

Notes to the consolidated financial statements continued

for the year ended 30 June

2. Investment property

	Note	2018 R000	2017 R000
2.1 Net carrying value			
Historical cost		14 973 825	14 830 378
Accumulated fair value movements		15 361 867	14 713 281
Assets classified as held-for-sale	13	(194 665)	(415 182)
		30 141 027	29 128 477
2.2 Movement for the year			
Investment property at valuation at 1 July		29 128 477	28 187 357
Capital expenditure		263 640	123 721
Foreign currency translation difference		98 216	(270 183)
Change in fair value		646 359	1 181 786
Interest capitalised	22	6 665	872
Straight-line rental income accrual		3 847	(39 587)
Transfer to non-current assets held-for-sale		(6 177)	(55 489)
Investment property at valuation		30 141 027	29 128 477
2.3 Reconciliation to independent valuation			
Investment property at valuation at year-end		30 141 027	29 128 477
Straight-line rental income accrual		550 182	553 119
Building appurtenances and tenant installations		163 068	148 530
Centre management assets		(5 076)	(4 794)
Independent valuation ⁽ⁱ⁾		30 849 201	29 825 333
Capitalisation rate used to determine interest capitalised		8,3%	8,3%

⁽ⁱ⁾ Excludes property held-for-sale

2.4 Encumbered investment property

The funding in Hystead Limited (Hystead) has been provided through bank loans secured by Hyprop and PDI guarantees. Hyprop's properties have been used as security for the bank funding. As Hystead is not consolidated, this bank funding does not appear on the consolidated statement of financial position. (Refer to note 8 – Financial guarantees.)

The following properties have been pledged as security by means of mortgage bonds (refer to note 17 – Borrowings):

To Standard Finance (Isle of Man) Limited and Standard Bank of South Africa Limited, to secure borrowing facilities of USD280 million and EUR111,5 million:

1. A 75,16% undivided share in The Glen
2. A 40% undivided share in Canal Walk
3. Woodlands Boulevard.

To Old Mutual Specialised Finance Proprietary Limited to secure borrowing facilities of R400 million:

Somerset Mall

To Rand Merchant Bank (a division of FirstRand Bank Limited) to secure borrowing facilities totalling R200 million, USD23 million and EUR164 million:

1. A 40% undivided share in Canal Walk
2. Clearwater Mall.

To Nedbank Limited to secure borrowing facilities totalling EUR92 million:

1. CapeGate
2. Atterbury Value Mart.

To Stanbic IBTC Bank PLC to secure borrowing facilities totalling USD31,6 million:

Ikeja City Mall

To Investec Asset Management Proprietary Limited to secure borrowing facilities totalling USD23,7 million:

Ikeja City Mall

Encumbered properties total R20,2 billion (2017: R22,1 billion).

2. Investment property continued

2.5 Investment property valuation

Valuation process

It is the policy of the group to obtain an independent valuation of the South African and Nigerian investment property portfolio on a six-monthly basis. Investment properties held by subsidiaries or associates of AttAfrica and Hystead are valued by independent valuers on an annual basis. More than one independent valuer may be used to provide the valuations. Investment property is reflected at fair value at 30 June 2018.

The South African portfolio plus Ikeja City Mall in Lagos, Nigeria, was valued at R30,8 billion (2017: R29,8 billion), excluding property held-for-sale. The portfolio was valued by three independent, professionally qualified property valuers:

Valuer and qualifications	Properties valued	Method
Viking Valuations – led by Trevor King, managing director The investment properties were valued by Mr Trevor King, BSc Hons (Building Science, UCT), Dip Surveying (UK, Reading University), Professional Registered Valuer and member of SA Council for the Property Valuers Profession, Chartered Valuation Surveyor and Associate Member of the Royal Institute of Chartered Surveyors (MRICS). Mr King has over 32 years' experience in the property valuation industry. The valuations were conducted in accordance with local and International Valuation Standards.	Eight South African properties (retail and offices)	Discounted cash flow
Jones Lang LaSalle Proprietary Limited (JLL), led by Joshua Askew The investment properties were valued by, the valuations division of JLL led by Joshua Askew (BA (Hons) English and Philosophy, FRICS MIV(SA)), FRICS, Head of Valuation: Sub-Saharan Africa, National Director, RICS Regulated Valuer, Chartered Valuation Surveyor and Fellow of the Royal Institution of Chartered Surveyors. Licensed European Pfandbrief (Covered Bond) MLV Valuer.	Two South African properties (both retail)	Discounted cash flow
Mills Fitchet – Thomas Bate, partner/member Ikeja City Mall was valued by Mr T Bate, BSc (Urban Land Economics) University of Westminster London, MSc (Reading University UK), Chartered Valuation Surveyor (Royal Institute of Chartered Surveyors RICS), Professional Registered Valuer (SA Council of Valuers). Mr Bate has 37 years of international experience in the property valuation industry, including London and Sydney, before returning to South Africa. He also has considerable experience working in various parts of Africa. The valuations were conducted in accordance with International Valuation Standards.	One Nigerian property (retail)	Discounted cash flow

Lakefield Office Park is classified as held-for-sale and valued at fair value less costs to sell. It was revalued at 30 June 2018 based on a conditional sale agreement.

