the content analysis in the previous chapter, disclose individual building revenue, but only two of these companies disclose the corresponding expenditure of each building. Net income can; therefore, only be analysed for two of the six companies on an individual building basis.

In this chapter, and in line with the method stipulated in Chapter 3, information was requested from an asset manager of a super-regional shopping centre in South Africa. The purpose of the analysis is to ascertain if—from the data received and analysed—valuable insight could be obtained on the building's performance, with specific focus on turnover rent. If significant, this insight may affect decision making of stakeholders, and ultimately the share price.

5.2 REQUESTING AND SOURCING OF DATA

The information for the chosen retail centre was available from asset management and was not specifically designed and sourced for this study. It was originally obtained as part of the property management process by means of lease obligations (e.g. lessee turnover), technology (e.g. footfall), and legal documents

(e.g. lease agreements). The information is used internally to manage the centre.

5.3 ESTABLISH AND CONFIRM AVAILABILITY OF RELEVANT DATA

A preliminary review of the available data indicated, as anticipated in Chapter 3, that it is relevant to the study, which availability was confirmed by entering into an academic contract with the asset manager. Data was made available for the purposes of this study on the condition that the names of the centre and the stores would not be published, and ethical clearance was obtained. Refer to the Ethical Clearance Certificate in 'Appendix B' of this study.

5.4 SORTING OF DATA

Information was received from asset management specifically relating to the retail building analysed. It consists of monthly data for each lessee starting from January 2007–December 2014 (eight years). Changes in lessees and store sizes could have occurred through this period; therefore, the total contribution to lessor revenue was calculated on a merchant category level and analysed over the period to establish notable trends. The data includes the following:

- Master occupant number
- lease ID
- suite ID
- merchant category the lessee belongs to
- lessee name
- annualised trading density
- annualised rent to sales
- turnover rent percentage
- base rent per month
- rent per square metre
- annualised breakpoint turnover
- turnover (sales history)
- marketing percentage
- occupancy status

- monthly footcount numbers for the centre

The following information relating to each lease in place for each lessee was received:

- Occupancy date
- starting date
- expiry date
- vacating date

The following information relating to turnover rent was received on an annual basis:

- Annual turnover rent charged (billed) per lessee
- annual turnover rent charged per merchant category
- annual turnover rent receipted (paid) per lessee merchant category under which the lessee is classified

The following additional information was sourced for the analysis:

- Monthly Inflation Rates from January 2006 to December 2014 (Statistics South Africa, 2015)
- Quarterly Prime Interest Rates (Statistics South Africa, 2015)
- Quarterly Growth Domestic Product (“GDP”) Growth Rates (Statistics South Africa, 2015)
- Monthly Inflation Rates for Consumer Products (Statistics South Africa, 2015)
- Annualised Trading densities for the South African Retail Market (MSCI Real Estate, 2015)
- Rental Growth Rates for South African Shopping centres (MSCI Real Estate, 2015)

5.5 PREPARATION OF PIVOT TABLES OF RELEVANT DATA FIELDS

Pivot tables were prepared on the centre level as well as the merchant category level, as follows:

- Pivot tables were created from the data received from the asset manager.
- Turnover rent data was used to create a pivot depicting the turnover rent per merchant category for each year from 2007–2014.
- Footcount data was used to create a pivot depicting the centre's footcount for each year starting from 2007–2014.
- The monthly inflation rate data was used to calculate an average inflation rate for each year from 2007–2014.
- The monthly prime interest rate data was used to calculate an average prime interest rate for each year from 2007–2014.
- The quarterly GDP growth rate data was used to calculate an average GDP growth rate for each year from 2007–2014.
- The monthly CPI data was used to calculate an average CPI amount for each year from 2007–2014.
- The quarterly trading density data was used to calculate an average trading density amount for each year from 2007–2014.
- For each merchant category the total base rent, the total turnover (trade), and average turnover rent percentage were sorted. The pivots were also configured to show the turnover rent billed, total footcount, inflation rate, CPI, prime interest rate, and GDP growth rate for the respective years comparatively.
- Annualised Trading densities for the South African Retail Market (MSCI Real Estate, 2015) and Rental Growth Rates for South African Shopping centres (MSCI Real Estate, 2015) were used to get comparative super regional shopping centre data.
- Rental income growth was calculated on a centre and merchant category level.
- Turnover (trade) growth was calculated on a centre and merchant category level.
- Line, bar, and pie charts were created after the above was done.

5.6 PERFORM DATA ANALYSIS AND DEPICT IN TABULAR AND GRAPHICAL FORMAT

A centre analysis was performed using data created as above, and included in 'Appendix A' in graphical format. Numbers for figures starting with "A" indicates that the figure is included in 'Appendix A'. The graphs are included in paragraph 5.7 below where trends are discussed in more detail, with the Appendix numbers indicated in brackets in the title of the graph. The following summarises what information is available in 'Appendix A':

- Figure A1 depicts the rental income over the period 2007–2014 for the shopping centre. The rental income is divided between base rent and turnover rent, and showed on a year-on-year basis.
- Figure A2 depicts the contribution, in percentage terms, of both base rent and turnover rent towards rental income for each year from 2007–2014.
- Figure A3 depicts the relationship between the centre's turnover and the GDP growth rate in South Africa for the years 2007–2014.
- Figure A4 depicts the relationship between the centre's annual turnover rent and the centre's annual turnover growth rate.
- Figure A5 shows the real growth rate for the centre's turnover rent. The real growth rate is the difference between the nominal growth rate and the inflation rate, both depicted on the same chart.
- Figure A6 compares the centre's rental income growth rate to both the rental income growth rate for super regional shopping centres and the GDP.
- Figure A7 depicts the changes in the centre's rental income on an annual basis (both base rent and turnover rent), and shows how the changes compared to the growth of rental income for super regional centre rental growth and GDP growth.
- Figure A8 depicts the changes in the centre's base rent, year-on-year, and shows how the changes compared to the growth of base rent for super regional centre rental growth and GDP growth.
- Figure A9 depicts how changes in the prime interest rate and inflation rate compared to the changes in the centre's rental income.
- Figure A10 depicts the relationship between the centre's turnover rent and

the centre's footcount.

- Figure A11 depicts the relationship between the centre's rental income and the centre's footcount.
- Figure A12 depicts the relationship between the centre's turnover rent and the trading density of super regional shopping centres in the country.
- Figure A13 depicts the relationship between the centre's rental income and the trading density of super regional shopping centres in the country.
- Figure A14 shows the merchant categories that are the biggest contributors to the centre's turnover rent.
- Figure A15 shows the merchant categories that are the biggest contributors to the centre's turnover (trade).
- Figure A16 depicts the relationship between the centre's turnover growth and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A17 depicts the merchant categories that are subject to the highest turnover rent percentages. It compares their average turnover rent percentages to their respective percentage contribution towards the centre's turnover rent.
- Figure A18 depicts the merchant categories that are the top contributors towards turnover rent. It compares their average turnover rent percentages to their respective percentage contribution towards the centre's turnover rent.
- Figure A19 shows the merchant categories that are the biggest contributors to the centre's base rental income.
- Figure A20 depicts the relationship between the centre's footcount and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A21 depicts the relationship between the centre's turnover (trade) and the centre's footcount.
- Figure A22 depicts the relationship between the trading density of super regional shopping centres and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A23 depicts the relationship between the centre's turnover and trading density of shopping centres.
- Figure A24 depicts the relationship between turnover rent for department stores and economic indicators (GDP growth rate, inflation rate, and prime

interest rate).

- Figure A25 compares the base rental growth for department stores to the comparative growth for the centre and other super regional shopping centres.
- Figure A26 compares the rental income growth for department stores to the comparative growth for the centre and the GDP growth rate.
- Figure A27 depicts the relationship between the rental income for department stores and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A28 depicts the relationship between the turnover from department stores and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A29 depicts the relationship between the turnover growth for department stores and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A30 shows the real growth rate for the turnover from department stores. The real growth rate is the difference between the nominal growth rate and the inflation rate, both depicted on this chart.
- Figure A31 depicts the relationship between turnover rent for movies and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A32 compares the base rental growth for movies to the comparative growth for the centre and other super regional shopping centres.
- Figure A33 compares the rental income growth for movies to the comparative growth for the centre and the GDP growth rate.
- Figure A34 depicts the relationship between the rental income for movies and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A35 depicts the relationship between the turnover from movies and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A36 depicts the relationship between the turnover growth for movies and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A37 shows the real growth rate for the turnover from movies. The real growth rate is the difference between the nominal growth rate and the inflation rate, both depicted on this chart.

- Figure A38 depicts the relationship between turnover rent for unisex wear and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A39 compares the base rental growth for unisex wear to the comparative growth for the centre and other super regional shopping centres.
- Figure A40 compares the rental income growth for unisex wear to the comparative growth for the centre and the GDP growth rate.
- Figure A41 depicts the relationship between the rental income for unisex wear and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A42 depicts the relationship between the turnover from unisex wear and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A43 depicts the relationship between the turnover growth for unisex wear and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A44 shows the real growth rate for the turnover from unisex wear. The real growth rate is the difference between the nominal growth rate and the inflation rate, both depicted on this chart.
- Figure A45 depicts the relationship between turnover rent for food service and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A46 compares the base rental growth for food service to the comparative growth for the centre and other super regional shopping centres.
- Figure A47 compares the rental income growth for food service to the comparative growth for the centre and the GDP growth rate.
- Figure A48 depicts the relationship between the rental income for food service and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A49 depicts the relationship between the turnover from food service and economic indicators (GDP growth rate, inflation rate, and prime interest rate).
- Figure A50 depicts the relationship between the turnover growth for food

service and economic indicators (GDP growth rate, inflation rate, and prime interest rate).

- Figure A51 shows the real growth rate for the turnover from food service. The real growth rate is the difference between the nominal growth rate and the inflation rate, both depicted on this chart.

5.7 RESULTS OF ANALYSIS

5.7.1 Centre level information

Figures 5.1 (A1) and 5.2 (A2) show the contribution from turnover rent to the revenue earned reduced from 2007–2014 on an overall building basis. In 2007, fifteen percent of total rent earned was from turnover rent, and in 2014 this ratio had reduced to eight percent. The actual amount remained fairly consistent between R26.7 million in 2007 to R25.3 million in 2014. The risk to earn revenue from variable rent, meaning dependency on the turnover of the lessee, and in turn other economic factors, and centre management performance factors, was reduced over the period under review.

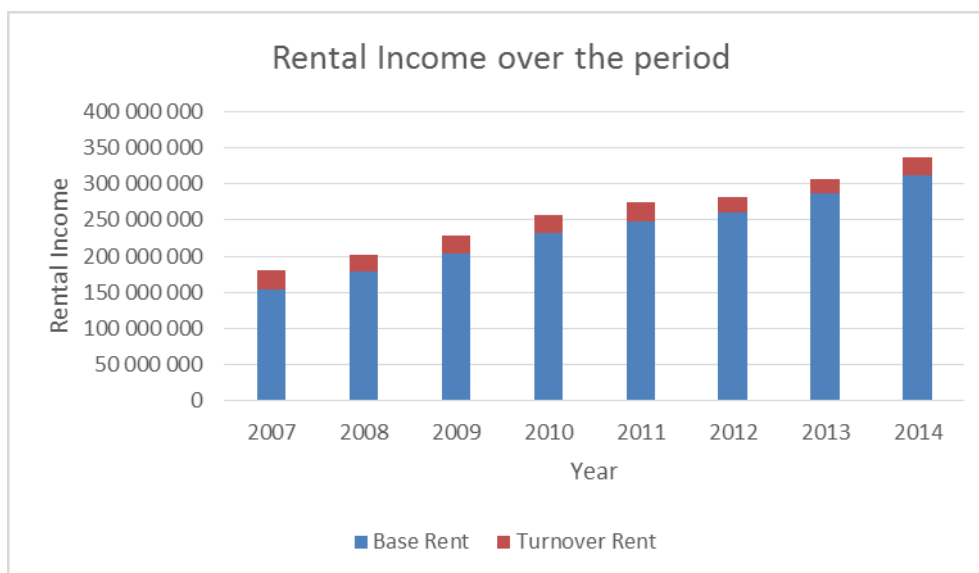


Figure 5.1 (A1): Total rental income

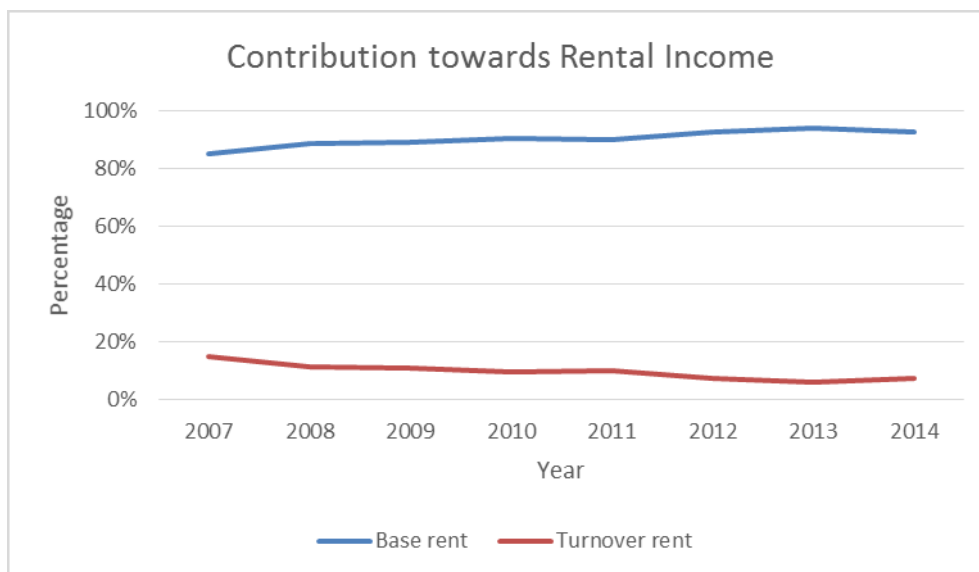


Figure 5.2 (A2): Turnover rent contribution

There is a fairly strong correlation between turnover rent and turnover growth as showed in figure A4, although the turnover rent is achieved a year later due to the accounting principles of recognition of the revenue only once the amount is known (as certified by the auditor of the lessee in the annual turnover certificate). There is a strong indirect correlation between the prime interest rate and the turnover achieved by lessees as showed in figure A22 as well as between the prime interest rate and total rental collected as showed in figure A9. There was a strong direct correlation between rental collected and the footcount of the shopping centre as showed in figure A11. The same direct correlation was identified between the footcount and the lessee trade as showed in figure A21. There is a strong indirect correlation between the footcount and the prime interest rate as showed in figure A20. It can therefore be concluded that the prime interest rate influences the footcount, lessee turnover and total rental collected by the retail centre in a negative way. This is further supported by an article published by News24 (2015) which stated that seventy-six percent of South African household disposable income is used to repay debt and any further spending, be it on credit or in cash, would be influenced negatively by a rise in the prime interest rate.

Real turnover growth (after deducting inflation) was positive for five of the seven years as showed in figure A5. This shows the resilience of this specific retail centre to the recession of 2009 (figure A6). Rental collection, being directly

correlated to turnover growth (whether through turnover rent or increased base rent) grew in most years more than the super-regional rental growth as showed in figure A6. There is a light correlation between the super-regional rental growth and the GDP growth as showed in figure A7, with no correlation between this specific centre's rental growth (figures A7 and A8) and the GDP growth, or the super-regional rental for that matter. There was no correlation between the centre's turnover rent and the GDP growth of the country. This centre appears to have outperformed the market in a time of recession and recovery.

One consistent factor is the fact that base rent increased more than turnover rent and the reliance on turnover rent was reduced throughout the period under review (as showed in figure A2). In times of expected increase in retail sales (e.g. 2010 World Cup host cities expected an increase due to an increase in tourist volumes), turnover rent increased to the highest level of the whole period under review. This is evident in 2011 turnover rent (collected and accounted for one year later) as showed in figure A3. Turnover rent and footcount does not necessarily show a correlation (per figure A10) as the centre opted to reduce risk and collect rental through an increased base rent as showed in figure A2. The real turnover growth rate in 2010 (according to figures A5 and A16) was the highest due to the increase in retail sales during the World Cup host year and as a result of the recovery from the recession in 2009, which can be seen as a correction. This growth rate was ten percent in total. With turnover clauses in place, the centre had the benefit of higher turnover rent for the period where higher turnover was expected. The increased risk that variable rent brings, also brings higher returns as illustrated by this increase in growth in 2010 and subsequent recognition and collection of turnover rent in 2011. The utilisation of opportunities through skilled centre and asset management can become evident with the movement of influential economic indicators and specific occurrences or drivers.

The question arises how a centre performed in a time of recession. Once factors like the turnover of lessees and footcount are disclosed, stakeholders can judge whether the centre was prepared for the occurrence, how the centre was managed throughout the period and how much the total returns were for the specific centre. Separate building disclosure in a diversified property portfolio is therefore possible.

As showed in figure A12, turnover rent and trading densities are not necessarily correlated but total rent and trading densities are, as proven by figure A13. This supports the argument that rental income was made more secure with a higher reliance on base rent over the period and that reliance on turnover rent was reduced. An opportunity for an increase of total rental income due to an increase of turnover (and turnover rent) could possibly have been limited, depending on the specific lease arrangements. However, the effect of the recession on lessee turnover and subsequent rental collection could have been more detrimental to the income of the centre if turnover rent was to be a larger portion of the income.

The largest merchant category contributors to turnover rent for the centre, as illustrated by figure A14 were department stores, movies, unisex wear and food, representing seventy-one percent of the turnover rent over the period. These four categories were consistently the highest, evaluated on an annual basis, for the entire period under review. As showed in figure A15, the highest trading merchant categories were for three out of the previous four the same, being department stores, unisex wear, grocery stores and food services. There is a reliance on turnover rent from movies (twenty percent according to figure A14), a merchant category that only contributes minimally to the total turnover in the centre (refer figure A15 as included in the “other” category at a total of two percent).

Figure A17 shows no correlation between the turnover percentage and the amount of turnover recognised and collected in a specific merchant category. Figure A18 shows an indirect correlation for the four highest merchant categories contributing to turnover rent in the centre between turnover collected and the level of the turnover rent percentage. This means that the lower the percentage stipulated to calculate turnover rent, the higher the contribution of turnover rent is from this merchant category. Figure A19 shows that the four largest contributors to base rent are also the four largest contributors to turnover rent. This may indicate that these merchant categories take up the largest space in the centre. The bulk of turnover rent contributed to the centre came from the larger lessees with lower turnover percentages. According to the formula to calculate turnover rent, it is surprising that the lower percentage yielded a higher turnover rent. The lessor was then presumably willing to risk a high volume of rent on a specific group of lessees

(merchant category) and assigned a low percentage on those lessees with higher sales volume.

In the next section the data relating to the merchant categories with the highest contribution to turnover rent during the period under review will be analysed.

