



Financial
SAFEGUARD



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Investments:
Fixed and variable interest
investment products

Introduction

There are many different types of investments in South Africa. To ensure these transactions are conducted fairly for all concerned, the financial services industry is regulated by the Financial Sector Conduct Authority (FSCA), the Prudential Authority (PA) in the South African Reserve Bank (SARB), as well as the National Credit Regulator (NCR). These bodies oversee investment products and how they are marketed.





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1. Investment options

Investment options range from:

- Secure, low-risk banking products (such as a 32-day notice or tax-free savings account)
- Collective investment schemes (including money market accounts, bonds, equities, and unit trusts)
- Online trading accounts (where you can buy and sell assets listed on an Exchange, like the Johannesburg Stock Exchange)
- Offshore investments (which are regulated and subject to exchange control restrictions)
- Variable interest investments
- Fixed income investments

1.1 Risk appetite

Risk Spectrum

Low risk	Medium risk	High risk
You have a lower probability of losing your capital when invested in low-risk investments.	Medium risk investments offer higher gains than low-risk investments.	High-risk investments offer higher returns, but with a higher probability of capital loss.

1.2 Fixed vs. variable investment

Types of interest	Examples of investments	Description
Fixed interest	Savings accounts	Offer a steady, predictable interest rate and easy access to funds
	Fixed deposits	Lock your money for a fixed term with a higher interest rate
	Government bonds	A loan to the government, with guaranteed fixed returns over time
Variable income	Mutual funds (unit trusts)	Investments in a mix of stocks and bonds, with returns depending on performance
	Equities (Stocks)	Ownership in a company or stock price growth
	Real Estate Investment Trusts (REITs)	Investments in property; returns vary based on rental income and property value

2. Fixed interest investments


Debt instruments are assets that require a fixed payment to the holder, usually with interest.

Examples of debt instruments include:

- Bonds (government, municipal and corporate)
- Certificates of deposit
- Notes



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Debt instruments are classified according to their maturity:

- Bills - debt instruments typically maturing in less than one year
- Notes - debt instruments typically maturing in one to 10 years
- Bonds - debt instruments typically maturing in more than 10 years

2.1 Savings bonds

Like individuals, companies and governments also need to borrow money to meet their socio-economic development plans. The problem is that the amount of money needed sometimes far exceeds what an average commercial bank can provide, or bank rates are too high.

Money for these instances is raised by means of bonds which are sold on the stock exchange. Thousands of people buy these bonds, thereby contributing, in part, to the overall capital amount needed. Bonds are “promises to pay” issued by that government, municipality or large corporation to repay the money loaned to them. Bonds issued by companies are called corporate bonds.

These marketable certificates of loans are issued by the government or a lower government institution or organisation for the purposes of:

- Repaying maturing debt
- Regulating monetary conditions
- Financing expenditure

Bonds issued by the government are also referred to as:

- Government bonds, which are also called Gilts
- Government securities
- Government stock
- Parastatal bonds, for example, Eskom or Transnet

A safety aspect common to all fixed-interest investments is that the amount of interest you will earn if you keep your investment till maturity is pre-determined. They also often require you to provide notice before withdrawing funds.

The interest payment is referred to as the “coupon rate”. The capital amount is referred to as the “face value” of the bond. The date at which it has to be paid back by the issuer is the “maturity date”.

Government bonds are, however, not entirely risk-free. As interest rates rise, the capital value of a bond decreases. This is because you, as the investor, will be able to get a higher income for the same capital investment than you could by buying that bond, which will give you a lower rate of return than is available on the open market.


2.2 What are the different types of bonds?

Government bonds are like lending money to your local council to build a new community park, and they promise to pay you back with interest. Corporate bonds are similar to giving a loan to a trusted coffee shop chain so they can open more branches—you earn interest while helping the business grow.

Municipal bonds help cities pay for projects like upgrading public transport, and you earn interest in return. These examples show how bonds are essentially loans you give to trusted entities in return for regular payments and eventual repayment of your initial amount.



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2.2.1. Government stock or RSA bonds

These are government-issued bonds, which quite simply imply that you lent the government money and that they promise to repay you. Interest is payable on these bonds at the coupon rate, and the risk of default is quite low as the bonds are backed by the government (therefore they are also historically named Gilts).

2.2.2. Semi-government stock or gilts

These are bonds issued by institutions owned in part by the government. Examples of this include Telkom, Transnet and Eskom. These institutions issue bonds to raise funds for capital projects.

They are also referred to as Gilts when their capital and interest are guaranteed by the Government, offering a high degree of security. However, not all are guaranteed by the Government.

The values of these bonds vary in accordance with the current inflation rate.

2.2.3. Corporate bonds

These are bonds issued by corporates like Pick 'n Pay, Woolworths and Anglo American.