The valuers work independently of each other and their valuations are combined to arrive at a fair value for the investment property portfolio.

The significant inputs and assumptions in respect of the valuation processes are developed in close consultation with management.

The valuation processes and fair value changes are reviewed by the audit committee and the board of directors at each reporting date. The directors confirm that there have been no material changes to the assumptions applied by the registered valuers.

The most significant inputs to the valuation process, all of which are unobservable, are the estimated rentals at the end of the lease, assumptions regarding vacancy levels, the discount rate and the reversionary capitalisation rate. The estimated fair value increases if the estimated rentals increase, vacancy levels decline or if discount rates (market yields) and reversionary capitalisation rates decline.

Notes to the consolidated financial statements continued

for the year ended 30 June

2. Investment property continued

2.5 Investment property valuation continued

The valuations are sensitive to all four assumptions. The inputs used in the valuations at 30 June 2018 were:

- The range of initial capitalisation rates applied to the portfolio was between 6,3% and 8,5% (2017: 6,3% and 8,5%) with the weighted average being 6,7% (2017: 6,7%). The initial capitalisation rates approximate the average annualised property yields
- The discount rates applied ranged between 12,3% and 14,5% (2017: 12,3% and 14,5%) with the weighted average being 12,4% (2017: 12,5%)
- The permanent vacancy factor applied for shopping centres ranged between 0,5% and 2,0% (2017: 0,5% and 2,0%) and offices between 0,5% and 2,0% (2017: 0,5% and 2,0%)
- An average market rental growth rate of 6% (2017: 6%) was adopted for renewals and new leases.

Changes in discount rates attributable to changes in market conditions can have a significant impact on property valuations.

Effect on valuation of investment property portfolio:

- A 25 basis point increase in the average discount rate will decrease the value of investment property portfolio by R662 million (2,0%) (2017: R634 million (2,0%))
- A 25 basis point decrease in the average discount rate will increase the value of investment property portfolio by R689 million (2,0%) (2017: R660 million (2,0%))
- A 25 basis point increase in the capitalisation rate will decrease the value of investment property portfolio by R1,21 billion (3,6%) (2017: R1,17 billion (3,6%))
- A 25 basis point decrease in the capitalisation rate will increase the value of investment property portfolio by R1,3 billion (3,9%) (2017: R1,26 billion (3,9%))

Valuation techniques underlying management's estimation of fair value

The valuations were determined using discounted cash flow projections, based on significant unobservable inputs. These inputs include:

- **Future rental cash flows:** Based on the location, type and quality of the properties and supported by the terms of any existing leases or other contracts or external evidence such as current market rentals for similar properties.
- **Discount rates:** The discount rate is the rate of return used in a discounted cash flow analysis to determine the present value of future cash flows, and takes into account an assessment of the uncertainty in the amount and timing of future cash flows.
- **Vacancy rates:** Based on current and expected future market conditions after expiry of any current leases, as well as tenant failures during the course of a lease.
- **Maintenance costs:** Includes necessary investment to maintain the functionality of the property for its expected useful life.
- **Capitalisation rates:** Based on location, size and quality of the properties and taking into account market data at the valuation date.
- **Terminal value:** Taking into account assumptions regarding maintenance costs, vacancy rates and market rentals.

The valuation methods applied by the independent valuers were the same as the prior year.

Fair value hierarchy

Fair value is the price that would be received on the sale of an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date, regardless of whether the price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the group takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date.

In addition, for financial reporting purposes, fair value measurements are categorised into level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable. The three levels are explained as follows:

Level 1 – inputs are quoted prices in active markets for identical assets or liabilities that the company can access at the measurement date. These quoted prices are unadjusted.

Level 2 – these are inputs, other than quoted prices included in level 1, that are observable for the asset or liability, either directly or indirectly.

Level 3 – inputs that are unobservable inputs for the asset or liability.

2. Investment property continued
2.5 Investment property valuation continued

	Recurring fair value measurements – level 3	
	2018 Valuation R000	2017 Valuation R000
South Africa⁽¹⁾		
Shopping centres	27 351 847	26 490 589
Value centres	1 303 000	1 248 000
Standalone offices	125 000	117 000
Sub-Saharan Africa (excluding South Africa)		
Ikeja City Mall (Lagos, Nigeria)	2 069 354	1 969 744
Total consolidated	30 849 201	29 825 333
⁽¹⁾ Excludes property held-for-sale		
	Fair value less costs to sell – level 3	
	2018 Valuation R000	2017 Valuation R000
Assets held-for-sale	198 000	418 798
Total consolidated	198 000	418 798

Investment property held-for-sale was measured at fair value less costs to sell which, in instances where the property is already sold, but not yet transferred, is based on the sale price.

There are inter-relationships between unobservable inputs. Expected vacancy rates may impact the yield, with higher vacancy rates resulting in lower yields. An increase in future rental income may be linked with higher costs. If the remaining lease term increases, the yield may decrease.