5.7.2 Merchant category level information

The four largest contributors to turnover rent were selected for further analysis. This represents seventy-one percent of the total turnover rent for the building over the period under review. The remaining merchant categories, which represents twenty-nine percent, were not analysed as they were not seen as main contributors.

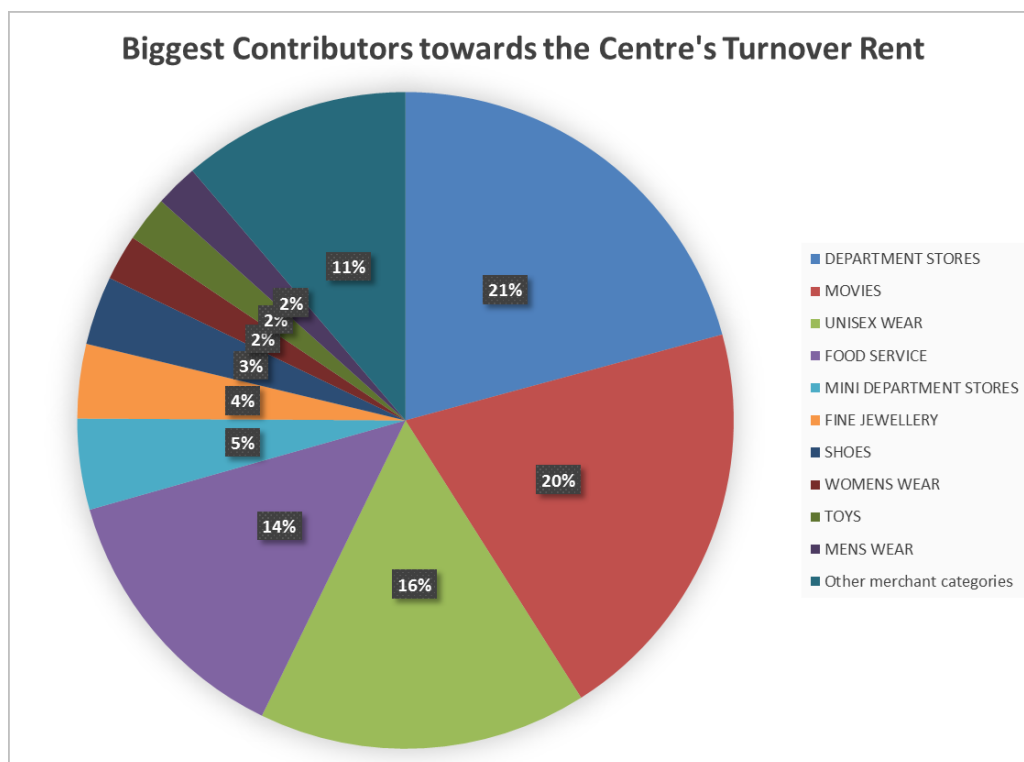


Figure 5.3 (A14): Main contributors to turnover rent

The merchant categories were made up of several lessees. Tenant level information will, due to confidentiality, not be disclosed or analysed. Any change in the smaller merchant categories or at lessee level would not be considered to result in a material change to the turnover received for the building over the period

under review. With the above limitations, the goal of the case study could still be reached, namely to identify if valuable insight could be obtained with additional data available, which are currently not a disclosure requirement.

5.7.2.1 Department stores

Department stores contributed twenty-one percent of the turnover rent (Figure A14) but only ten percent of the base rent collected for the period under review (Figure A19). Department stores were also consistently the highest contributors to turnover rent over the period under review seen on an annual basis.

There is a clear indirect correlation between the turnover rent contributed to the centre by department stores and the prime interest rate, as is shown in Figure 5.4 (A24).

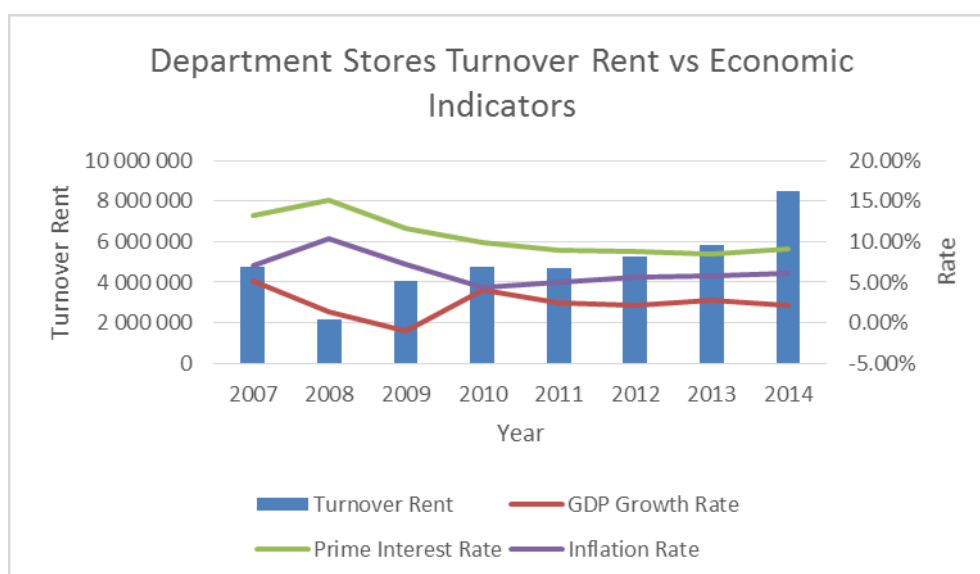


Figure 5.4 (A24): Turnover rent contribution from department stores

This is a stronger correlation than what was noted when comparing the prime interest rate to the turnover rent of the building (Figure A4). It would therefore appear that there is a heavier reliance on turnover rent from department stores than is the case in the rest of the building. The base rental growth in department stores declined from 2010 onwards to around five percent per year with an increase in turnover rent, ultimately in 2014 of above fifteen percent (Figure A25).

After 2011, the centre base rental growth was more or less on par with the super-regional rental growth rate and the department stores growth rate. Seen together, turnover rent caused an above centre level growth rate for department stores since 2011, post-recession and post-World Cup trade surge.

As is the case for the centre level analysis, department stores rental income and lessee turnover are indirectly correlated to the prime interest rate, as shown in Figures A27 and A28 respectively. The turnover growth rate in 2010 far exceeded the inflation rate being at fourteen percent with an inflation rate of below 5 percent at that stage. This is shown in Figures A29 and A30 where turnover growth rate is compared to the inflation rate and prime interest rate.

5.7.2.2 Movies

Movies is the second highest contributor to turnover rent for the period under review as shown in Figure A14. However, movies did not contribute materially to the turnover of the building as was the case of department stores, as shown in Figure A15. Movies contributed only six percent to the base rent of the building over the period under review. This ratio is lower than department stores and it would appear that movies are highly turnover rent dependent, even more so than in the case of department stores.

There was no real trend identified when analysing the correlation between turnover rent from movies and the economic indicators. It is worth noting that turnover rent from movies declined sharply after 2011 (Figure 5.5 (A31)).

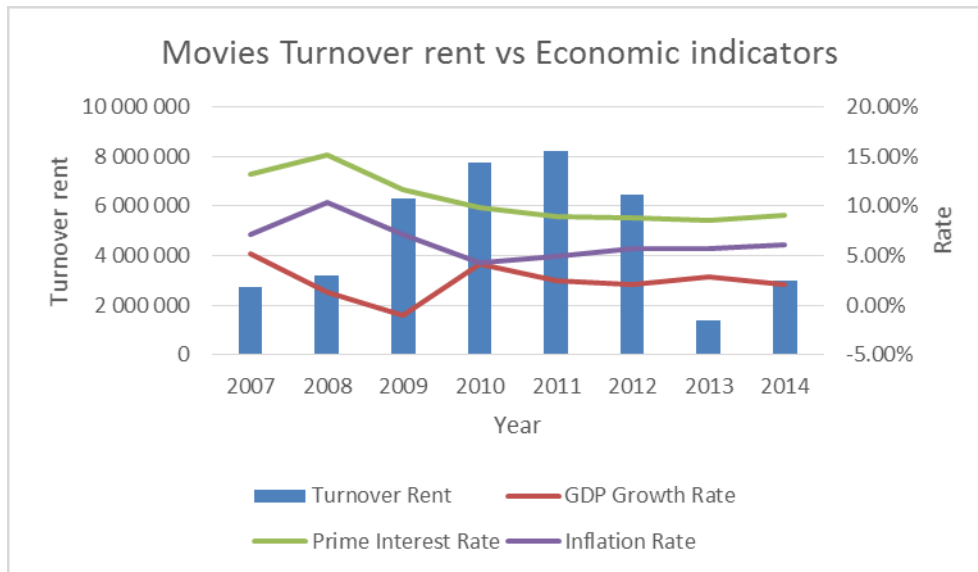


Figure 5.5 (A31): Turnover rent contribution from movies

After 2011, there was also a sharp decline in base rent with no growth noted from 2007–2011 and rental reductions noted in 2012 and 2013 (Figures A32 and A33). It would appear that there was a high impact on movies from an overall point of view during the period under review, reason being not instantly clear from the data and would require some explanation. This may be an indication of where additional disclosure is required, *i.e.* where certain factors or decisions cause a change in the rental model, *e.g.* in the case of a redevelopment or lessee resizing.

An indirect correlation was identified from 2009–2011 between total rental income from movies and the prime interest rate (Figure A34); however, this correlation was not shared between turnover collected by the movies and the prime interest rate. The 2011 negative trend of real turnover growth (as shown in Figures A36 and A37) confirms that there could be another unidentified reason why there was a reduction in the rental income in 2012 and 2014 (Figure A34).

5.7.2.3 Unisex wear

Unisex wear contributed sixteen percent to the total turnover rent collected by the centre (Figure A14), fourteen percent to the centre’s turnover (Figure A15) and fifteen percent to the centre’s basic rent. This is the most balanced contribution of a merchant category in the centre, compared to the previous two categories

analysed, namely department stores and movies.

As indicated in Figure 5.6 (A38), there is a direct correlation between the contribution to turnover rent from unisex wear and the prime interest rate.

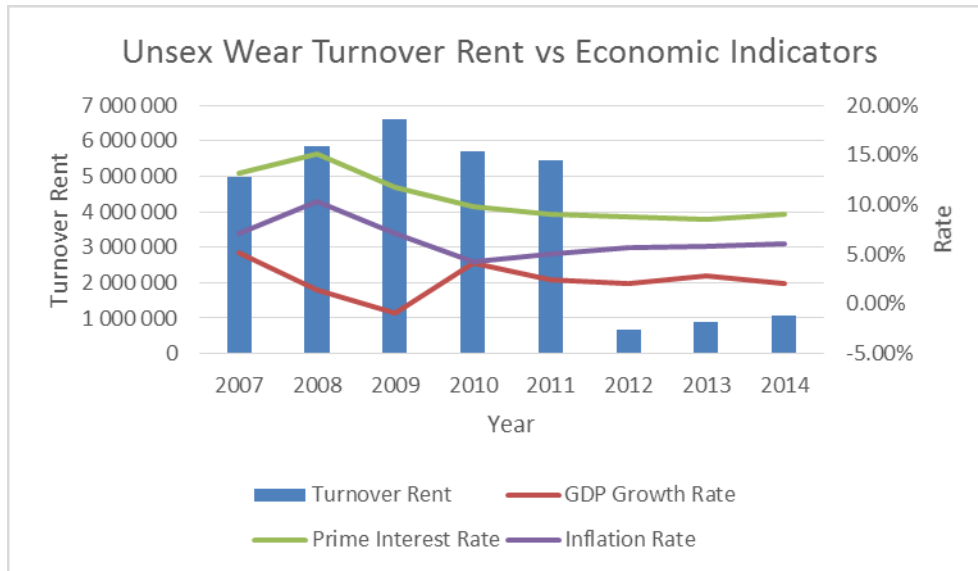


Figure 5.6 (A38): Turnover rent contribution from unisex wear

A sharp decline in turnover rent was noted after 2011 with a replacement with base rent as indicated in Figure A39. The income was; therefore, more secure with a lower risk taken with variable rent. Figure A40 shows the total rent outperformed the rest of the centre during the period when the turnover rent exposure was reduced and replaced with base rent. Figure A41 indicates the reduced exposure to turnover rent clearly after 2011 with an indirect correlation to the prime interest rate from 2008. The turnover in this merchant category grew consistently over the period under review (Figure A42) with consistent higher than inflation growth (Figure 44).

5.7.2.4 Food service

This merchant category represents fourteen percent of the turnover rent contributed to revenue, being the fourth largest contributor (Figure A14), but eleven percent of the base rent contributed to the revenue of the centre, which was the second largest contributor (Figure A15). This merchant category

contributed only six percent of the lessee turnover in the building (Figure A19). There was a direct correlation between turnover rent contributed by this merchant category, and the prime interest rate up to 2010, with a high percentage increase in 2011, being the World Cup host city effect (Figure 5.7 (A45)).

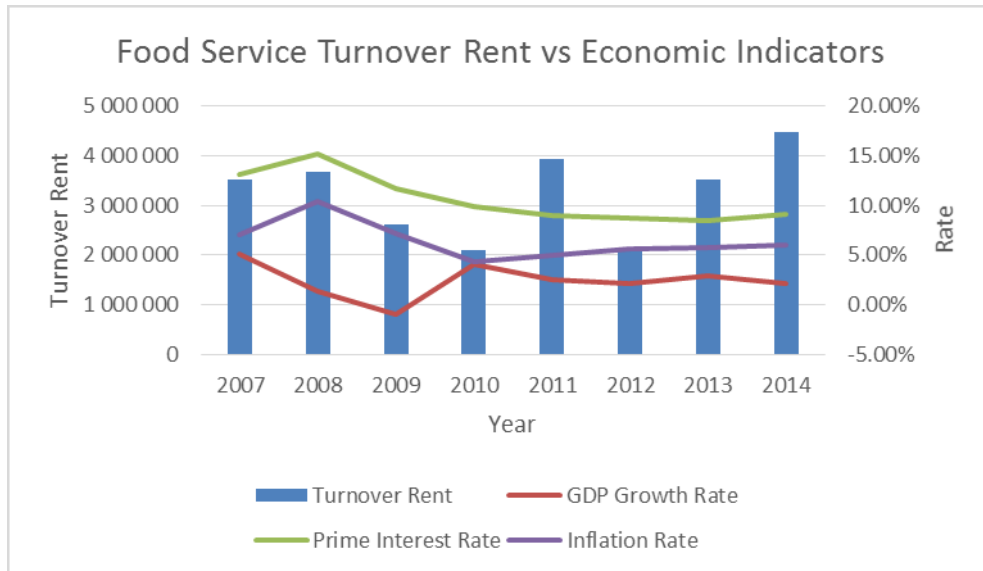


Figure 5.7 (A45): Turnover rent contribution from food service

The total rent and lessee trade have the same indirect correlation to the prime interest rate as the entire centre (Figures A49 and A48 respectively). Like other merchant categories and the entire centre, there is no clear correlation between total rent, GDP growth, and the inflation rate.

After 2010, the turnover growth declined at a steady pace (Figure A51), and in 2014, below inflation growth (Figure A50). The data does not disclose a reason for this lower growth.

5.8 DISCUSSION

The analysis evidently shows the influence of the economy on retail sales. For example, the centre data as well as the merchant category data clearly shows the effect that prime interest rates have on retail sales. The prime interest rate is governed by the monetary policy committee of the South African Reserve Bank. The bank had, since February 2000, a specific mandate to keep inflation

consistently within a target rate of three to six percent. The essence of the bank's monetary policy is its influence on interest rates through the refinancing system (South African Reserve Bank, 2007:4). With an increase in the prime interest rate, footcount, and subsequently turnover in the centre, declined. It appears that the centre reacted with a higher base rent to secure income through a long period of economic uncertainty and recovery. The success of this strategy should be measured from a rental optimisation perspective, as it appears that not all merchant categories were negatively affected by the economic decline. Factors such as location, financial status of customers, and forecasted retail sales should be taken into account.

Turnover rent is one of the performance formulae that indicates direct benefit to the lessor as well as lessee in the same number. Tenant turnover is sensitive to footcount changes and risks need to be weighed up against known opportunities to optimise total rent for the building. Turnover rent is directly affected by an external event, such as the effect of the World Cup host city retail sales increase. The utilisation of such an event by the management of a building to optimise total rent, should form part of the KPIs of management, and should be disclosed, whether utilised successfully or unsuccessfully to optimise revenue. This could be done as part of the risk strategy of the building.

5.9 SUMMARY AND CONCLUSION

The rental strategy of the building and the execution of this strategy, whether successful (optimised) or unsuccessful, is unknown to the user of the data. However, there is more information available than what is required to be disclosed by the current accounting standards. This information may allude to the rental strategy, certain occurrences in the centre (e.g. redevelopment), level of management performance, reaction to economic trends and forecasts, and preparedness for increases in the retail trade in the area where it is located. Individually and holistically, these factors can influence the performance of the building, and the optimisation of rental income. Should this information be made available to the reader of the financial statements, and in a meaningful format, more informed decisions could be made based on a more in depth understanding

of the operations and the ultimate performance of the shopping centre. This information should be concise and structured to provide the necessary information.

It is evident from this chapter that information is available that is rather used for management purposes, but is not consistently or as a norm disclosed by companies. In terms of more transparent operations, and performance information, it would be beneficial to stakeholders to be able to have more insight into these matters. In the next chapter the summary and conclusions of this study will be discussed. A summary will be included, indicating how the research problem statement was addressed in each chapter. An overall conclusion will be included. Recommendations will also be made for future research possibilities.

CHAPTER 6

SUMMARY, CONCLUSION AND RECOMMENDATIONS

6.1 INTRODUCTION

The previous chapter concluded on the retail centre case study as the second and last phase of the research methods described in Chapter 3. It was established that additional information is available—although not publicly—to assess the performance of retail centres with lessee turnover and turnover rent being one indicator of this performance. Meaningful trends were identified and documented as part of the findings in the previous chapter. The results of the first phase, being a content analysis of financial disclosure, were documented in Chapter 4.

The research intends to assess the availability of information in order to determine the contribution of turnover rent to the lessor's revenue measured per industry in the retail sector, both through a growth and contraction phase in the South African economy. In this chapter, a summary of each chapter is provided as well as a summary of the conclusions reached in addressing the research problem. The achievement of the research objectives set are then summarised and recommended future research is supplied at the end of the chapter.

6.2 SUMMARY OF EACH CHAPTER

6.2.1 Chapter 1: Introduction

In this chapter, the importance of turnover rent to the lessor is highlighted. Both advantages and disadvantages are discussed. The main advantages are that it provides flexibility to both lessor and lessee, which may provide more opportunity for optimum lessee mix, turnover maximisation, and therefore rental optimisation in a retail centre. The turnover information supplied by the lessee further provides valuable information to the lessor to track the performance of the asset.