2.2.4. Zero coupon bonds

These bonds pay no interest but instead, are sold at a substantial discount to the future redemption value.

For example:

A zero-coupon bond is like lending money to a friend who agrees to pay you back a larger lump sum in the future, instead of small amounts along the way. For example, imagine you lend your friend R700 today with the promise that they'll pay you back R1,000 in five years. You don't get any payments until the end, but when they pay you back, you'll have earned a profit because of the discounted upfront cost. Zero-coupon bonds work the same way, they don't offer regular interest payments but grow in value over time, making them a good option for long-term savings goals.

2.2.5. Municipal bonds

These bonds are debt obligations issued by local government entities to members of the public to generate income to meet capital expenditure.

The issuer of the bond guarantees to pay interest (coupons) at set periods and to repay the principal debt on a specified date. The interest paid on the bond is tax deductible. Issuing bonds is standard practice for cities in the developed world.

3. Variable interest investments


3.1 Stocks or shares

If you own stocks or shares, you own a portion of the company. Your profit is then determined by the performance of that company in the market.

As a shareholder or stockholder, you are entitled to vote at the company's annual general management meeting.



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Example 1:

If you own shares in Sony and Sony posts a record profit, other investors are going to want Sony shares too. Their demand for shares drives up the price, increasing your profit if you choose to sell your shares.

Example 2:

Samuel owns 100,000 Woolworths Ltd shares. There are currently 10,000,000 Woolworths shares issued. Therefore, Samuel owns 1% of the outstanding shares, and as such, he is entitled to 1% of the profit share, in the form of a dividend payout.

Woolworths announces that they will be distributing R1,000,000 in profits through dividends. To ensure an equal distribution, the R1,000,000 will be divided by the 10,000,000 outstanding shares. This equals 10c per share.

Therefore, Samuel receives a dividend of R10,000 in this financial period.

3.2 Business


Putting money into starting and running a business is also considered an investment. Entrepreneurship requires more than money and will be a long-term commitment, which may render very high returns. The South African economy is highly dependent on entrepreneurs, and there is ample opportunity to invest in a start-up or established business.

Examples of phenomenal South African entrepreneurs are:

- Elon Musk - Founder of Tesla, SpaceX, and other companies. Born in Pretoria, Musk is a global icon for innovation in technology and renewable energy.
- Black Coffee (Nkosinathi Maphumulo) - World-famous DJ and music producer who has also invested in property and technology.
- Vitaly Khinchev and Team (Yoco) - Innovators behind Yoco, a payment platform making it easier for small businesses to process card payments.
- Trevor Noah - International comedian and former host of The Daily Show, who has expanded into authorship and global entertainment ventures.
- Patrice Motsepe (African Rainbow Minerals)
- Tokyo Sekwale (Mvelaphanda Holdings)
- Mark Shuttleworth (Canonical Ltd)
- Sol Kerzner (Sun International)
- Herman Mashaba (Black Like Me)



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3.3 Real Estate (Property)

Investing in freehold and sectional title properties can be a very lucrative investment. You may choose to buy property to rent out or to repair and resell at a profit (a concept referred to as “flipping”). The property you live in is not considered an investment as such, as it fulfils a basic living requirement. Despite the fact that your property will grow in value over a period of time, you should not buy it with the sole intention of making a profit.


Despite the lucrative nature of this investment, investing in real estate is a lot more complicated than investing in shares.

 **NOTE:** The real estate crash of 2008 is a prime example of the dangers of considering your primary dwelling as an investment.

3.4 Money market funds

The return on money market funds is very small, but so is the risk. However, returns are better than for savings accounts. Money market funds are also more liquid than other investments, in that you can transfer the funds in and out of money market funds, just as you would with a current account.

Money market funds are investment funds (unit trusts/collective investment schemes) in which your money is managed by an investment professional. They pool your money with that of other investors and strive to achieve the best possible rate of interest for you. Because they are dealing in larger amounts of money than you would be able to as an individual, the manager is able to ask for better interest rates. A number of different money market instruments from different institutions are used, which diversifies your risk away from one company.

 **NOTE:** Money market funds are an alternative to savings or fixed deposit accounts and are short-term investment accounts.

3.4.1. How will you benefit?

There is no defined investment term, so funds can be invested into money market funds indefinitely and the rate of return may vary depending on the deposit balance - returns are normally higher than bank deposits. Your investment in a money market fund is liquid, which means that if you need the money, it can be withdrawn on demand and deposited into your bank account.

3.4.2. Who can help you with this?

A unit trust management company, your Authorised Financial Advisor or your local bank branch will be able to open a Money Market Fund for you and advise you of their specific product features and benefits. You must check whether your service provider charges upfront commission or fees on these accounts.