The implementation of turnover rent is further explored in this chapter and refers to the connection of property management KPIs to optimisation of rental in a retail centre. In this regard, the roles and measurement of performance of the lease agents and property managers are discussed with reference to the optimisation of rental income for the lessor.

The requirements for the disclosure of income derived from lease agreements, as stipulated in IAS 17 *Leases*, are introduced in this chapter. The standard does not require the separate disclosure of different types of rental income. To this effect, there is an apparent lack of availability of turnover rent information as well as other building performance information. This leads to the problem statement of the study as neither the current level of available information nor the prevailing IFRS requirements provide sufficient and useful information to perform an analysis of turnover rent. The research intends to assess the availability of relevant information in order to determine the contribution of turnover rent to the lessor's revenue through both a growth and contraction phase in the South African economy. Further research objectives are stated in this chapter. The achievement of these objectives is further discussed in paragraph 6.4.

Following the formulation of the problem statement, the importance of the study are discussed. Context is provided to the size of the industry relevant to the GDP of the country. Further reasons are highlighted why there is a current need for the research, and the beneficial input it would provide in several financial and performance evaluation processes in the industry.

The research design is introduced in this chapter, and elaborated on in Chapter 3. Terminology used in this study is defined in this chapter and a summarised chapter overview is provided. The chapter ends with an intention to provide an answer to the research problem statement.

6.2.2 Chapter 2: Literature Review: Relevant Legislation and Accounting Standards

Chapter 2 comprises literature review of relevant legislation and accounting standards. In order to confirm IFRS as the required accounting standards for listed

real estate entities, the relevant requirements of the Companies Act, 2008 (Act 71 of 2008) and Companies Regulations, 2011 are consulted. The requirement to use IFRS as financial reporting standard for listed entities (including REITs) is confirmed in this chapter.

Due to the use of lease agreements to establish the contractual relationship between lessor and lessee, law of contracts is analysed. The primary rights and obligations for both lessee and lessor are highlighted. The additional legal requirements relating to turnover rent are further discussed. These relate to the provision of information by the lessee to the lessor, relating to store performance and in specific turnover. This information would provide the basis of the retail centre case study performed to assess the availability of relevant information to determine the contribution of turnover rent to the lessor's revenue. The results of the case study are documented in Chapter 5. Reference is made to the law of property, which governs legal title and ownership of property. Legal title would not pass to a lessee based on a lease agreement, but co-ownership characteristics exist in this legal arrangement based on the rights and obligations of each party.

The relevant accounting standards are analysed where it relates to specific requirements for disclosure of turnover rent. The requirements of IAS 18 *Revenue* defines the determination and disclosure of income earned by retail stores. The retail lease agreement defines the determination of turnover. An analysis of an example of a retail lease agreement is performed in this chapter, where it relates to turnover rent. The definition of turnover rent is compared to revenue according to IAS 18 *Revenue*, and differences are explored. A calculation of turnover rent is included for explanatory purposes. The requirements of IAS 17 *Leases* are relevant for the determination and disclosure of contingent rent (or turnover rent). Contingent rent recognised in this period should be disclosed in the annual financial statements (IAS 17.56). This disclosure requirement would provide the basis for the content analysis of financial disclosure (documented in Chapter 4) in order to assess the availability of relevant information; in order to determine the contribution of turnover rent to lessor's revenue.

If it can be determined that a specific building (or group of buildings) meet the requirements of IFRS 8 *Segment Reporting*, the entity should disclose information

relating to that building (or group of buildings) in its capacity as an operating segment. IFRS 8 allows for flexibility in disclosure if minimum requirements are not met. This would allow a lessor to disclose only certain information of, for instance, better performing buildings or group information jointly where a favourable combination may hide buildings with less favourable performance.

The requirements of IAS 40 *Investment Property* are analysed in this chapter. One of the requirements for the selection of annual financial statements for the content analysis, as indicated in Chapter 3, is that the retail buildings should be held as investment property and details disclosed according to the relevant requirements of the above standard as well as IFRS 13 *Fair Value Measurement*. Valuation requirements for retail buildings are discussed in this chapter, although the focus of the study is not the fair value measurement of retail buildings.

It is indicated in Chapter 2 that the IASB has considered additional disclosure requirements relating to contingent rent payments by lessees, but has not implemented these. These additional requirements would pave the way for lessors to disclose contingent rent income in the future. Currently there are no disclosure requirements for the performance of individual real estate assets. This adds to the research problem of the availability of information in order to determine the contribution of turnover rent to the lessor's revenue.

6.2.3 Chapter 3: Research design

The research method for this study is discussed in this chapter. It focuses on two phases, being a content analysis and a case study. The choice of methods is explored and the reasons for the methods are highlighted. The following is a summary of the two methods:

6.2.3.1 Content analysis of financial disclosure

The objective to establish the extent of financial and performance information available from the annual financial statements of REITs, and real estate funds owning retail buildings is addressed in the content analysis. This objective supports the overall research problem statement of assessing the availability of

relevant information in order to determine the contribution of turnover rent to lessor revenue. The critical questions of the content analysis are answered in this chapter. The sourcing and availability of data is discussed, with the main source being the published annual financial statements of listed real estate entities. It is indicated in this chapter that results of the content analysis cannot be extrapolated, even though the results provide an indication of the disclosure of turnover rent and building performance, therefore supporting the research problem. The steps to follow in the selection of annual financial statements, and the analysis of the relevant disclosure of building performance are stipulated in this chapter as well as the presentation of the results.

6.2.3.2 Retail centre case study

Considering academic literature and examples of case studies, a case study is considered the appropriate method as a second phase of this study in order to address the research problem. The main 'how' and 'why' questions, and other criteria are addressed specifically for this study. The sourcing and availability of data, with related limitations are discussed in this chapter. Ethical clearance was obtained for the use of data supplied. The use of data was subject to certain confidentiality requirements. The asset manager who supplied the data did not allow disclosure of the name of the building or the names of the lessees. These requirements are adhered to in this study.

The steps to follow to complete the case study are indicated in this chapter. These include the entire process from the data request to performing the data analysis and depiction of results. It is indicated that results will be presented mainly in graphical format, to allow for the interpretation of trends in the period analysed, being 2007–2014. In analysing the performance data of the retail centre and the merchant categories, a comparison is made to relevant economic indicators. Findings took the form of notable trends identified in the data analysis, as documented in Chapter 5. The content analysis provides additional information of the availability of relevant data related to turnover rent and other building performance aspects.

6.2.4 Chapter 4: Content analysis: Review of Annual Financial Statements

The content analysis endeavours to ascertain how the prevailing accounting standards are applied in the commercial real estate industry in South Africa. The availability of relevant information to determine the contribution of turnover rent to lessor revenue is assessed by the analysis of published annual financial statements of listed entities owning multiple retail investment property. The 2012 financial statements of SAC was analysed. Due to the inadequate disclosure of turnover rent and building performance to address the research problem, a further four listed REITs or listed real estate entities as well as an insurance company (being a large owner of multiple retail real estate assets) were selected to evaluate the application of disclosure requirements relating to turnover rent. The results of the analysis is documented in the chapter and a summary of the conclusions is documented in section 6.3.1.

6.2.5 Chapter 5: Retail centre case study

In this chapter, and in line with the method stipulated in Chapter 3, information was requested from an asset manager of a super-regional shopping centre in South Africa. The purpose of the analysis is to ascertain if—from the data received and analysed—valuable insight could be obtained on the building's performance, with specific focus on turnover rent. Chapter 3 stipulated how data should be prepared in pivot tables, and analysed and depicted graphically to determine the contribution of turnover rent to lessor revenue. The results of the analysis is documented in Chapter 5. It was performed on two levels; firstly at a centre level, and secondly at a merchant category level. The results are documented in Chapter 4 with graphical depiction in 'Appendix A' to this study. A summary of the conclusions is documented in paragraph 6.3.2.

6.3 CONCLUSIONS FROM THE STUDY

6.3.1 Summary of conclusions from the content analysis

In applying the relevant financial disclosure requirements, it was found that inconsistencies existed in the application of the requirements by listed entities owning retail investment property. The main inconsistencies and inadequacies being as follows:

- Four of the six companies include an accounting policy for (contingent turnover rent in their financial statements.
- None of the companies discloses turnover rent on the face of the statement of profit or loss and other comprehensive income.
- Three of the companies disclose the amount of turnover rent for the year in a note disclosure as part of revenue.
- One company has an accounting policy but no further disclosure whatsoever on turnover rent.
- Five of the six companies, the other being the insurance company where investment property income may not be material, do segment reporting in accordance with IFRS 8.

Internal property management and asset management ratios, which indicate building performance, are not consistently disclosed in the annual financial statements, and is not required to be disclosed. The main inconsistencies are as follows:

- Four of the six companies disclose building revenue separately per individual building.
- Two of the six discloses expenditure per building.
- One of the six discloses linked debentures and premiums for individual buildings.
- Four of the six disclose vacancies per building.
- One of the six discloses footfall, lessee churn and trade densities per building. From this, total lessee turnover for the building can be calculated.
- None of the companies discloses turnover rent collected per building.

- None of the companies discloses property management performance criteria and achievements or shortfalls.

With the above inadequacies and inconsistencies in the disclosure of required financial information and non-required building performance information, it is not possible to make accurate and complete comparisons through analysis in order to determine the contribution of turnover rent to lessor revenue. Additionally, the income, expenditure, gearing, and performance of each building cannot be ascertained and consistently compared with other buildings based on publicly available information. It is recommended that building performance should a disclosure requirement, including all critical factors affecting building performance, e.g. turnover rent. Further examples of proposed required and optional disclosure are included in paragraph 4.5. If these inadequacies and inconsistencies are addressed with structured guidance and limited optional disclosure, it would positively aid in the decision-making process of stakeholders. It is; therefore, recommended that the SA REIT Association design and supply guidance to listed entities owning retail real estate as investment property. This guidance should include compulsory and voluntary disclosure requirements and prohibitions. This would allow for consistency in disclosure as well as increased comparativeness of the results of REITs and statuses of their assets. Refer in this regard to paragraph 6.5 for further research recommendations.

6.3.2 Summary of conclusions from the retail centre case study

The purpose of the analysis is to ascertain if—from the data analysed—valuable insight could be obtained on the building’s performance, with specific focus on turnover rent in order to determine the contribution of turnover rent to the lessor’s revenue. This analysis follows the identification of inadequate and inconsistent disclosure of turnover rent, and building performance in publicly available information. The analysis is performed on two levels, namely at building level and at merchant category level, and the results are reported accordingly. A summary of the main findings following the centre level analysis is included below:

- There is a strong correlation between turnover rent and turnover growth, with

turnover rent received a year later due to the prevailing financial disclosure requirements applicable to contingent rent

- There is a strong indirect correlation between the prime interest rate, and the following performance indicators:
 - turnover achieved by lessees
 - total rental collected
 - centre footcount
- There is a strong direct correlation between the footcount and the lessee turnover

It can be concluded from the above results that the prime interest rate movements influences footcount, lessee turnover, and rental collected in a negative way, *i.e.* the higher the prime interest rate, the lower the performance of the centre, and *vice versa*. This would negatively affect the contribution of turnover rent to lessor revenue. It indicates a strong reliance of the South African retail sector on credit sales. In executing a risk based performance strategy for a retail centre, the economic indicators should be taken into account. In this instance, the reliance on turnover rent was reduced throughout the period under review, and replaced by fixed rental income. It is suggested in paragraph 6.5 that future research be conducted on the assessment of the risk strategy for a retail centre.

With higher risk, higher returns should be possible as illustrated by the increase in growth in 2010 (the year of the soccer World Cup) and subsequent recognition and collection of turnover rent in 2011. The contribution of turnover rent to lessor revenue increased in this period due to an increase in lessee turnover as a result of a specific driver of retail sales.

The four largest contributors to turnover rent were identified. Those are department stores, movies, unisex wear, and food service. These merchant categories contributed seventy-one percent of turnover rent earned by the lessor in this building during the period under review. Largely, similar reliance were identified on the prime interest rate as what was identified in the building.

The overall risk strategy of the building and the execution of this strategy are unknown to the user of the data. However, execution of a risk-based strategy is

evident in the decrease of reliance on turnover rent during the period. There is more information available for meaningful analysis than what is required to be disclosed by the current accounting standards. This information may allude to the rental strategy, certain occurrences in the centre (e.g. redevelopment), the level of management performance, reaction to economic trends and forecasts, and preparedness for increases in the retail trade in the area where it is located. Individually and holistically, these factors can influence the performance of the building, and the optimisation of rental income. Should this information be made available to the reader of the financial statements, and in a meaningful format, more informed decisions could be made based on a more in-depth understanding of the operations, and the ultimate performance of the retail centre. This information should be concise and structured to provide the necessary information.

6.4 SUMMARY OF RESEARCH OBJECTIVES

The problem statement intended to assess the availability of relevant information in order to determine the contribution of turnover rent to the lessor's revenue through a growth and a contraction phase in the South African economy. The research problem was addressed through firstly assessing and consulting publicly available information by means of a content analysis. Since it was established that inadequate and inconsistent information is available to address the research problem, relevant data was requested from an asset manager in order to perform a case study on one retail centre. In answering the research problem with a dual approach, the additional objectives as stated in Chapter 1, section 2 were achieved. Below is a summary of these objectives, and whether, and to what extent it was achieved.

Table 6.1: A summary of the research objectives

Research objective	Achieved (yes/no/partial)	Comments and reference
To establish the extent of financial and performance information available from the Annual Financial Statements	Yes	Chapter 2 focused on required financial disclosure and Chapter 4 focused on the application and actual disclosure
To calculate and analyse the contribution of turnover rent to revenue in a retail building	Yes	Chapter 5 (and 'Appendix A') discussed and graphically depicts the contribution of turnover rent to revenue at the building level
To express and analyse this contribution as a percentage of revenue for this specific building from each major contributing merchant category	Yes	The contribution of turnover rent to revenue from each major contributing merchant category is analysed in Chapter 5 (and 'Appendix A')
To compare this contribution over a period to economic indicators to establish possible correlations	Yes	Chapter 5 provides the results of the retail centre case study from 2007 through 2014

Source: Own

The research objectives were achieved by following the methods stipulated in Chapter 3 and executed in Chapters 4 and 5. The next section will highlight future research recommendations related to this study.

6.5 RECOMMENDATIONS FOR FUTURE RESEARCH

The immediate need for additional research and action by the IASB, is for improved, more transparent disclosure requirements for investment property (and specifically, individual retail buildings) in annual financial statements of REITs. This increased transparency would allow for better shareholder decision making due to consistent building information included in the financial statements. Meaningful comparisons would be possible between buildings and between different entities.

It is recommended that future research be performed once IRFS 16 leases become effective. The compulsory disclosure of this standard may address inadequacies identified in this study. Future research is needed on the possible

inclusion of performance information of building management on the valuation of the specific building, e.g. the identification of non-financial factors influencing the fair value of the building, the value of forecast increased rental on a risk basis (fixed or variable based) and the optimisation of rent over a period of time. The focus of this study was not the influence on the fair value of the building but rather on the availability of information and the sensibility of the disclosure there-of.

Future research can be performed on the alignment of the definitions of turnover and revenue. This possible alignment will promote operational efficiency. Finally, further research is also required on the execution of a risk strategy in a retail centre, and the effect on rental optimisation and subsequent disclosure. This may include an optimisation model of combining fixed and variable rent in different merchant categories with a related sensitivity analysis. The disclosure of the risk strategy of a building could provide valuable information to readers of the annual financial statements. Guidelines should be set to govern the disclosure of this risk strategy.

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- IAS 1 *Presentation of Financial Statements*
- IAS 17 *Leases*
- IAS 18 *Revenue*
- IAS 39 *Financial Instruments: Recognition and Measurement*
- IFRS 8 *Segment reporting*
- IAS 40 *Investment Property*
- IFRS 13 *Fair Value*
- IAS 39 *Financial Instruments: Recognition and Measurement*
- IFRS 9 *Financial Instruments*
- IAS 32 *Financial Instruments: Measurement*
- IFRS 15 *Revenue from Contracts with Customers*
- ED 2013/6

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APPENDIX 1: GRAPHICAL RESULT OF EXPLORATORY DATA ANALYSIS

Centre Analysis

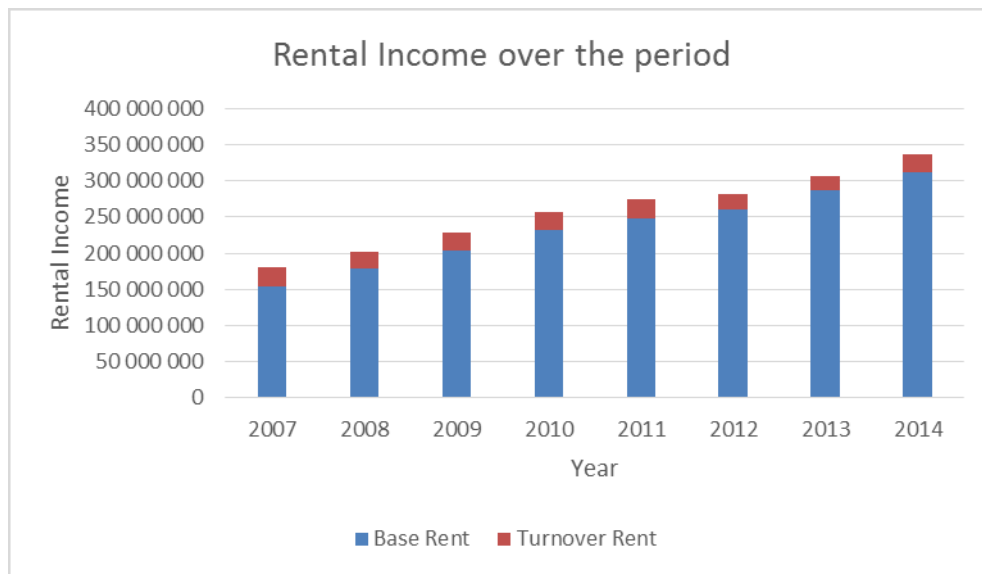


Figure A1

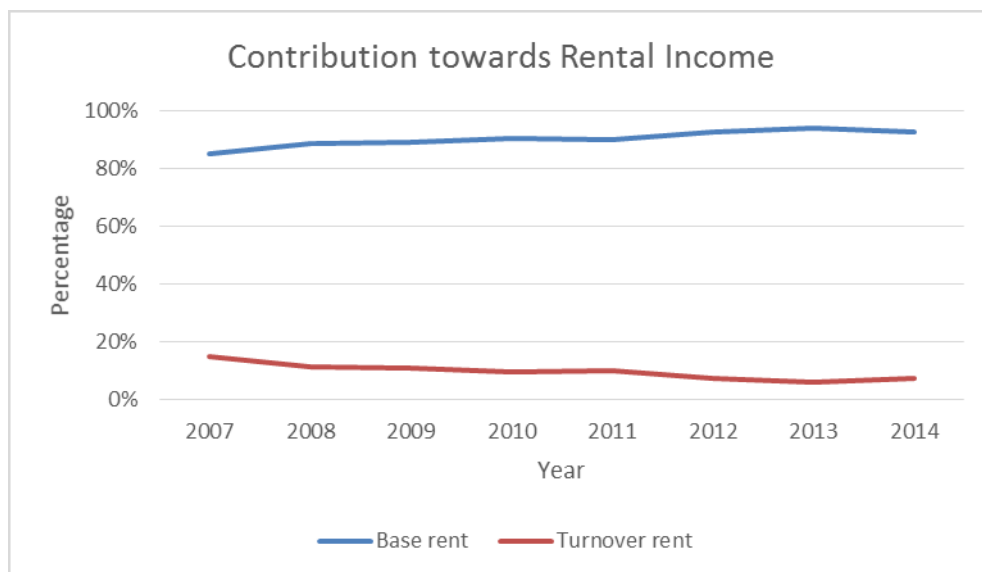


Figure A2

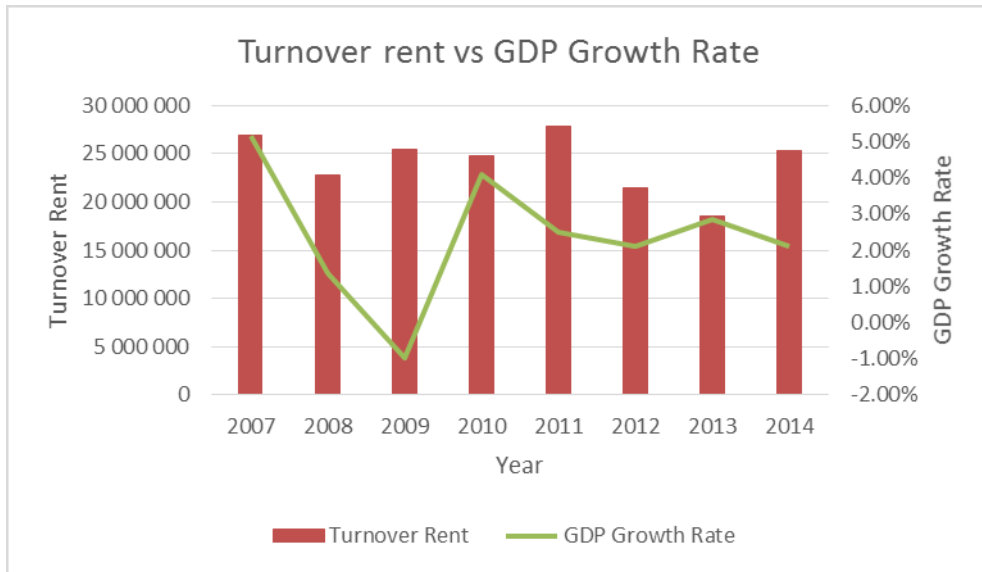


Figure A3

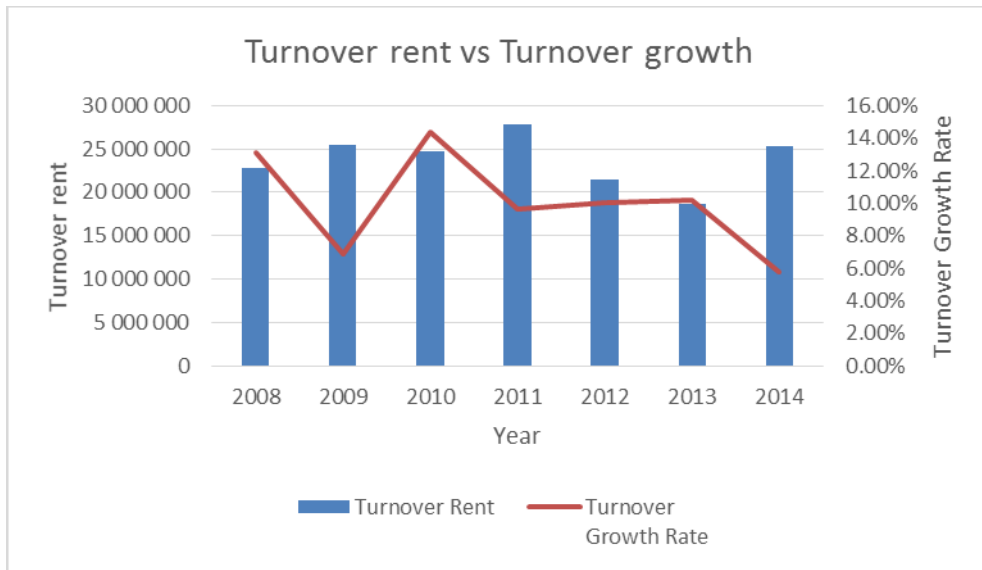


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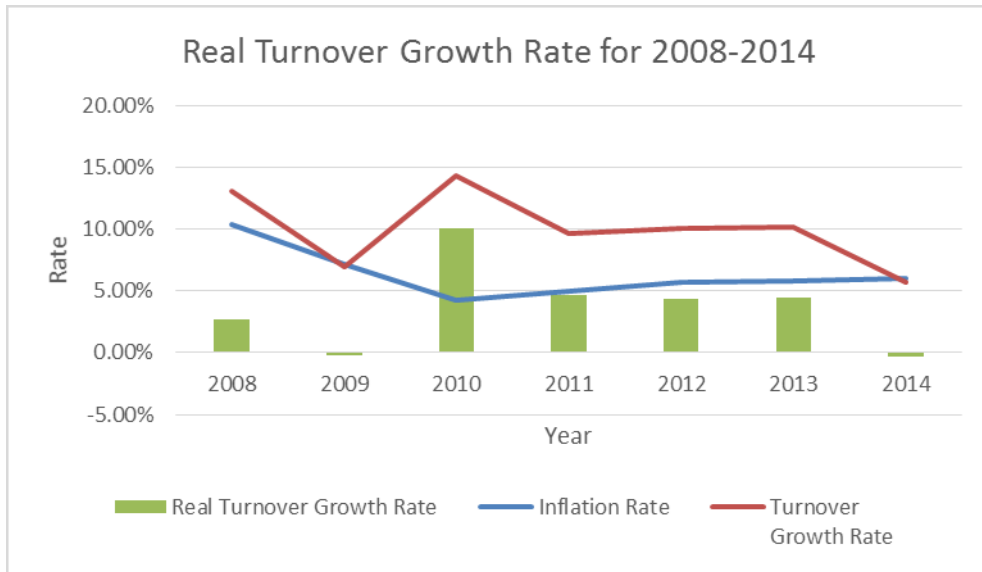


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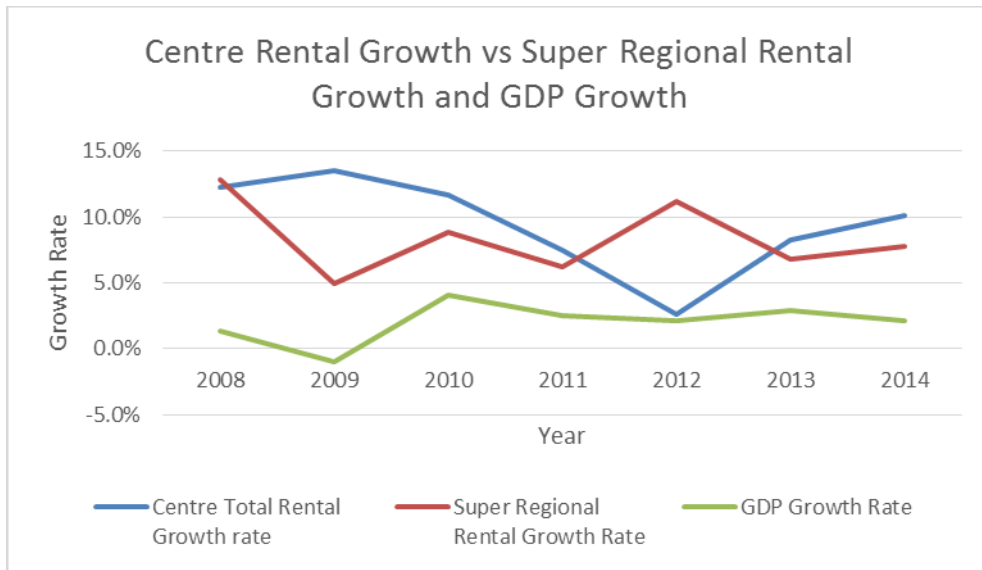


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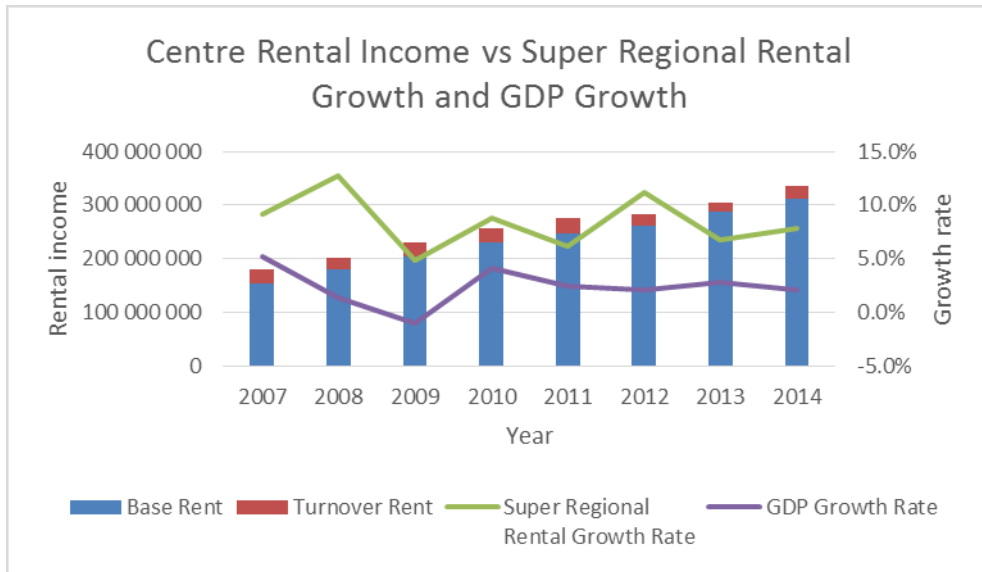


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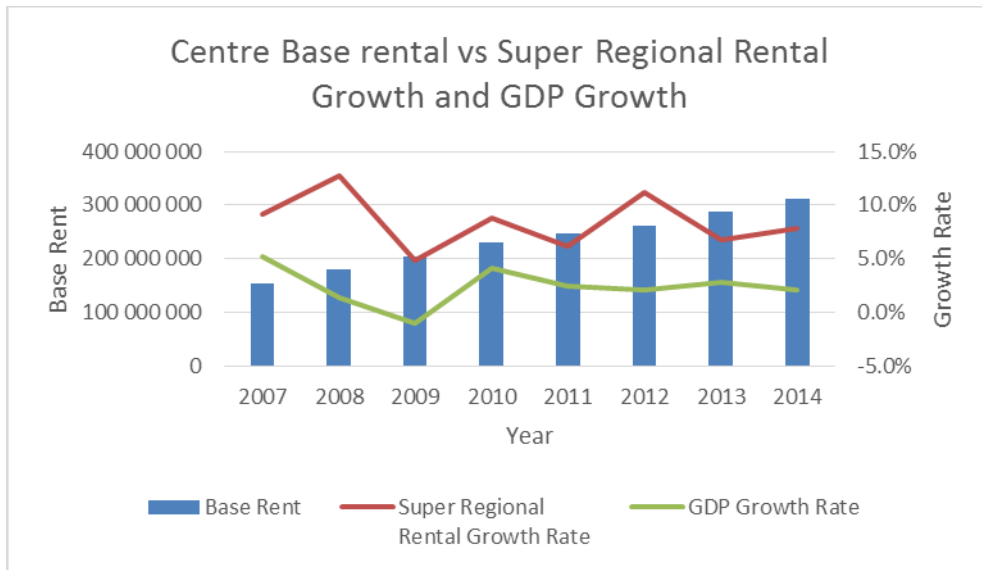


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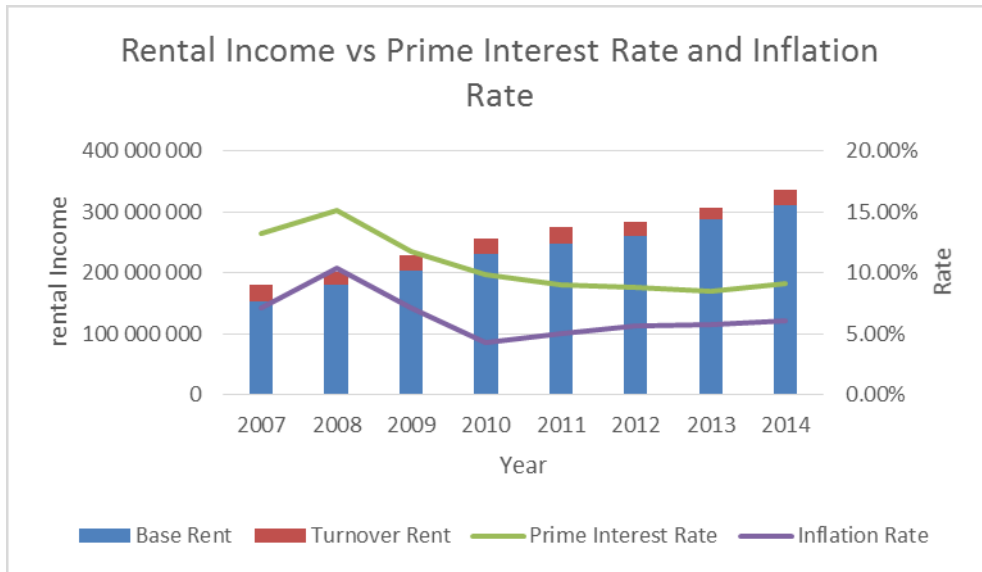


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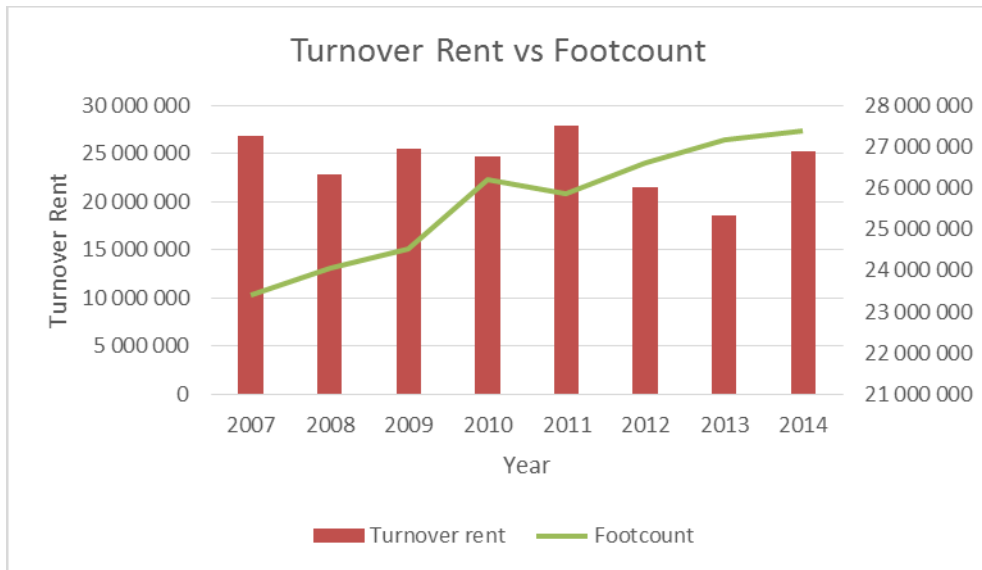


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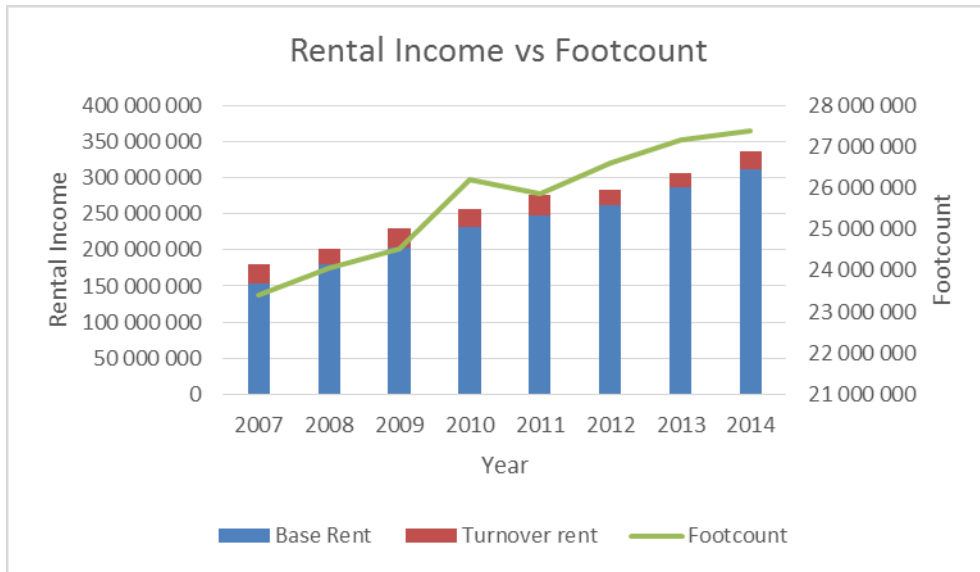


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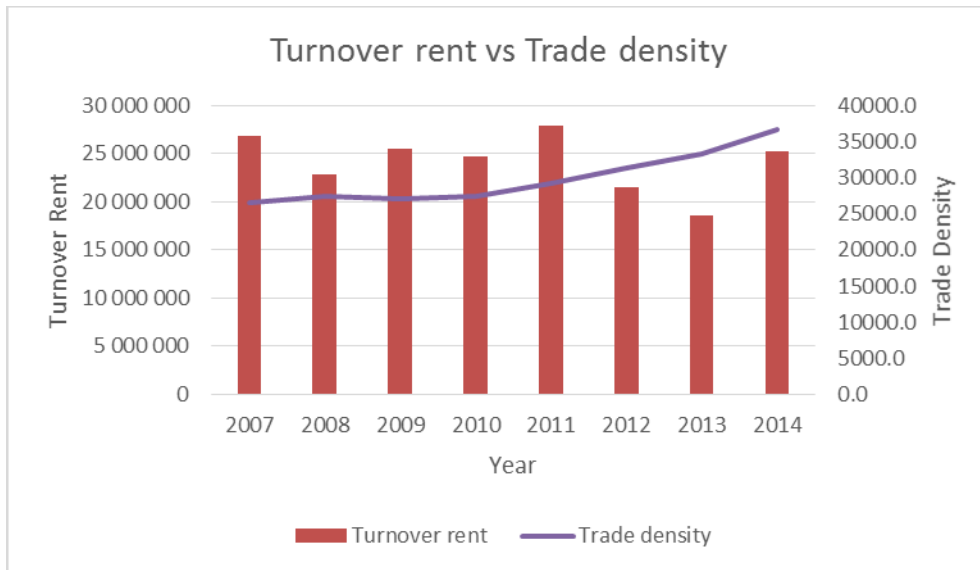