3.4.3. What is the investment amount?

Although it varies with each provider, there is usually a minimum investment requirement for lump sum investments. You can deposit into your investment on an ad hoc basis or set up monthly amounts via a debit order.

3.4.4. What are the risks?

These are very conservative or safe investments (risk-averse) because you invest in the money market, not the capital market. Returns are higher than for bank deposits. However, there is a small chance that you may lose some of your capital over the short term if one of the banks invested in should fail.



3.4.5. What are the tax implications?

Interest earned must be reported to the South African Revenue Service (SARS) when submitting your annual tax return. The first R23,800 of interest income is currently exempt (changes annually).

3.5 Collective Investment Scheme (CIS)

Collective investments are also known as unit trusts. CISs are investments in which different investors' funds are pooled. This money is then invested in a variety of local and international assets (such as stocks/shares, bonds, deposits, money market instruments, real estate, etc.). The investments are managed by professional investment managers, who use the pooled money to invest in a selection of assets, according to the unit trust's investment objective.

Investing in stocks/shares has traditionally provided excellent returns, giving investors the chance to grow their wealth, but the large amounts of money required to purchase these shares directly are often out of reach of smaller investors. Pooling investors' funds means collective investments are the ideal option, making it cheaper to invest in stock markets worldwide.

One of the main characteristics of a CIS is that investors get to share the equities (risks and benefits) of their investment in a CIS in proportion to their participatory interests in the total CIS. The assets of a CIS portfolio are held by trustees which, in South Africa, are often the big banks.

CIS investments provide a fairly secure avenue for investors of all categories to participate in the stock market. There are four different types of collective investment schemes:

- CISs in Securities (which can in turn be focused more on stocks and equities or interest income)
- CISs in Hedge Funds
- CISs in Property
- CISs in Participation Mortgage Bonds
- Money Market Funds

A CIS is a simple and effective way of saving money.



NOTE: CISs are portfolios of assets such as equities, bonds, cash and listed property, in which investors can buy a participatory interest. This allows investors to spread their risk, whilst getting the benefits of professional fund management.

CISs are suitable investment options for everybody from an investment novice to a seasoned investor. They allow you to build a balanced and diverse investment portfolio with stock market exposure. You can invest in a host of different funds, depending on your expected returns and your appetite for risk.

When you decide to invest in CISs, it is important to remember that growth is not immediate, and you should regard it as a medium- to long-term investment. Most CIS companies recommend an investment period of at least five years. This helps the investment recover from ups and downs in the stock market.



Example:

Jonas decides that he would like to start investing. He wants a balanced portfolio, broken down like this:

- 50% stocks
- 20% bonds
- 30% cash

However, Jonas has only R500 a month to invest. This means that he has only R250 available to buy stocks and even less to balance out his portfolio. By investing his R500 in a CIS fund, he is able to invest in a balanced portfolio, with exposure to all of the desired asset classes.



NOTE: Since January 2013, investors have been able to choose from the following portfolios:

- South African
- Worldwide
- Global
- Regional portfolios

3.5.1. What are the benefits of a collective investment scheme?

- They allow ordinary people to invest in shares they would not usually be able to invest in.
- They provide a means of beating inflation as the returns are usually higher than the inflation rate.
- They are a flexible form of investment, allowing the investor to make regular monthly instalments or invest a lump sum.
- They offer liquidity, as the investor can choose to cash in a portion of the CIS or all of it. Funds are always accessible.
- CIS investments are transferable between parties and can be invested on behalf of another person.
- CIS performances can be monitored on a daily basis, as they are printed in newspapers and are available online.
- Funds are managed by professionals in the field.
- CIS funds can be selected based on personal needs and investment time-frames.
- CIS funds are investable all over the world, which allows the South African investor to benefit from the variation in exchange rates.
- Capital gains are taxed in the hands of the investor and are delayed until the investor disinvests.



NOTE: The Collective Investment Schemes Control Act, No. 45 of 2002 regulates the administration, management and sale of collective investments.

The 2002 legislation replaced the Unit Trust Control Act of 1965. It makes provision for various types of collective investments, including hedge funds, open-ended investment schemes, exchange-traded funds, and others.



NOTE: When the anticipated Conduct of Financial Institutions (COFI) Bill is passed, it may replace existing legislation. Be sure to check for the latest legislative changes.

3.5.2. What are the tax benefits of a collective investment scheme?

Unit trusts fall into two different categories and as such the tax treatment and fee treatment differ.



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Category 1

Those that are “voluntary” investments, allowing investors to buy and sell when they wish.

Most CISs or unit trust investors are liable for:

- Tax on the interest paid out by the unit trust
- Dividend tax paid on the dividends received
- Capital gains tax on the profit portion earned from the sale of the unit trust

You can defer the sale or transfer of your unit trust to a time that would be more tax-efficient, because the Capital Gains Tax liability is deferred until such time.