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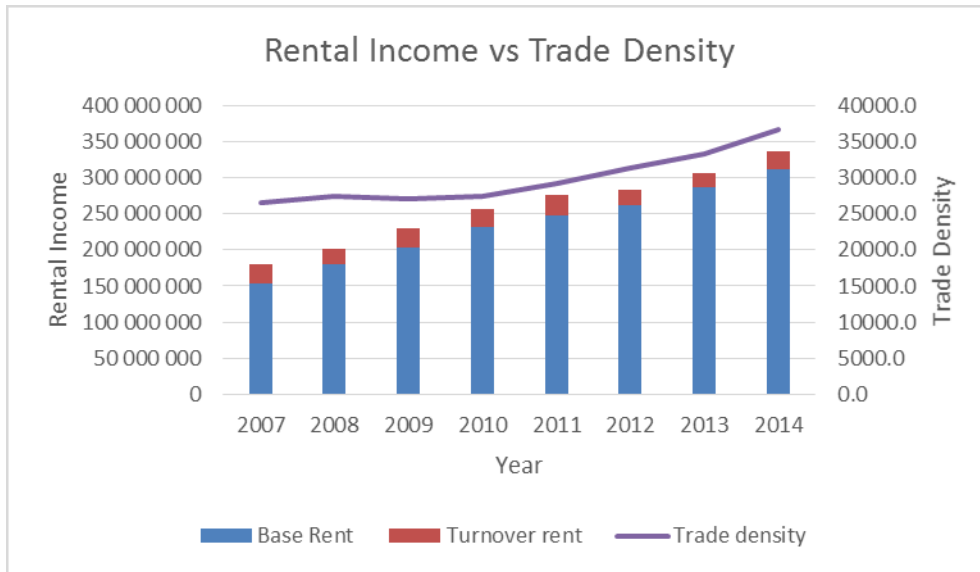


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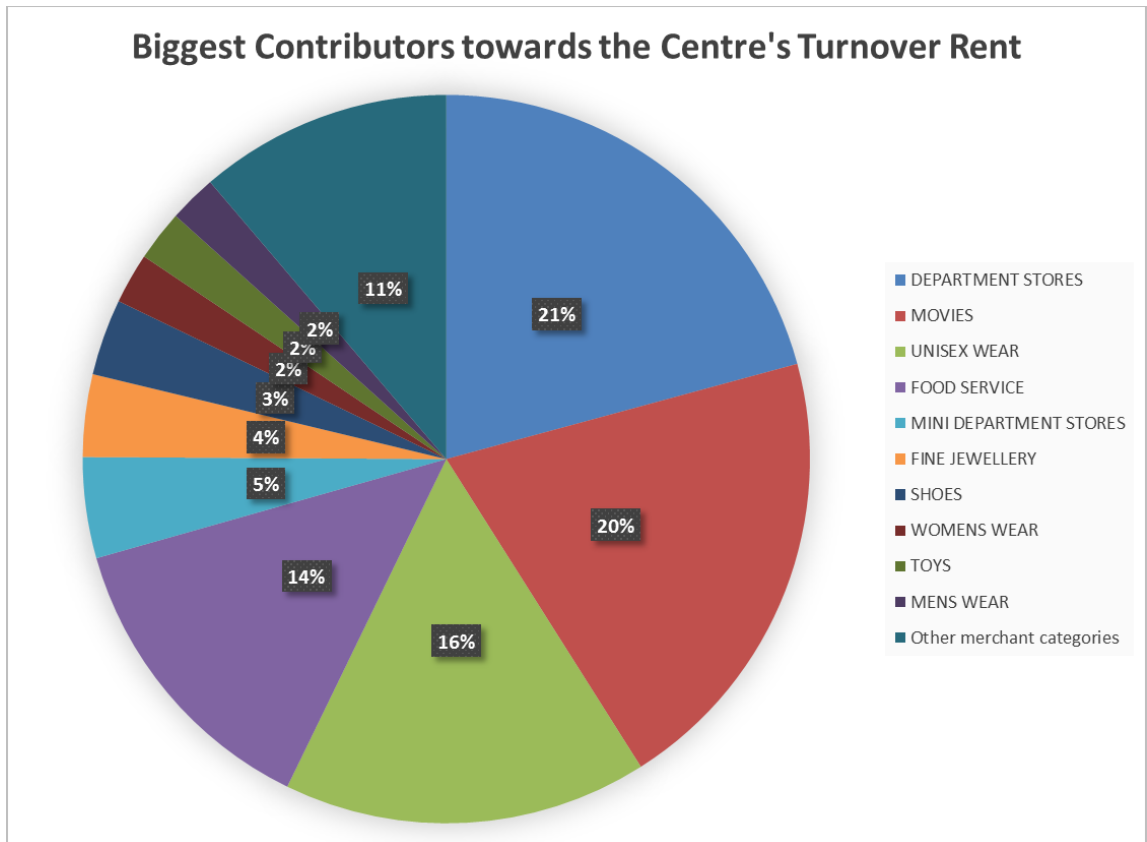


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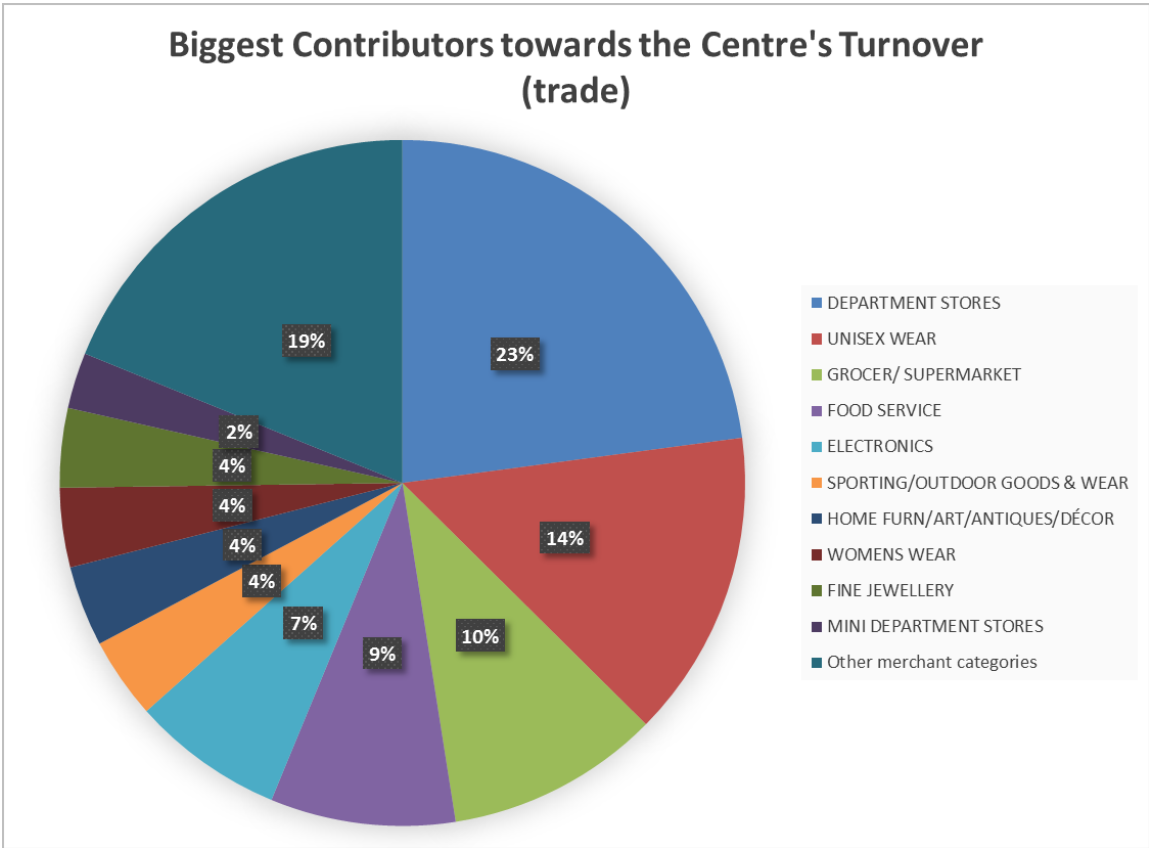


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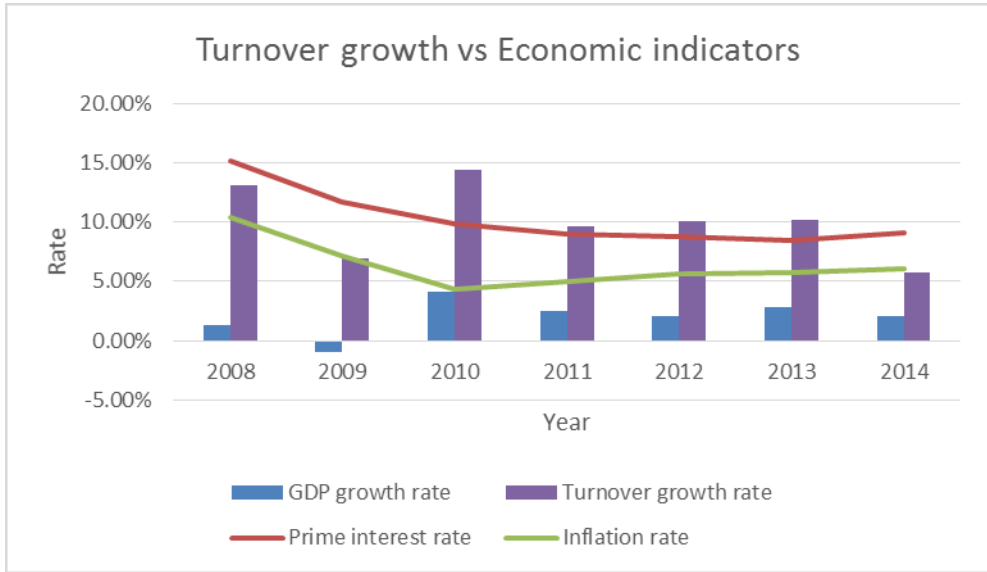


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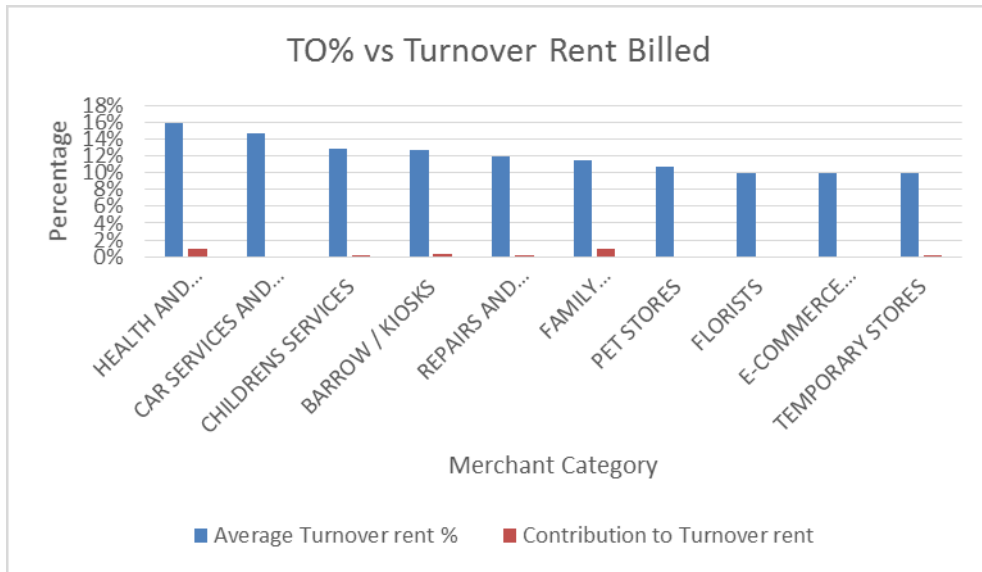


Figure A17

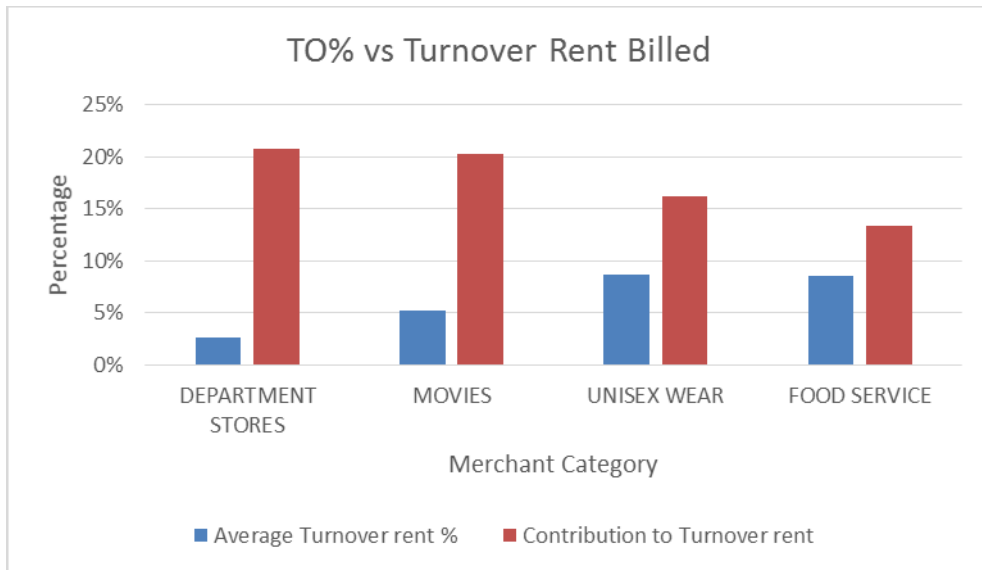


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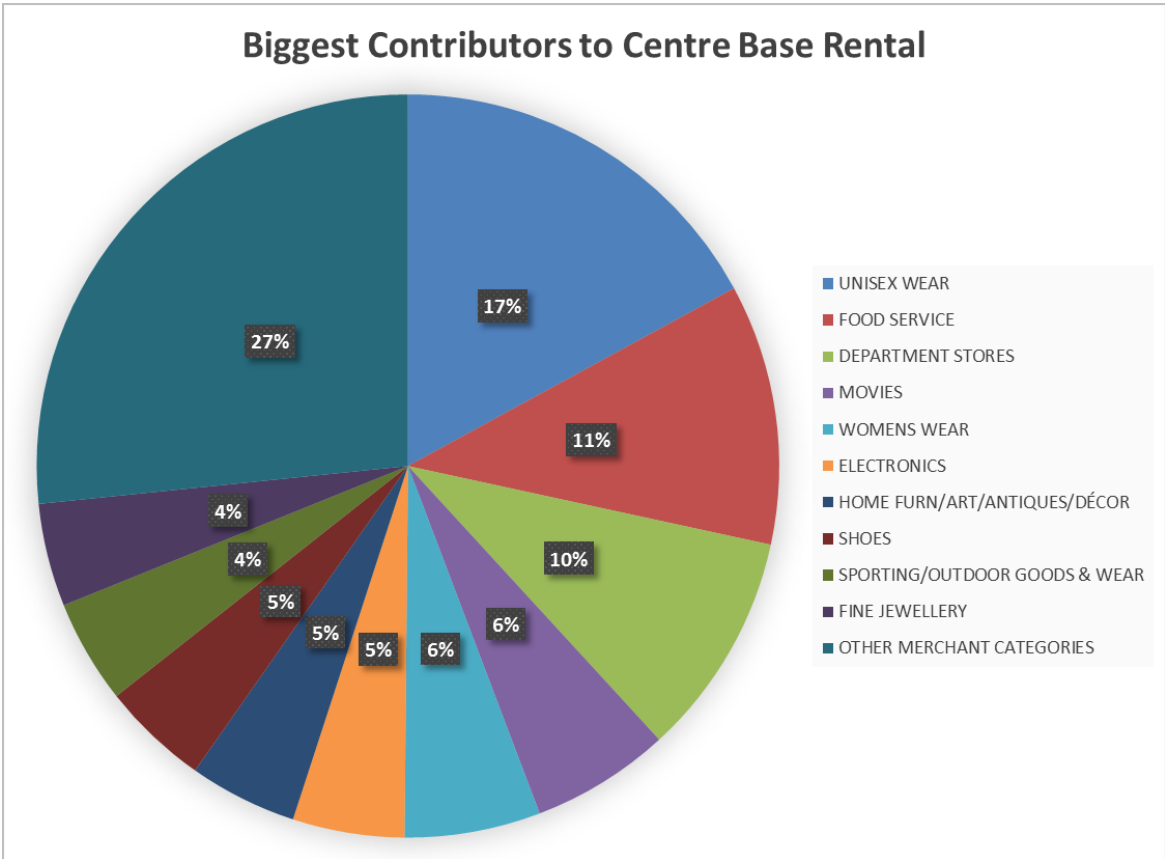


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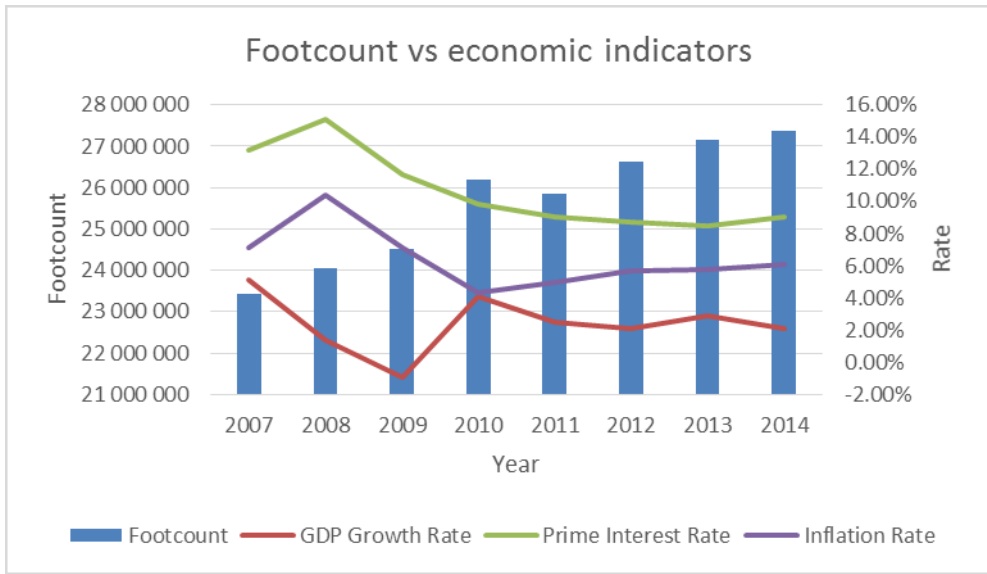


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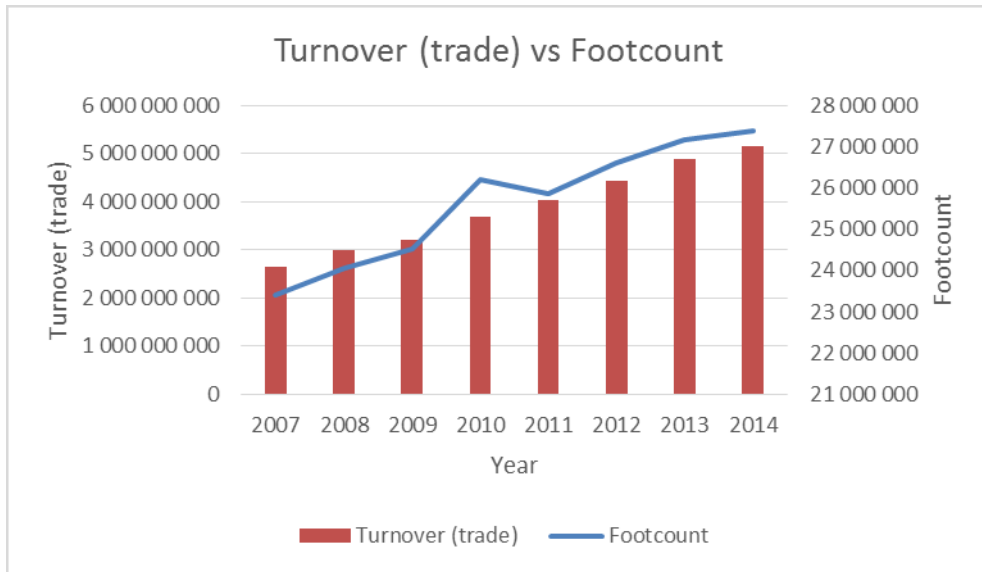


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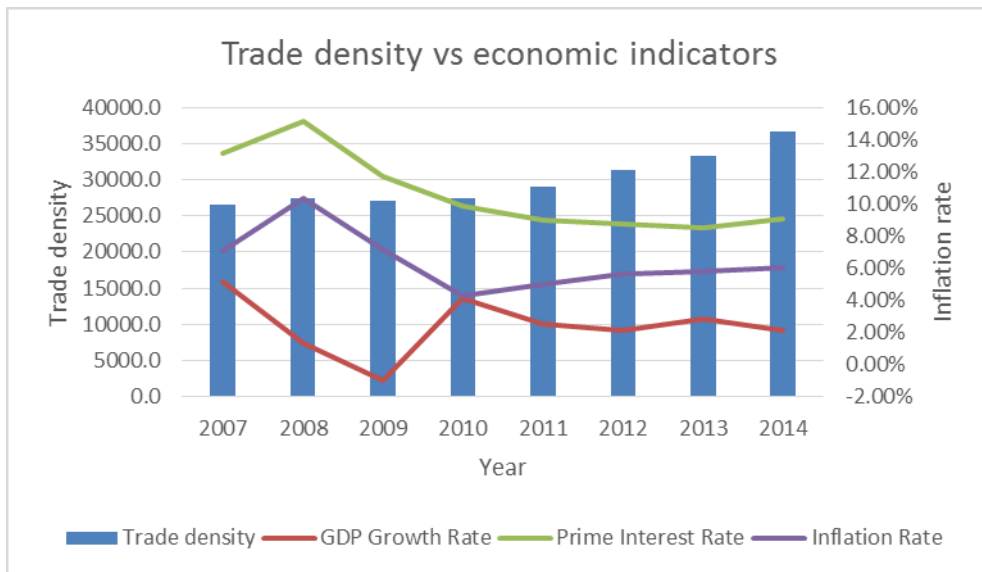


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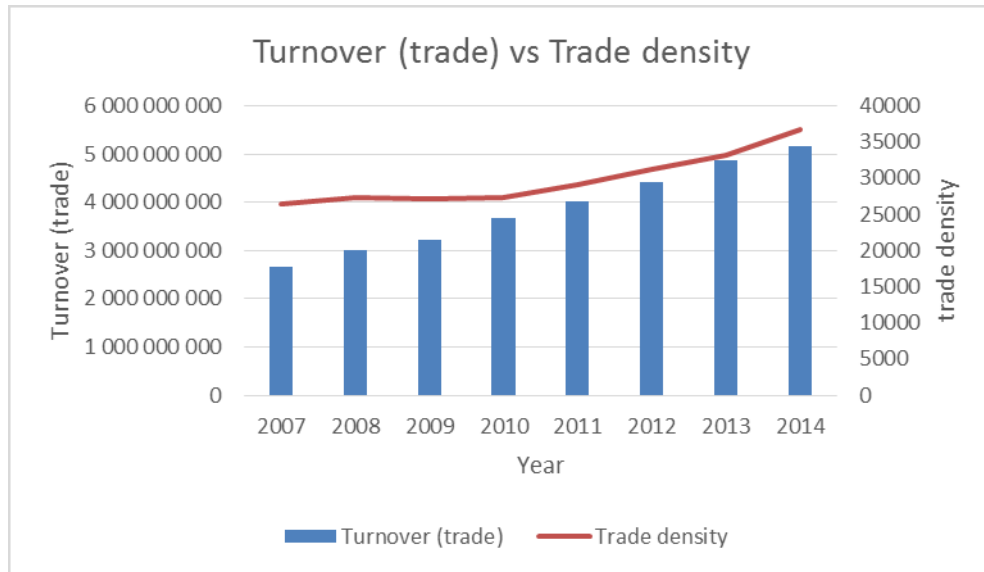


Figure A23

Merchant Category Analysis

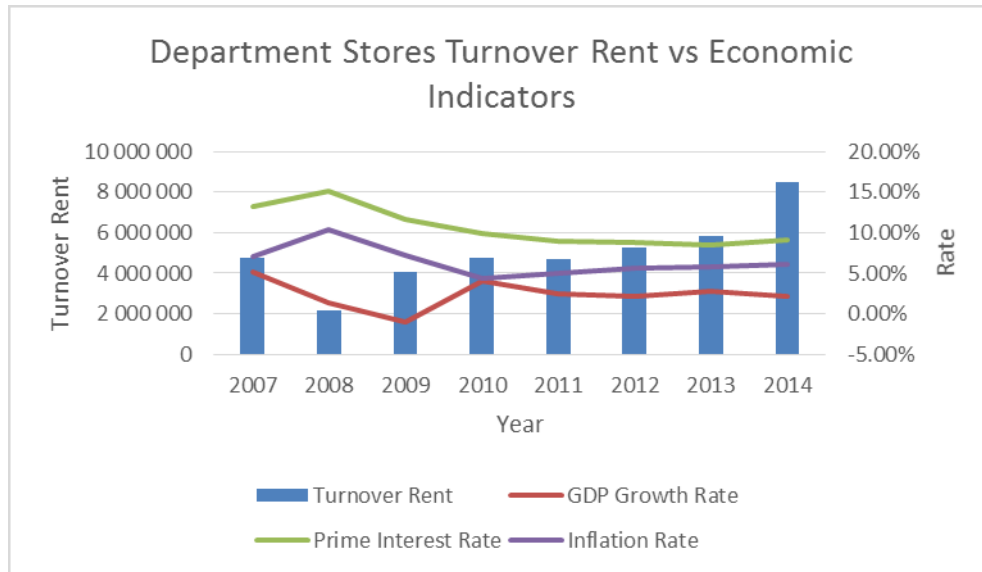


Figure A24: Department Stores

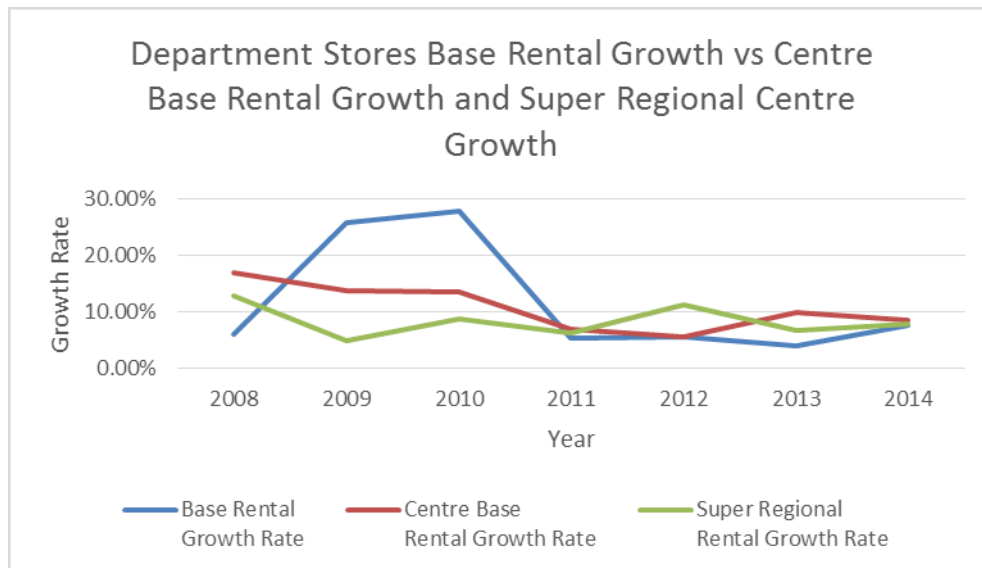


Figure A25



Figure A26

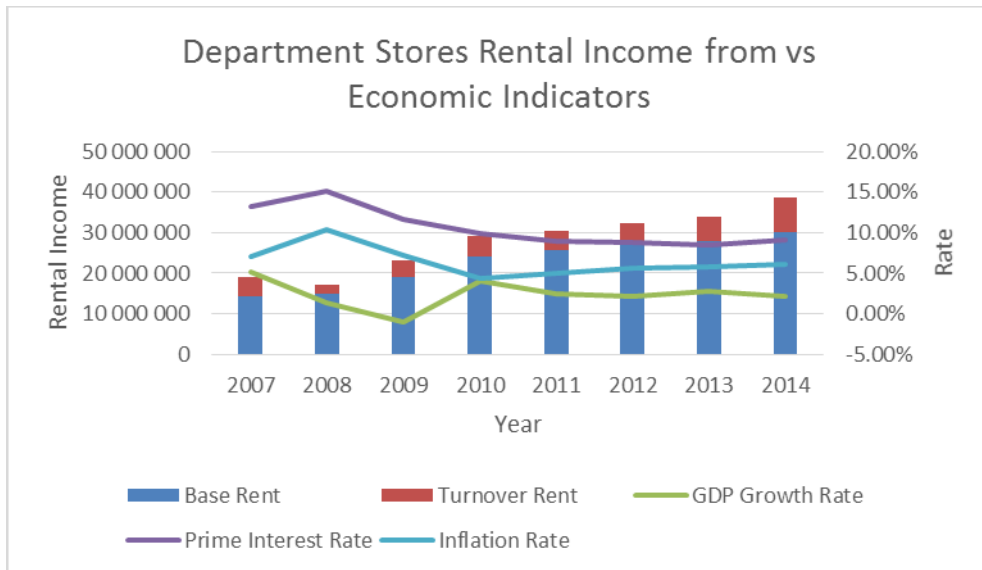


Figure A27

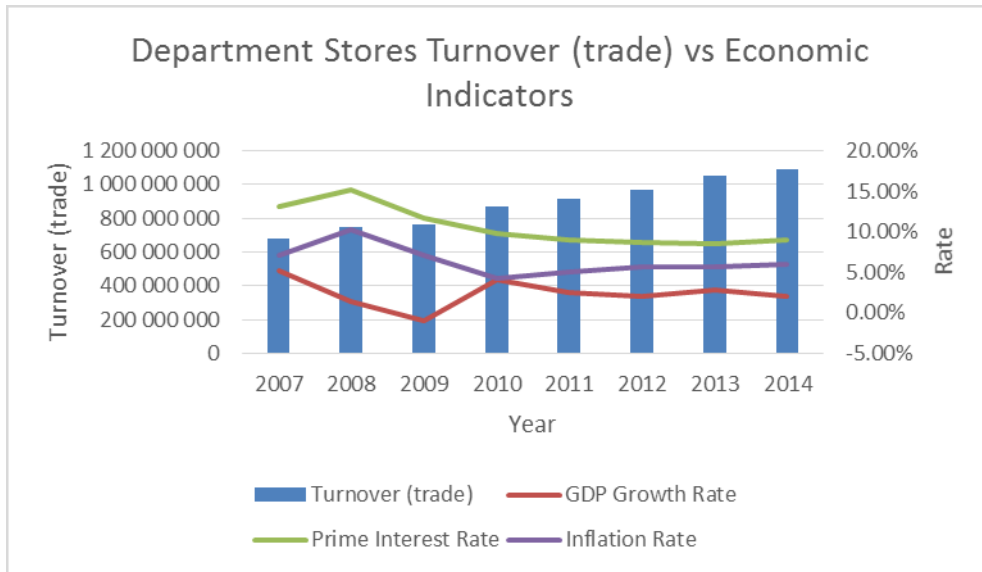


Figure A28

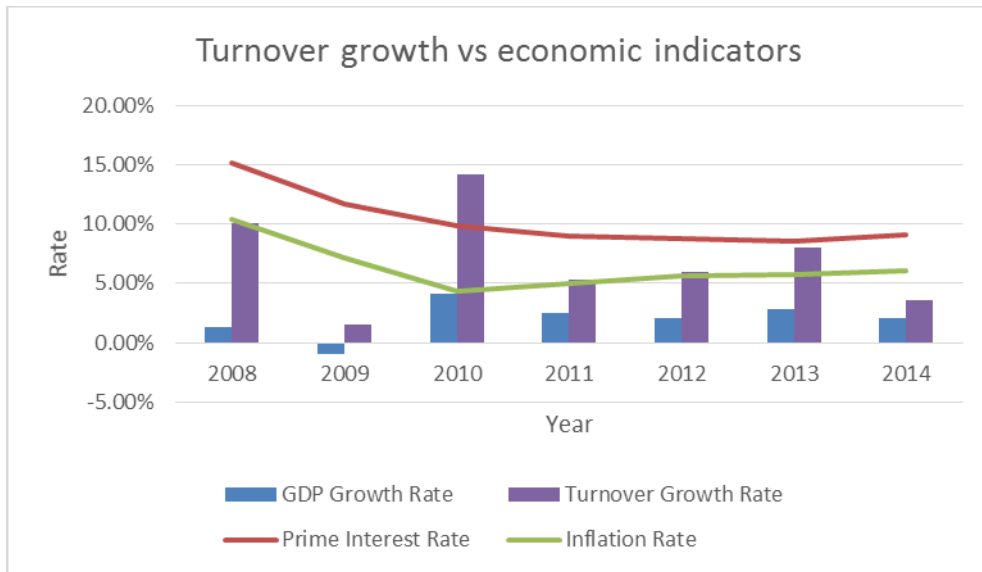


Figure A29

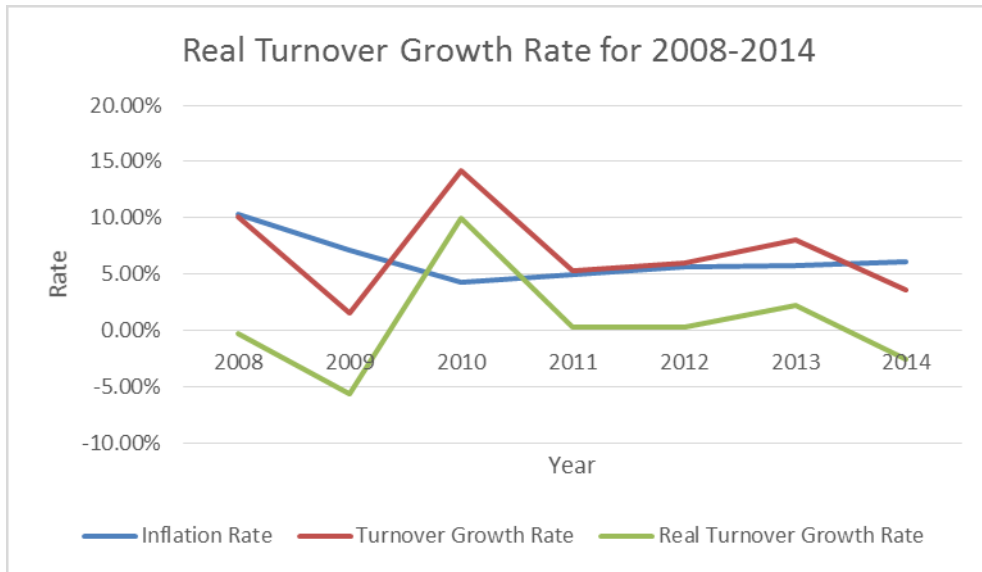


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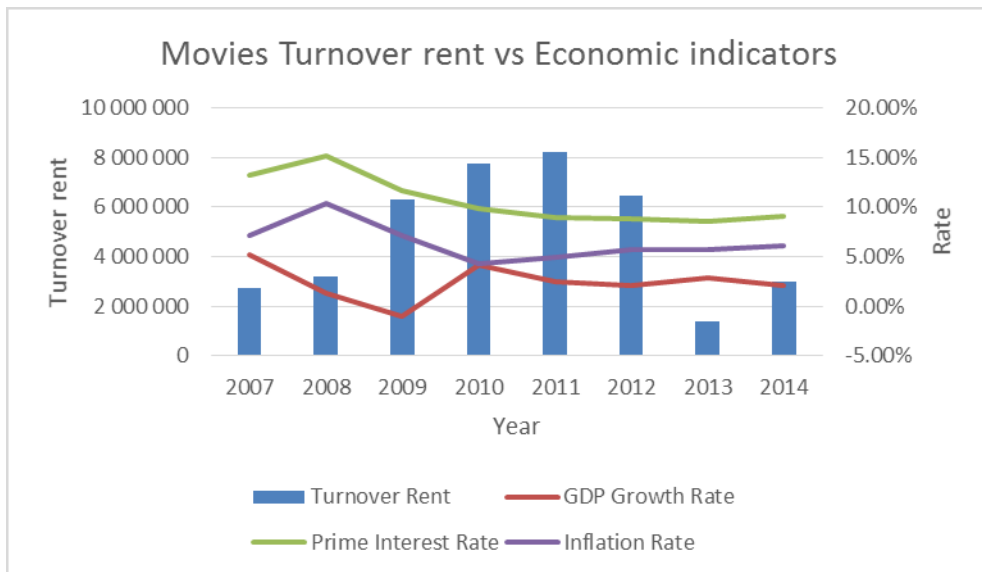