One of the catalysts for the enormous growth in the number of unit trust Collective Investment Schemes was the introduction of capital gains tax (CGT). Capital gains tax (CGT) was introduced by the Taxation Laws Amendment Act, 2001 that came into effect on 1 October 2001.

This legislation exempted investors in collective investment schemes from capital gains tax (CGT) within a portfolio. For example, the shares in the portfolio held over a ten-year period can be bought and sold many times, but capital gains tax (CGT) is only triggered when the investor sells a unit or units.

The capital gains tax (CGT) is levied on the difference between the “buying price” and the “final selling price” of a CIS, in the case of lump sum investments, or the average acquisition price in the event of debit order investments. This tax increased the popularity of collective investments relative to other investment vehicles. Investors in bespoke share portfolios, for example, could be liable for capital gains tax on each trade.

Fund managers of unit trusts are permitted to use a range of sophisticated mechanisms to protect their portfolios in downward markets. These strategies usually fall outside the skill set of small investors. Used judiciously by a fund manager, they provide a powerful portfolio management tool.

Capital gains or losses are incurred when:

- You make once-off withdrawals regularly
- You switch between funds
- The ownership of the units changes
- You get a divorce, and you have to sell the unit trusts to divide the proceeds between yourself and your ex-spouse
- A sequestration, emigration or death of an investor occurs

Rate of tax

You do not pay tax on the total gain in the value of the investment. There are exclusions that apply to capital gains tax, and you should check this with your advisor.


Category 2

The tax treatment of unit trusts held in retirement portfolios is more favourable than the tax treatment of “voluntary investments”.

Retirement portfolios include all retirement assets held in pension funds, provident funds, preservation funds and retirement annuity funds.



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Retirement portfolios are granted tax exemptions on dividend and capital gains tax, as well as tax on interest income. Tax levied on interest and property rental income within retirement funds was abolished in 2008.

Dividend Withholding Tax (DWT) was implemented with effect from March 2015, which means that all paid dividends are taxed at 15% before being distributed to investors.

3.5.3. Fees

A range of different fees are associated with a CIS or Unit Trust. Unlike the Unit Trust Control Act of 1947, the Collective Investment Schemes Act of 2002 does not regulate initial, ongoing or administrative fees.

The Act does, however, force the disclosure of fees of unit trust management companies and Authorised Financial Advisors. As an investor you may pay:

- Initiation or entry fees
- Admission fees
- Annual fees
- Authorised Financial Advisor fees
- Performance fees
- Switching fees

All these fees are liable for VAT at the current rate of 15% (2024).

3.5.4. Multi-manager costs

The biggest concern investors have when looking at multi-manager funds is cost. This is because funds-of-funds inevitably create an extra layer of fees. You have to pay fees to the multi-manager as well as to all the underlying fund managers.

But that doesn't mean that all multi-manager funds are expensive. A number are, but there are some that place a lot of emphasis on keeping costs down by negotiating lower fees with the funds in which they invest. As a result, a number of multi-manager, multi-asset funds are actually cheaper than certain single-manager alternatives.

3.5.5. Total Expense Ratios (TER)

The Association of Collective Investments (ACI) introduced the Total Expense Ratio (TER) in May 2007. ACI was incorporated into the Association for Savings and Investment South Africa (ASISA).

The TER measures the direct costs involved in managing a unit trust. It is updated quarterly and indicates the total value of all the expenses and fees of the unit trust portfolio, on a one-year basis and shown as a percentage of portfolio assets. There are no taxes applicable in the CIS structure. It is only applicable in the hands of the investor.

A TER should not include trading costs.

The TER will show you:

- The expenses that are incurred in a portfolio
- The impact of the performance fees that are levied by the asset management companies
- The actual expenses paid out for the management of the fund



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- Exact fees levied for:
 - Management
 - VAT portion
 - Administration costs
 - Trustee
 - Custody
 - Bank charges
 - Audit fees

The TER will not reflect the:

- Stockbroking fees
- Trading costs
- Initial fees
- Annual fees paid to either the Linked Investment Provider, Unit Trust Platform or Authorised Financial Advisor

3.5.6. What are the risks of a collective investment scheme?

- CISs are medium- to long-term investments that require patience.
- All CIS investments are at risk of losing money due to market volatility.
- The CIS investment is managed by a professional portfolio manager; therefore the investor is at the mercy of the fund manager's decisions.
- A specialised CIS may be very quickly affected by downward turns in the economy.
- CIS charges differ from one fund manager to another, as the charges are not regulated.
- Some funds have become increasingly specialised in terms of their mandates and sophisticated in terms of the instruments used.