Figure A31: Movies

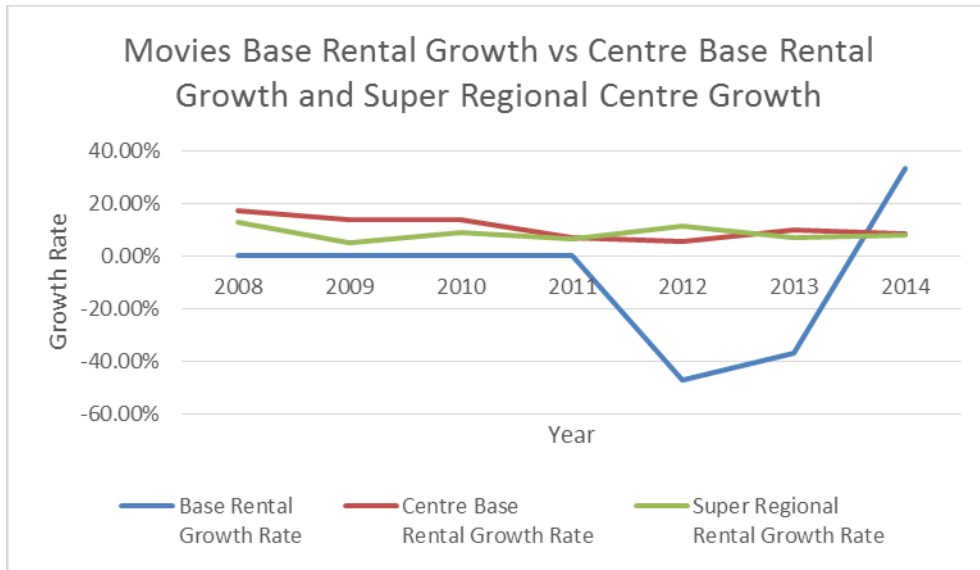


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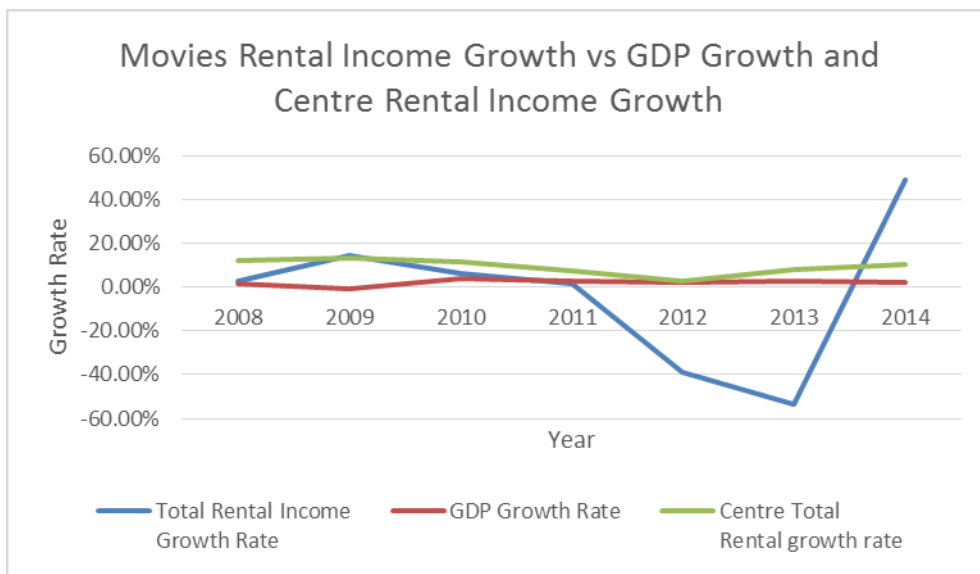


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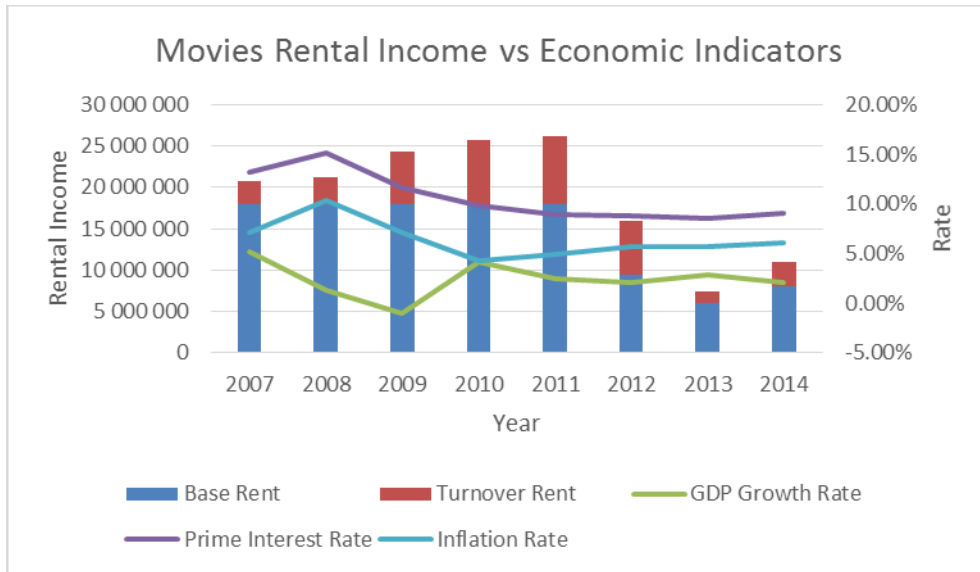


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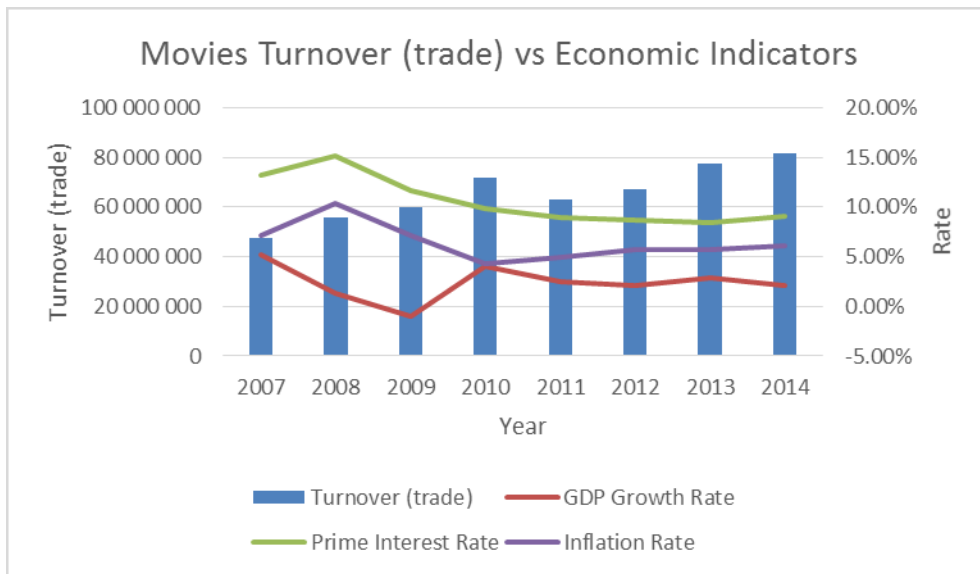


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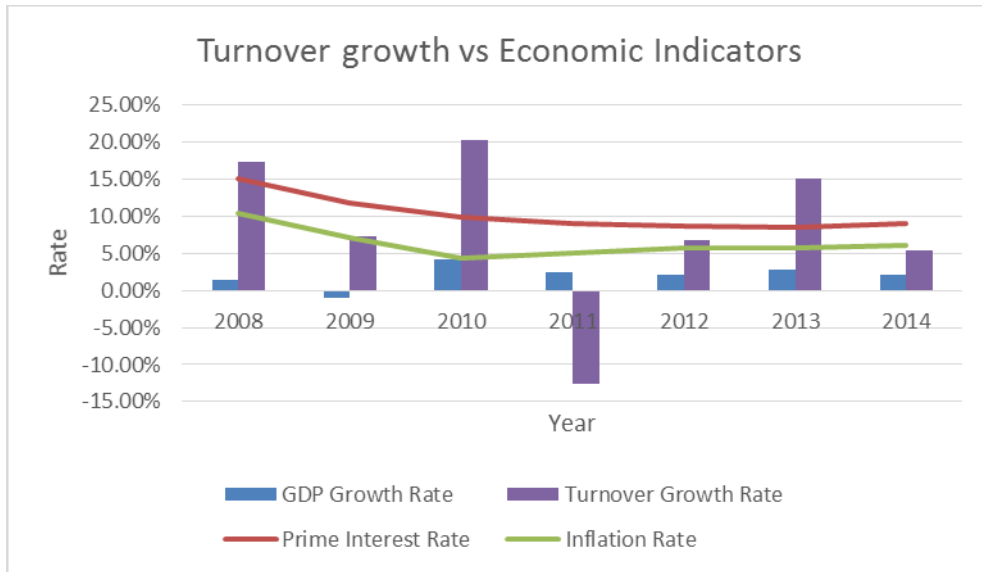


Figure A36

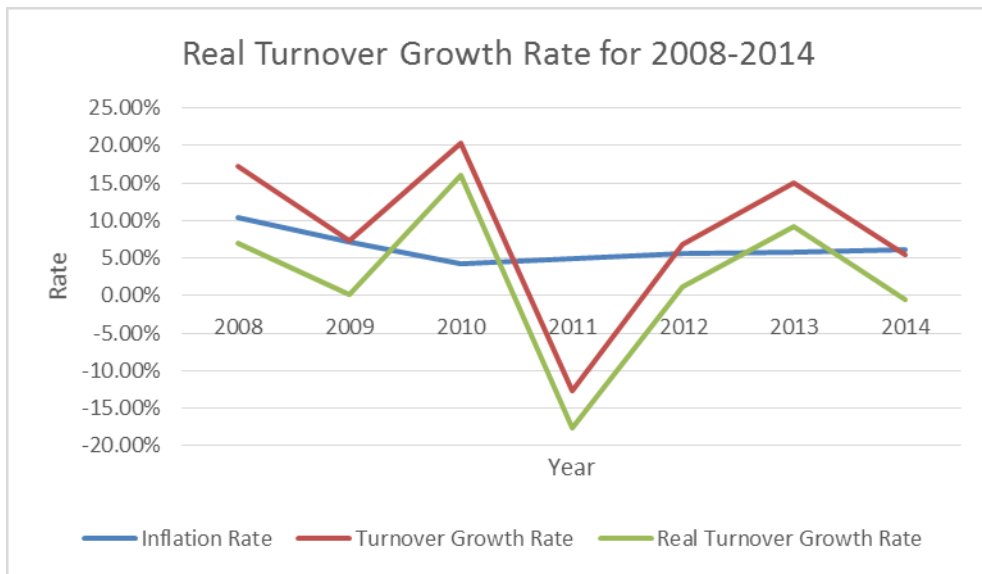


Figure A37

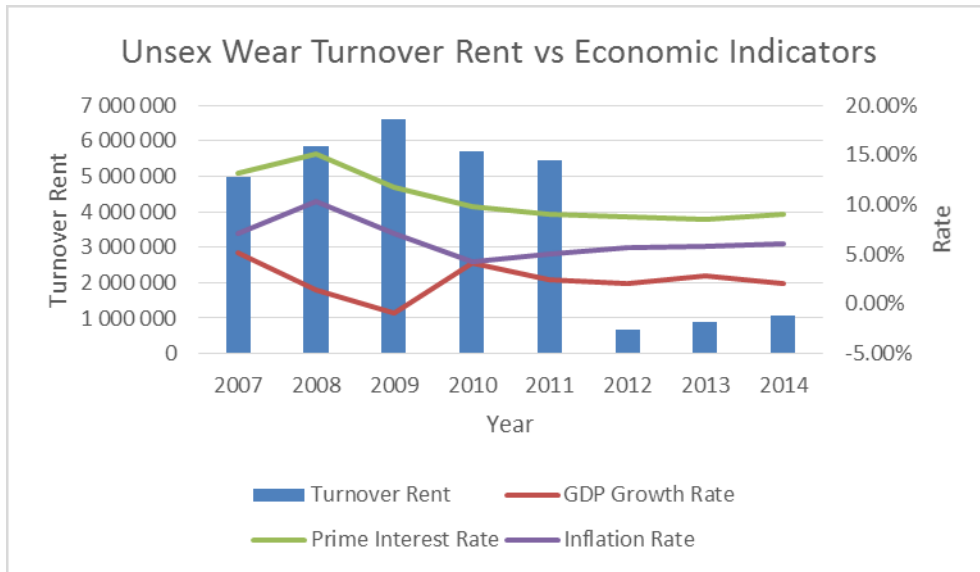


Figure A38: Unisex Wear

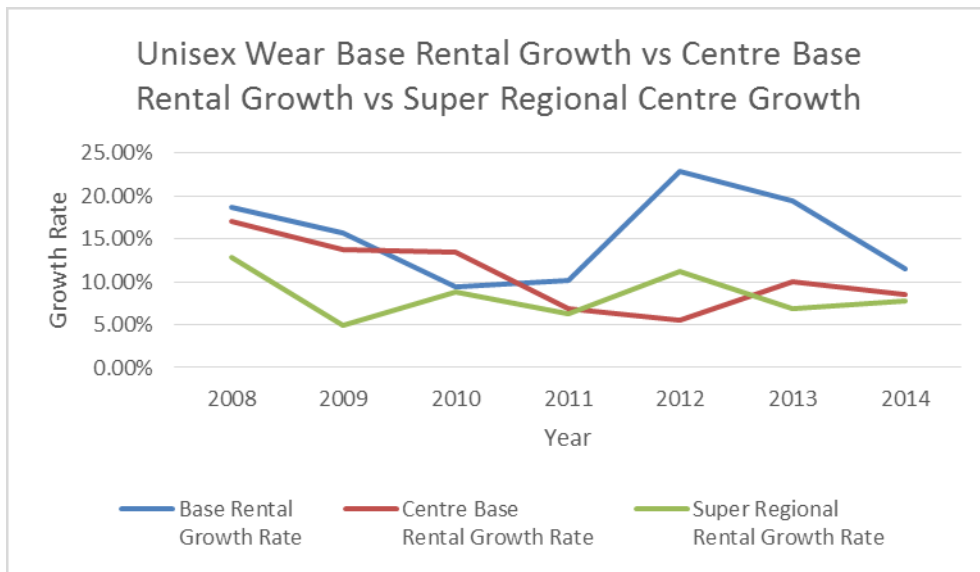


Figure A39

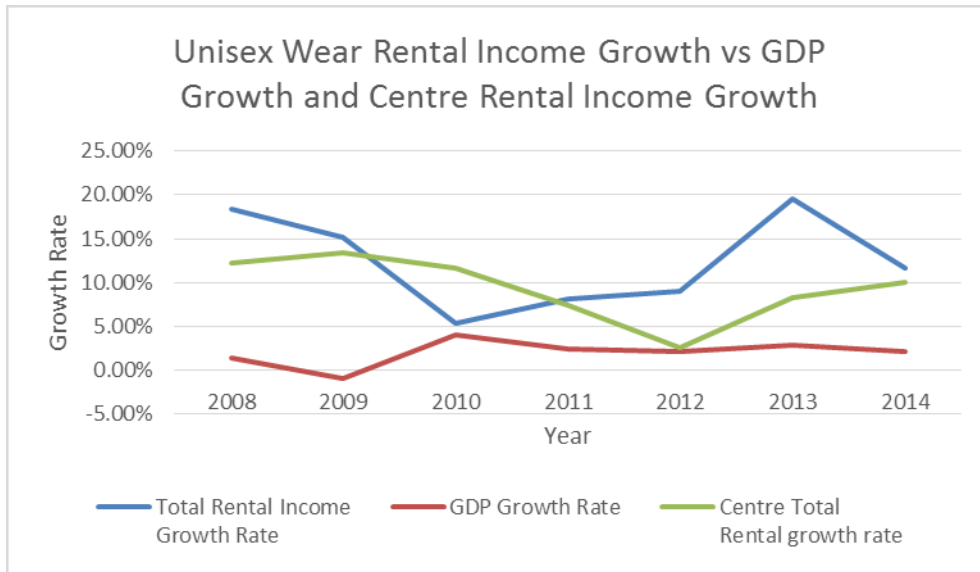


Figure A40

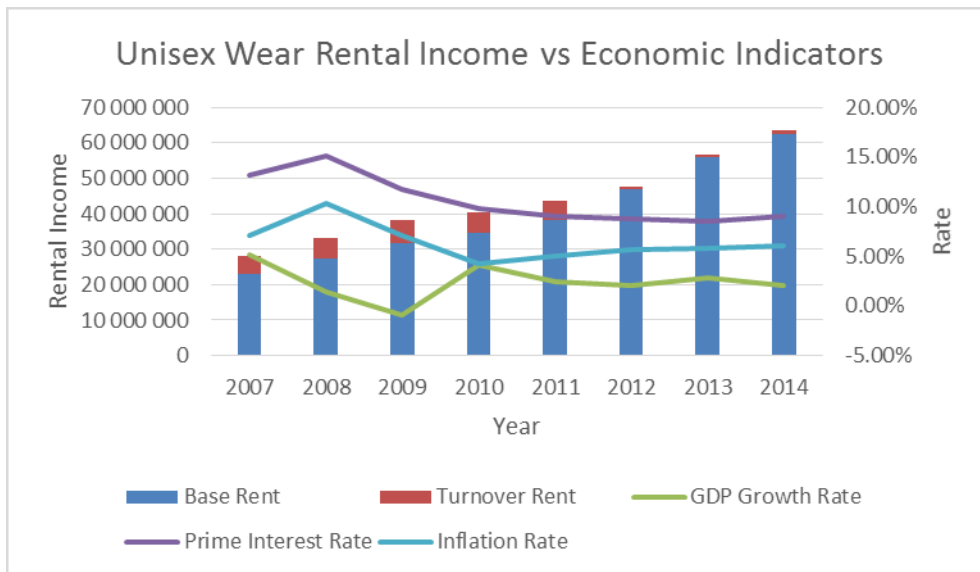


Figure A41

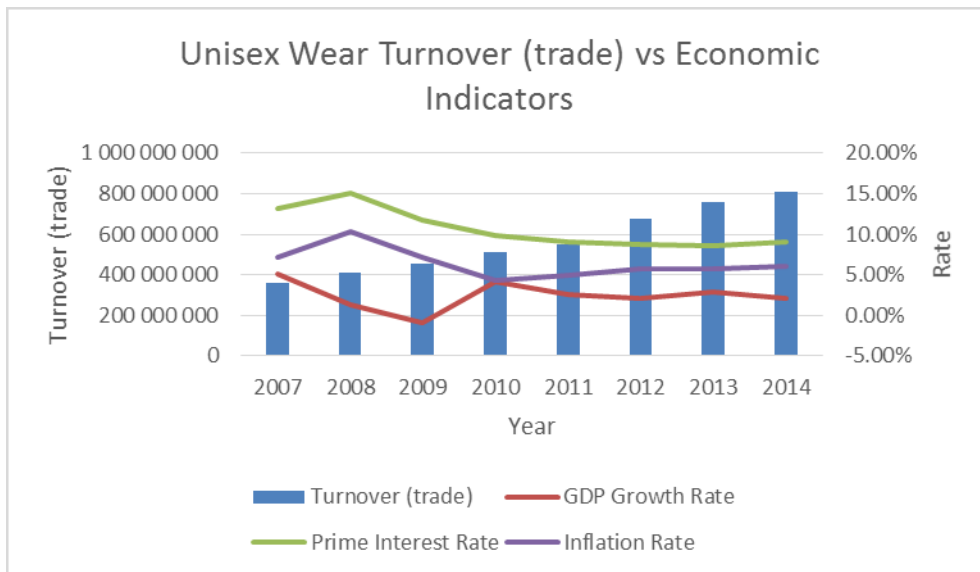


Figure A42

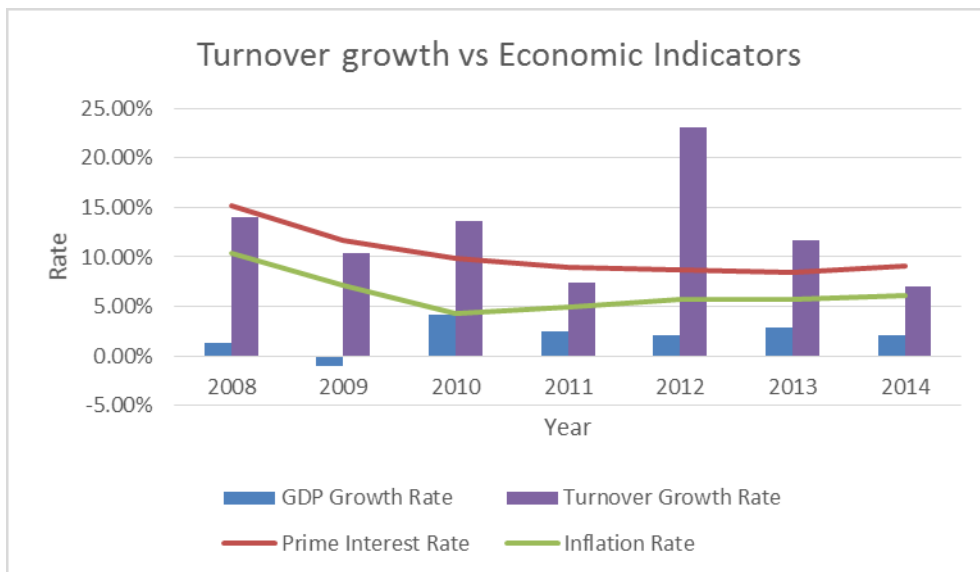


Figure A43

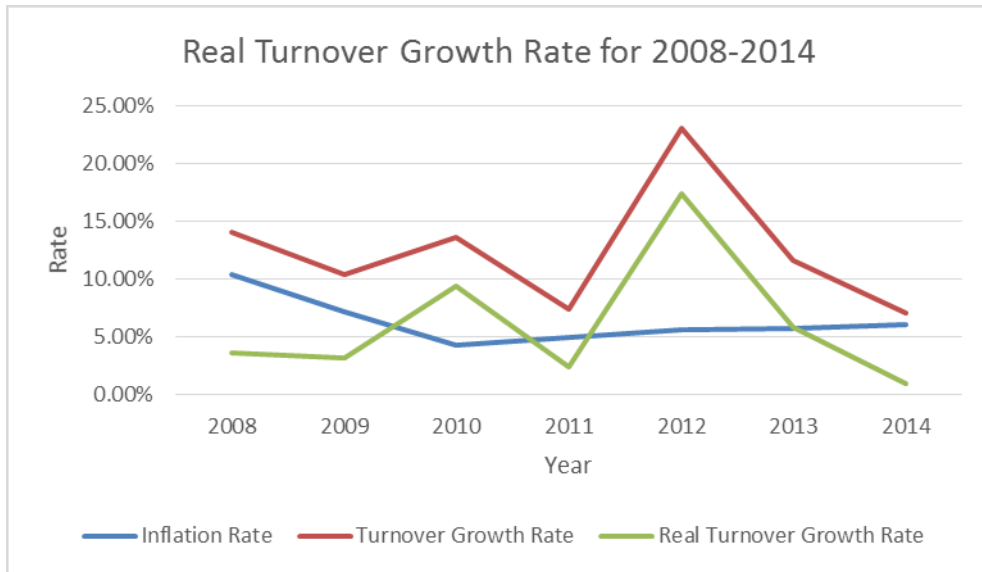


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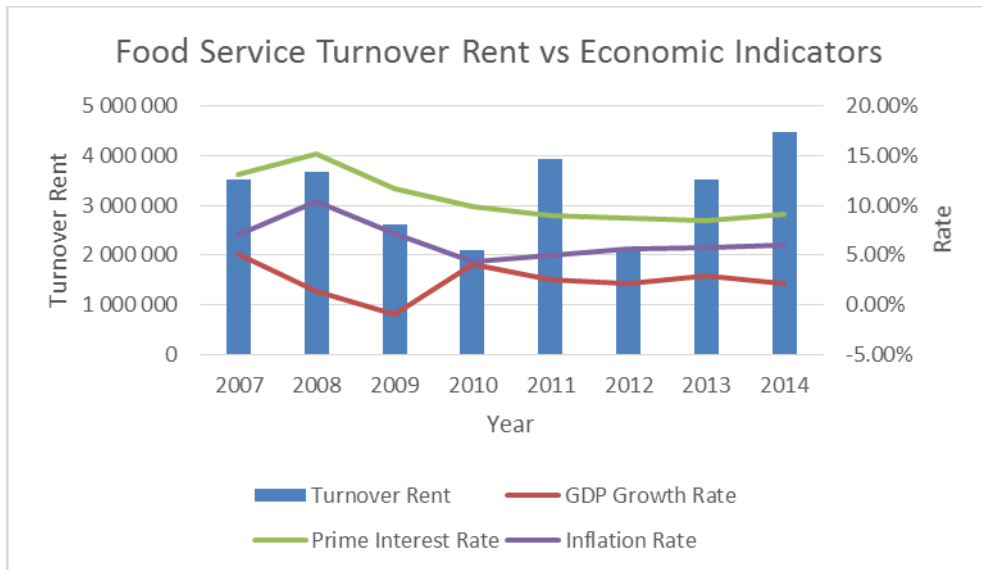


Figure A45: Food service

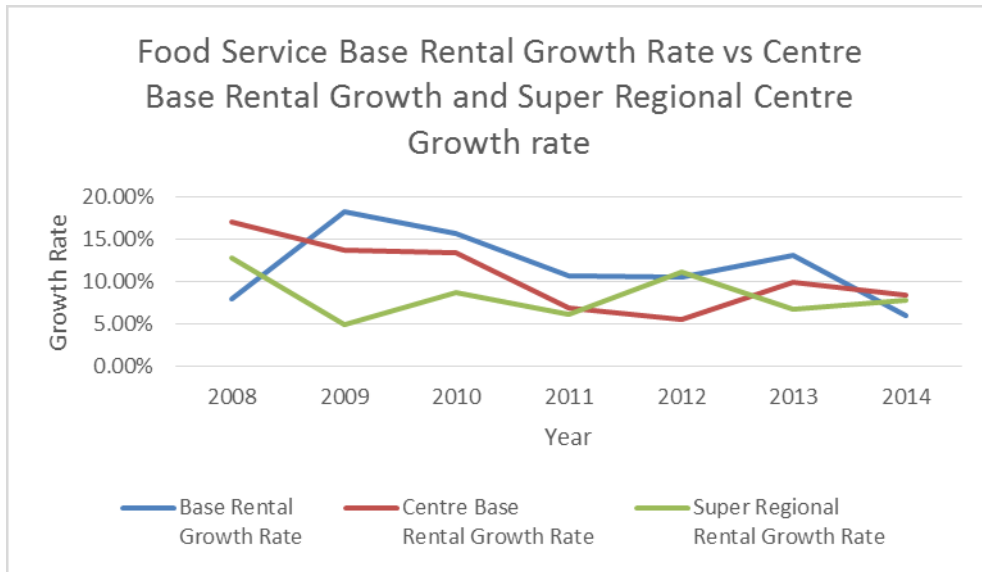


Figure A46

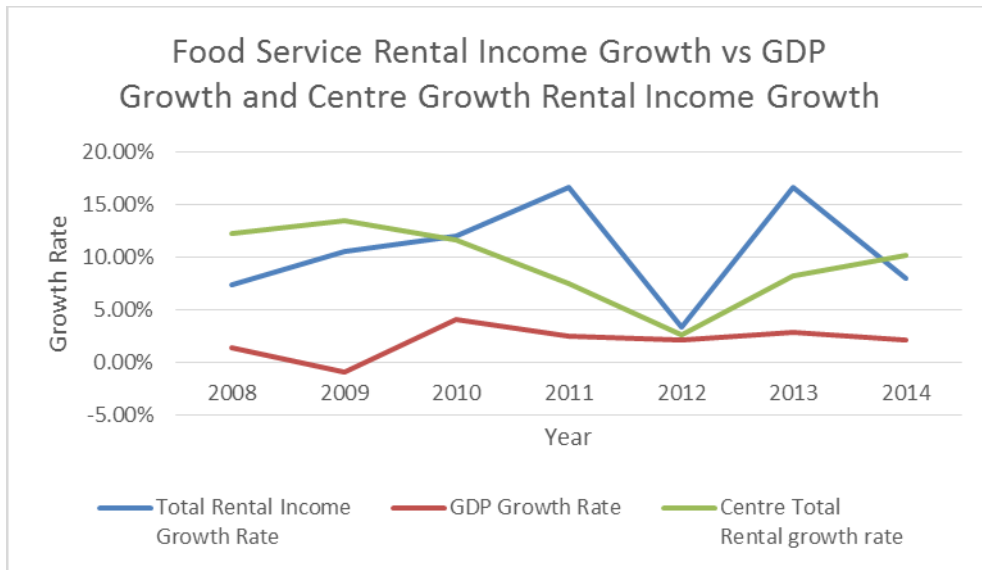


Figure A47

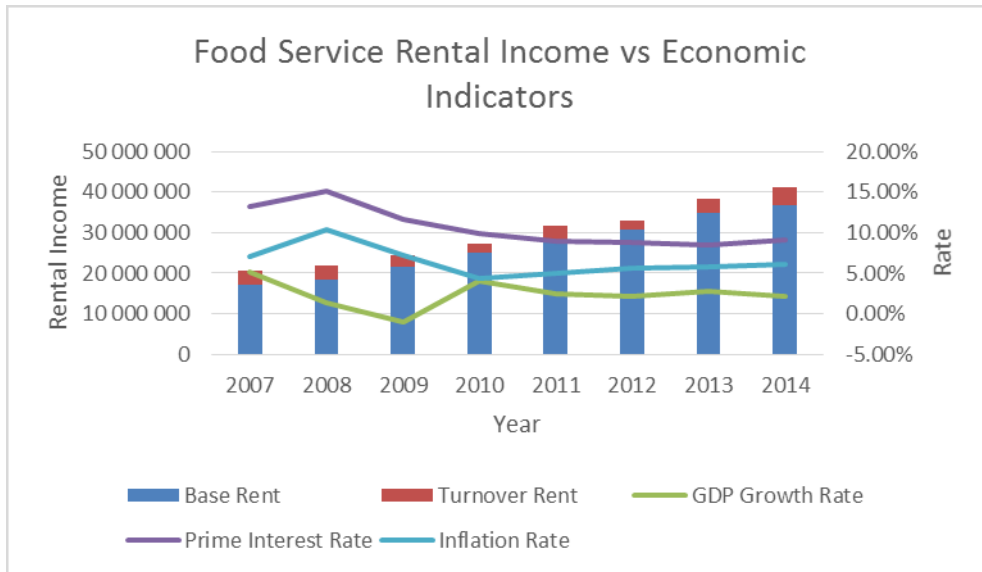


Figure A48

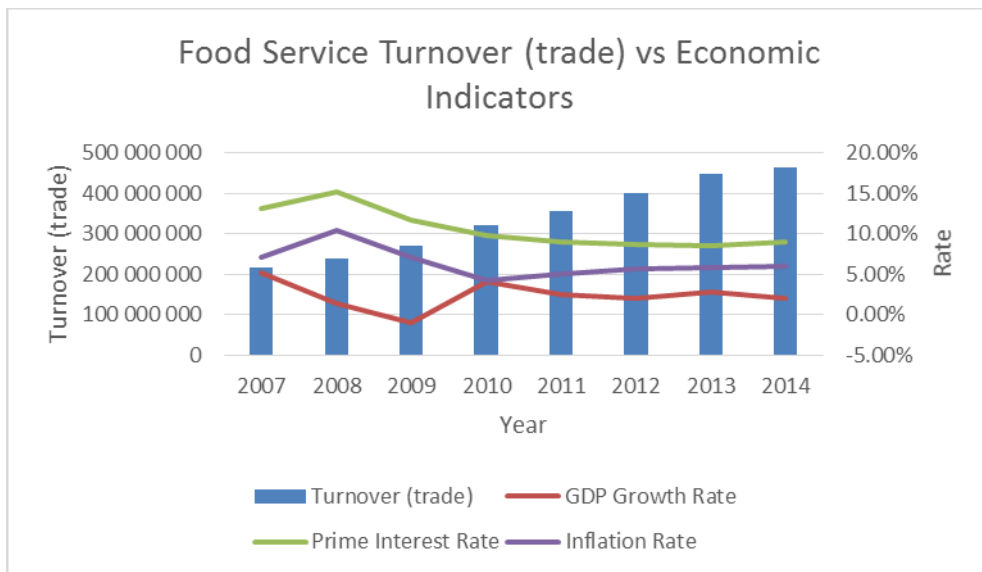


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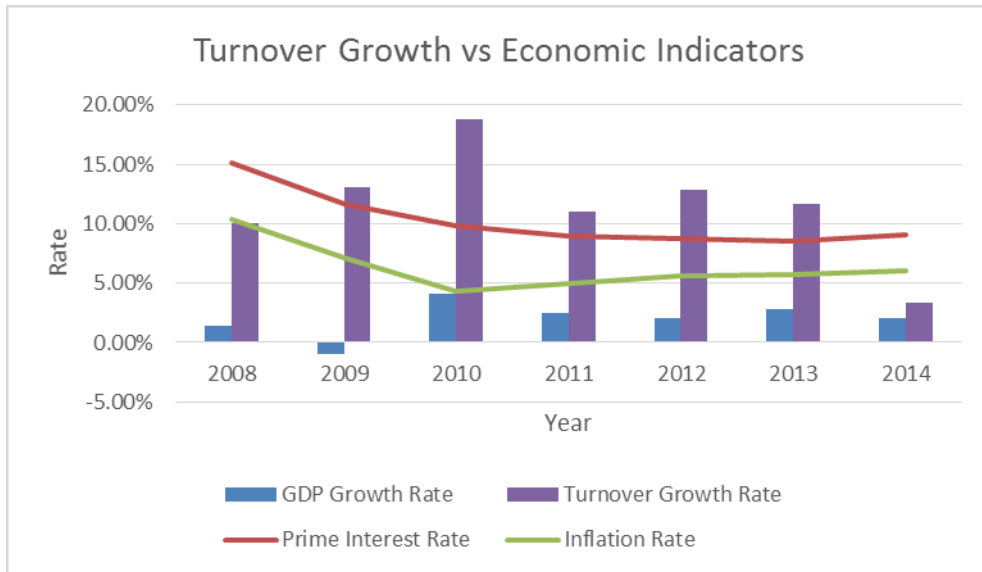


Figure A50

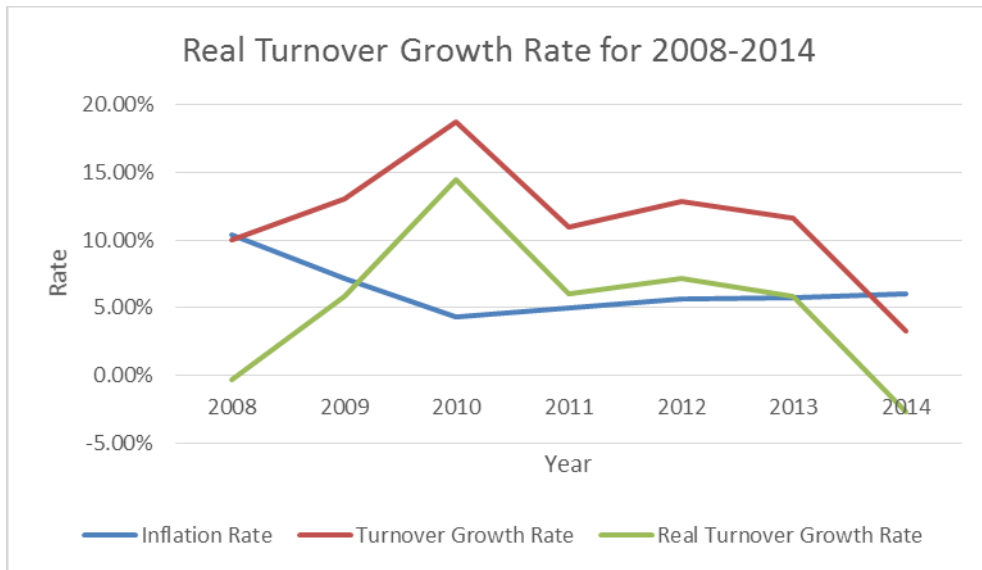


Figure A51

APPENDIX 2: ETHICAL CLEARANCE CERTIFICATE



Ref #: 2014/CAS/SAS/0010

**RESEARCH ETHICS REVIEW COMMITTEE:
COLLEGE OF ACCOUNTING SCIENCES**

Mr L Kruger (student number 50800957)
Supervisor: Prof HC Wingard (staff number 1100017)
Co-supervisor: Mr JAC Bosman (staff number 1992856)

This is to certify that the application for ethics clearance submitted by
L Kruger (50800957)
for the study

The net contribution of turnover-based rental – a landlord view
in the fulfillment of the Degree of MPhil (Accounting Sciences) has been **approved**.

The application for ethics clearance for the above-mentioned research was reviewed by the CAS Research Ethics Review Committee on 21 July 2014 in compliance with the Unisa Policy on Research Ethics. **Ethical clearance has been granted**. Please be advised that the research ethics review committee needs to be informed should any part of the research methodology as outlined in the Ethics Application (Ref. Nr.: 2014/CAS/SAS/0010), change in any way.

The Research Ethics Review Committee wishes you all the best with this research undertaking.

Kind regards,

Prof HC Wingard

Chair: CAS Research Ethics Review Committee
College of Accounting Sciences
Unisa
wingahc@unisa.ac.za

15 August 2014

Prof E Sadler
Executive Dean
College of Accounting Sciences
Unisa



University of South Africa
Preller Street, Muckleneuk Ridge, City of Tshwane
PO Box 392 UNISA 0003 South Africa
Telephone: +27 12 429 3111 Facsimile: +27 12 429 4150
www.unisa.ac.za