3.5.7. How to invest in a collective investment scheme?

There are three different ways in which you can buy a CIS (unit trust):

- Option 1: Select a unit trust management company. This will be a good choice if you simply wish to invest in the funds of a specific management company.
- Option 2: Find a Authorised Financial Advisor.
- Option 3: Invest directly using a unit trust platform.

3.5.8. What are the securities in a collective investment scheme?

Collective investments (also known as unit trusts or participatory interests) are investments in which many different investors put their money together or pool their money into a portfolio. Then this pooled money is managed by professional investment managers.


These professional investment managers invest the pooled money in different assets. These assets include a wide range of local and international shares or equities of companies listed on an exchange, bonds, property and money market instruments.

The total value of the pool of invested money is split into equal portions called participatory interests or units. When you invest your money in a collective investment scheme portfolio, you buy a portion of the participatory interests in the total collective investment scheme portfolio. The trustees hold the assets of a collective investment scheme portfolio.

Those trustees are big banks in South Africa.



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The participatory interest price, also known as unit price or the net asset value (NAV) price, depends on the market value of the underlying investments in which the pool of money is invested. This participatory interest price rises and falls (fluctuates) according to the value of the underlying investments.

3.5.9. The Benefits of investing in CIS Securities

The benefits of investing in CIS securities include:

- It's affordable and easy as you can invest a small amount of money, which makes it possible for more people to easily invest in assets they would not normally be able to invest in.
- The investor benefits from rand cost averaging, which works on the principle that a monthly premium buys more units when the market is low and fewer units when the market is high. It results in the investor buying units at an average price over a period of time.
- Your risk is reduced as you invest in a range of different underlying assets. If one asset performs poorly, your overall investment does not necessarily have to perform poorly. It is therefore advisable to invest in a range of different CIS portfolios ranging from equity to income.
- CIS portfolios offer good returns provided that you leave your money invested for at least a 3 to 5 year period.
- Professional investment management is provided by an investment manager, who charges a fee for this service. Bear in mind that this manager must be registered with FSCA in terms of the FAIS Act.
- Your money is accessible at any time, as these investments can be sold in full or part at any time. You will generally have to wait about 3 days before your money is back in your account.
- Different investment options can be selected, for example.:
 - Lump sum investments
 - Debit order investments
 - Switching between portfolios
- You are always informed of how much you own, as participatory prices are published daily. You can calculate the value of your CIS by multiplying the number of participatory interests you own by the price of the participatory interest of the portfolio you have invested in.

3.6 Unit trust vs collective investment schemes

The Collective Investment Schemes Control Act, No. 45 of 2002 effectively changed the name of “unit trusts” to “collective investment schemes”.

The Act refers to “a participatory interest” in a scheme, as opposed to “a unit” in a unit trust fund. However, despite the fact that the terminology was changed, investors continue to refer to “units” and “unit trusts”.

3.7 Collective investment schemes in property

A collective investment scheme in property is one in which different investors pool their money for investing directly in property.


A collective investment scheme in property consists of a number of different types of properties, for example, industrial property, factories, shopping centres, etc., in different areas within a town, city, the country or even overseas.

A collective investment scheme in property brings current and future income to the investor as follows:

- The investor gets a portion of the rental income of the property.
- The properties are expected to increase in value over time, and this is reflected in the increased price of a unit or participatory interest.



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- Once received, investors are taxed on that income.
- According to the Income-tax Act of South Africa, income from collective investment schemes in property is treated as interest.
- Collective investment schemes in property are taxed on their interest income and capital gains components.

3.8 Property Funds or Real Estate Investment Trusts (REITs)

In the past, there were Property Unit Trusts (PUTs) and Property Loan Stocks (PLSs) on the JSE. Both types of listed property investment entities in South Africa were given a chance to convert to the REIT regulatory framework, set out by the JSE in May 2013.

A REIT is a company that owns, and in most cases, operates income-producing real estate. REITs own many types of commercial real estate, ranging from office and apartment buildings to warehouses, hospitals, shopping centres and hotels. Some REITs also engage in financing real estate.

A REIT is like a unit trust. It allows small and large investors to buy a share in real estate that they normally couldn't afford. This includes commercial property like hospitals, apartment buildings and shopping malls.

REITs must have at least 100 shareholders, of whom no five may hold more than 50% of the shares between them. 75% of the income must be derived from real estate. They pay out a minimum of 75% of their profits as dividends to their shareholders, which in turn offer a healthy tax benefit to the REIT. Most REITs offer re-investment plans that allow for revenue to compound over a period of time.

There are several ways of investing in REITs listed on the exchanges. You should contact your bank, stockbroker, or advisor before choosing this option.

3.8.1. Direct

You could achieve direct ownership of SA REIT shares by either:

- Opening a stockbroking account with a stockbroker. Here you can pick and buy shares in SA REITs yourself or tell your stockbroker to do it for you; or
- Opening an online trading securities account with your bank. Once you have opened this account and transferred your funds, you can trade online in SA REITs and any other shares listed on the JSE.

3.8.2. Indirect

You can achieve indirect ownership by investing in a fund that owns SA REIT shares through either:

- Investing in a property unit trust fund. Many institutions and fund managers offer property unit trust funds, which invest in several REITs at the same time; or
- Buying shares in a property index fund. You buy the share directly like a SA REIT share, but it is tracked, on the SA Property Index, by a property unit trust that invests in every REIT on the JSE.

3.8.3. Types of REITs

There are two types of REITs:

- Company REITs (old PLS)
 - In a company, REIT shareholders are active participants. They enjoy the full protection of the Companies Act and Takeovers Regulations Panel. They can vote on specific issues in a general meeting. Shareholders vote for the company to be a REIT.



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- The company has the REIT structure recorded in its Memorandum of Incorporation.
- Company directors are responsible for its ongoing compliance with the JSE's listing requirements and the Companies Act.
- Companies can have external or internal management and/or property administration.
- Trust REITs (old PUTs)
 - An existing PUT becomes an SA REIT when an application is lodged with the JSE. Evidence must be provided that it is compliant with the JSE listing requirements and that it is registered with the FSCA. Most PUT's have already converted.
 - Investors' interests are protected by a trust deed and the trustee, whose role it is to ensure compliance with the Collective Investment Schemes Control Act and to safeguard investors' assets
 - The Trust REIT needs to meet all JSE listing requirements but is not subject to the Takeovers Regulations.
 - Trustees report to the FSCA and must meet all the requirements of the Collective Investment Schemes Control Act.
 - One must have an external asset and property manager in terms of the Collective Investment Schemes Control Act.

Examples of REIT's in SA are:

Growthpoint Property Ltd
Investec Property Fund Ltd
Vukile Property Fund Ltd
Hyprop Investment Ltd
Redefine Properties Ltd

3.8.4. What are the benefits of investing in REITs?

Diversification

REITs give investors indirect exposure to a wide variety of expertly managed properties.

Regular income stream

REITs are supported by lease agreements, which generally increase and grow on an annual basis.

Exposure to immovable property

Investors may gain exposure to immovable property, with lower initial outlays.

Taxes

REITs are exempt from capital gains tax (CGT) for disposal of its own properties, shares in another REIT or shares in a controlled property company.

A REIT shareholder will only pay capital gains tax (CGT) when the shares are sold. Interest distributions by a REIT to a South African resident investor are not subjected to Dividend Withholding Taxes (DWT).


Non-residents do not pay income tax on REIT earnings.

Liquidity

REITs traded on the JSE are considered more liquid than other property investments.



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Regulations

REITs are subjected to:

- The JSE Listing Authority
- The REIT Legislation
- Companies Act
- Collective Investment Schemes Control Act
- Own Articles of Association

Price transparency

The prices are determined by market supply and demand and are publicly listed.

Fees

When investing in REITs, the brokers will levy a brokerage and administration fees.

Risk

You are exposed to market risk as well as other risk factors. REITs are very lucrative investments compared to your low-risk banking products, but at the same time, they are extremely risky due to the volatility of the economy.



NOTE:

A word of advice from portfolio managers of REITs

REITs: THE POSITIVE LONG-TERM INVESTMENT CASE COMES WITH MORE VOLATILITY THAN MANY APPRECIATE

“REITs offer an attractive investment proposition, but one which comes with risk. This risk is often misunderstood or ignored by individual investors looking only at the sector’s stellar historical track record. Listed property provides a desirable long-term return outlook with a relatively high yield combined with ongoing earnings growth, which should result in capital appreciation. Critically, however, this is accompanied by risk. The volatility of REITs has been similar to that of equities and materially greater than that of bonds.


This short-term volatility has been evident recently. For example, 2015 has seen listed property fall 10% from peak to trough in a matter of weeks. In mid- 2013 the peak to trough fall was almost 20%. Often, as demonstrated by these two recent sell-offs, the primary driver was not property issues, but the macro economically determined increase in bond yields, off which property is valued. Property benefited when these bond yields fell. As such, listed property will benefit if bond yields fall again as they have already retraced substantially. Domestic property fundamentals, however, remain tough, although you would not guess this from the distribution growth rates REITs has been generating despite this environment.

Property is best included as part of a diverse portfolio. Listed property is for the long-term and in the short term – certainly in a world of volatile global interest rates – the ride may be bumpy although the final destination should be worth it.”

Evan Robins | Portfolio Manager



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3.9 Collective investment schemes in participation mortgage bonds

A participation mortgage bond or part bond is a collective investment scheme under which investor money is pooled to provide loans to commercial, industrial and retail property owners and/or developers.

Investors are paid interest monthly. First mortgage bonds on the various commercial and industrial properties within the portfolio are held by the investors as security.

Participation mortgage bonds are normally considered low-risk investments and are governed by the Collective Investment Schemes Control Act, which also governs the unit trust industry.

The Act is administered by the FSCA.

3.9.1. What are benefits of investing in part bond?

Benefits of investing in a participation bond are the following:

- It is an easy to understand interest-bearing investment. Interest received is paid out monthly, quarterly or yearly in advance.
- You have the option to re-invest the interest received.
- The compounded effect of interest reinvested will give you higher returns.
- It offers a very competitive rate.
- The capital is always secured.
- It is a fairly low-risk investment.

3.9.2. What are the rules of investing in part bonds?

Your investment is fixed for a minimum of 5 years.

- After the 5-year period has lapsed, you will only be able to withdraw your investment if another investor for the property is found.
- You will only receive a monthly income on the amount of money invested. There is no capital growth on the amount invested.
- The income comes from the interest that the scheme earns from the money loaned out to property developers.
- The interest rate received by the investor may be higher than commercial rates as a result of the risk associated with this investment.

3.10 Endowments

By far the most expensive and complex form of investing but, at the same time, probably the most tax-efficient vehicle. If your income tax rate is higher than 30%, an endowment has tax benefits that may be of interest to you.

An endowment can also be used for estate planning. This is because your beneficiaries may be paid out straight away on your death, instead of waiting for your estate to be wound up. The value of the investment will still be included in your estate for the calculation of estate duty, but an endowment allows your estate to save on the executor's fees.

With an endowment, you will not incur any tax liabilities (income or capital gains tax) since tax is paid within the fund and you will receive your proceeds after tax has been deducted. However, endowments are the cause of many misconceptions in the marketplace. For example, many people do not understand that an endowment is not an investment portfolio per se; it is just a vehicle in which investment portfolios are housed and to which risk benefits can be added.



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In the past, the cost of the risk benefits was not shown, and therefore the returns of endowments were perceived to be less than satisfactory. The risk premium often was not taken into account as if the whole contribution was allocated to the investment account.

3.10.1. What are the benefits of an endowment?

- An endowment allows people who pay income tax at a marginal rate of more than 30% a year to pay a fixed tax rate on their investment income.
- An endowment allows you to structure your estate plan in a more tax efficient manner.
- An endowment forces you to save a specific amount of money on a regular basis which is fixed for a minimum period of 5 years.

3.10.2. How do you invest in an endowment policy?

You can invest a lump sum or set up a debit order. Once you have invested, there is a 5-year restriction period during which you may make only one withdrawal. The amount you may contribute each year is limited, based on the amount contributed previously.

If you contribute more than you are allowed during any year, this results in a further 5-year withdrawal restriction period.

3.10.3. What are the tax implications in an endowment policy?

Your investment return, including both interest and capital growth (gain), would normally be included in your taxable income and taxed at your marginal income tax rate.

In an endowment, investment return is taxed at a fixed rate of 30% for individuals. This investment is taxed during the life of the investment. When it pays out at maturity, you will not pay any further tax as this has all been accounted for during the period of investment.

These investments are subject to a range of taxations. Let's have a look at an example of the tax structures for an endowment.

	Individuals or trusts with only natural persons as beneficiaries	Companies or trusts with a beneficiary that is not a natural person	Tax-exempt entities such as a public benefit organisation
Income tax	30%	28%	Exempt
Capital gains tax	12%	22.4%	Exempt
Dividend withholding tax	20%	Exempt	Exempt

When the investment pays out, it is net of tax, as all taxes have already been paid.

3.10.4. What are the rules of an endowment policy?

An endowment investment runs on a "120%-Rule":

- Investments run for a period of 5 years. During this time, you may have restricted access to your funds.
- You can make once-off lump sum investments.
- You can make regular, monthly, quarterly, half-yearly or annual debit order investments.
- You can invest a combination of a lump sum and debit order investment.



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- In the first year, there are no restrictions on the amount you may contribute to the endowment. From year two, if your annual contribution is greater than 120% of the contributions made in the past two years, your investment will be locked in for a further 5 years.
- During the initial restriction period, you may take out one loan from your investment without paying interest.
- During the initial restriction period, you may make one withdrawal without having to pay it back.
- The value of your loan or withdrawal cannot be more than the money you invested plus 5% compound growth per year.
- You may use your investment as security for a loan, or cede it to a third party.
- You may not transfer your endowment investment to another provider.
- In the event of your death, your investment will be disbursed to your nominated beneficiaries subject to tax. Your beneficiaries may choose to receive the lump sum or reinvest it in further endowments. In the event of your having nominated your estate as a beneficiary or not having nominated a beneficiary at all, Estate Duties will be levied.

3.10.5. What are the risks of an endowment policy?

- Your investment is linked to the market value of an underlying instrument. As already indicated, the market is not predictable or guaranteed.
- You need to manage this risk by ensuring that you are comfortable with the risk your money is exposed to, based on the underlying investment instrument that you have chosen.
- Endowments are not protected in the event of a divorce. Therefore, should you get divorced during the lifetime of the endowment, the funds will be distributed between yourself and an ex-spouse, as per the divorce decree, at maturity.
- Endowments are also not protected from the Receiver of Revenue, and the receiver is entitled to attach your payout for any unpaid taxes that you may owe the South African Revenue Service (SARS).

3.10.6. What are the fees associated with an endowment policy?

- An ongoing investment administration fee which is deducted from your investment account
- Asset management fees are payable to the asset manager in whose unit trust you have invested. These fees are incorporated into your unit trust price.
- Advice fees are charged by the Authorised Financial Advisor if you used one.
- Processing and governance fees are also charged to cover the preservation fund expenses.
- If you make a withdrawal from your investment before your 5-year investment term is over, you will pay a fee of 1% on the withdrawal.
- Fund management charges may also be levied depending on the kind of fund you have invested in.

3.11 Offshore investments

The allocation of a portion of your investment offshore spreads your risk across different economies and geographic regions and opens up the possibility of earning returns under different conditions. South Africans are permitted to invest up to R10 million offshore every year, subject to tax clearance from the Reserve Bank.

You should consider discussing this investment with a Authorised Financial Advisor.



3.11.1. Why invest offshore?

- Many advisors expect the developed markets like those of the United States and Europe to outperform the South African emerging market.
- Offshore investment is an effective way to participate in growth in foreign markets and to hedge against the weak economic growth experienced in South Africa.
- By investing offshore, you diversify your portfolio by exposing yourself to more than one economy. Should South Africa under-perform, the chances are that foreign markets are reaping the benefits, and so too will you.
- Offshore investment allows you to hedge against currency risks. Your local assets will depreciate along with our rand. By holding assets based on a US or Euro currency, you will be able to hedge against the depreciation of the rand.
- Offshore investment is a matter of timing. You have to make sure that you enter the market when it is cost-effective to do so. Investing offshore when the rand has been experiencing a tremendous depreciation would not be the most cost-effective choice. If your risk appetite is of such a nature and you enjoy the gamble, you may want to hedge your bets on the fact that the rand may continue to depreciate, and the foreign markets may continue to perform.
- The growing currency disparity is in itself a reason for investment into assets in a foreign currency.

3.11.2. Who may invest offshore?

- Individuals over the age of 18.
- Taxpayers who have received a tax clearance certificate from the South African Revenue Services. However, the first R1 million does not need a tax clearance certificate.

3.11.3. What are the minimum amounts you can invest offshore?

You can transfer a maximum of R5 million per year from South Africa without specific South African Reserve Bank approval. If you wish to invest more, you have to obtain approval through an application that is submitted by the authorised dealer.

You are allowed to invest more than the R11 million offshore. However, you need to request special clearance from the South African Reserve bank (SARB) and South African Revenue Service (SARS). This is a complex application process and may take months before SARB issues you with the special tax clearance. Once you obtain the special tax clearance the funds are subject to restrictions, and you are responsible for annual reporting to SARB.

In the past you needed to prove that you have other funds legally exported, like:


- Income generated on funds previously retained abroad
- Income earned abroad from a foreign employer
- Inheritances retained abroad
- Inheritances paid out abroad but remitted to South Africa
- Foreign inheritances
- Own foreign capital introduced to South Africa
- Funds on which amnesty was granted in terms of the Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003 (Act No. 12 of 2003)
- Any funds for which specific approval was granted by the South African Revenue Service (SARS)

Much of this may still be relevant in the SARB's approval evaluation.

You no longer need to obtain a tax clearance certificate from the South African Revenue Services (SARS) on the first R1 million in any given year. However, you will need a tax clearance certificate for the further R10 million that you want to invest offshore.



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The clearance-free allowance, however, applies to forex transactions for a variety of reasons (not only investment) including overseas travel, study and gifts. Therefore, bear in mind that this is a cumulative figure.

You may still take an additional R4 million per annum offshore, but you have to obtain a tax clearance certificate from the South African Revenue Service.

A tax clearance certificate is valid for a period of 12 months. Should the certificate expire unutilised or partially utilised, you will need to apply for a new certificate.

3.11.4. What are the tax implications of investing offshore?

The tax implications are similar to those affecting local investments.

- Capital gains tax (CGT) is payable on the difference between what you paid for your investment and what you are selling it for.

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