Property Focus

BusinessDay
MARCH 15 2018
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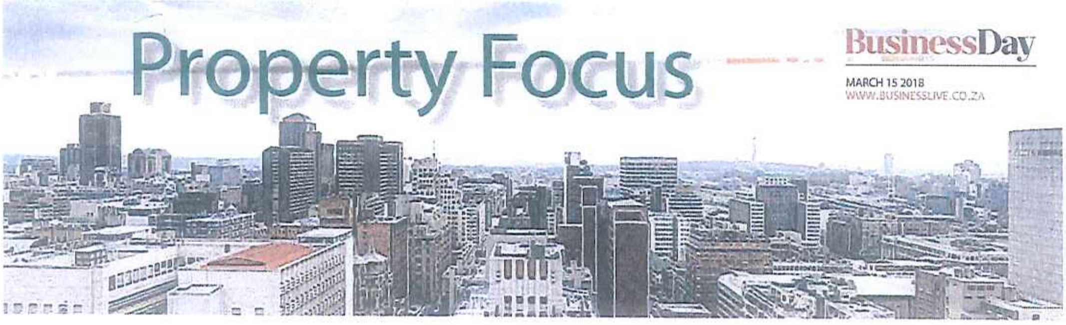


Sector off to a rocky start

Share price weakness has created buying opportunities for investors who are prepared to sit out current volatility, writes *Joan Muller*

The sharp sell-off of a number of blue chip property stocks since January including the Resilient stable of companies and pure rand hedge counters such as MAS Real Estate, Sirius Real Estate, Intu Properties and Hammerson has dragged the South African listed property sector down more than 16% year to date. Last year, property stocks delivered am impressive 17% average total return.

In early January, most analysts were expecting a still-decent, albeit somewhat lower, 10%-14% total return for 2018 as a whole. However, the extreme volatility seen in the share prices of some property counters since January 10, coupled to a general nervousness among JSE investors following the near collapse of former JSE heavyweight Steinhoff in December, will prompt property investors to become far more discerning in their stock selection.

PROPERTY SHARE PRICES ARE LIKELY TO REMAIN ERRATIC, WHICH MAKES IT DIFFICULT TO PREDICT THE LEVEL OF RETURNS

Catalyst Fund Managers property analyst Naeem Tilly says recent events will undoubtedly alter the perception and risk evaluation of the sector. "In our view, companies with weak corporate governance, opaque sources of earnings and complicated structures will face increasing scrutiny."

Tilly says property share prices are likely to remain erratic in the short term, which makes it difficult to predict the level of returns likely to be achieved for 2018 as a whole. However, he still expects property stocks to deliver an average 12%-14%/year total return over the longer term. But he stresses that there will be a big divergence in individual stock performance.

Latest figures from Anchor Stockbrokers show that the share price differential between the best and worst performing property stocks year to date is already more than 80% (read the table). While offshore stocks led the pack last year and South African-focused companies lagged behind, there has already been a marked turnaround in the fortunes of local funds. Top performers year to date include Emira Property Fund, Rebosis Property Fund, Indluplace Properties and Fairvest.

Craig Smith, head of research at Anchor Stockbrokers, says it's important to note that ongoing share price volatility will have a limited effect on the sector's distribution growth prospects over the short to medium term. He says despite the dramatic change in the investment landscape year to date, the sector as a whole should still deliver solid distribution growth of between 8%-9% for 2018.

Though the recent sell-off in the Resilient group of companies including Resilient Reit, Fortress Reit, Greenbay Properties and Nepi Rockcastle has seemingly been caused by short-sellers and negative sentiment fuelled by various reports, other offshore-focused stocks have also been sold-down, mostly on the back of a stronger rand.

Smith says share price weakness among rand hedge property stocks can also be ascribed to rising bond yields globally as well as SA's improved political landscape under the new leadership of president Cyril Ramaphosa, which has supported demand for South African-focused property stocks.

Given the change in sentiment towards SA Inc and an uptick in local consumer and business confidence, Smith expects pure South African-focused portfolios to be most attractive to investors over the short to medium term. But he warns that liquidity – or lack thereof – and index weightings will have an impact on the effective demand, especially for smaller South African-focused portfolios.

Smith adds: "However, one also has to ask whether recent rand strength may present an attractive entry point to invest in quality, 100% offshore-focused listed property companies given the recent de-rating among these stocks."

LISTED PROPERTY WINNERS

Share price movement year-to-date

Balwin Properties	19.8%
Emira Property Fund	18.9%
Indluplace Properties	17.3%
Fairvest	16.8%
Arrowhead Properties	14.0%
Rebosis Property Fund (A)	12.1%
Gemgrow Properties (B)	10.6%
Growthpoint Properties	10.5%
Ingenuity	10.0%
Redefine Properties	8.9%

...AND LOSERS

Fortress REIT (B)	-64.1%
Resilient REIT	-56.1%
Greenbay Properties	-45.1%
NEPI Rockcastle	-42.3%
MAS Real Estate	-20.7%
Acsion	-17.7%
Hammerson	-17.1%
Intu Properties	-17.0%
Investec Australia	-16.3%
Capital & Counties	-15.7%

Graphic: RUBY-GAY MARTIN Source: ANCHOR STOCKBROKERS

He refers specifically to Central and Eastern European-focused mall owner Nepi Rockcastle.

"A business like Nepi Rockcastle is extremely difficult to replicate given its quality asset base, attractive pipeline, strong balance sheet, deal making ability and development expertise and networks," says Smith.

Liliane Barnard, CEO of Metope Asset Managers, voices a similar sentiment: "South African property stocks stand to gain from improved investor sentiment given the country's change in leadership. There's also the potential for a re-rating among South African-focused property counters following recent bond yield strength."

Barnard notes that any improvement in economic growth should drive rental growth, particularly in the ailing office sector. The retail property sector, which has been hit by slowing consumer spending over the past few years, should also benefit from a potentially stronger economic growth outlook, says Barnard.

But she agrees that there are a number of offshore property stocks that are now trading at attractive yields. "We particularly like stocks that are exposed to high-growth economies, including Central and Eastern Europe, and offer double-digit distribution growth."

Barnard says MAS Real Estate, which offers investors exposure to the high-growth Central and Eastern Europe region through its partnership with highly regarded developer Prime Kapital, is one of their top picks. "We believe MAS is one of the JSE's more exciting real estate investment vehicles due to its ability to deliver strong distribution growth in euros and a strong balance sheet that will enable the company to deliver on its development pipeline without coming to the market for further capital raises."

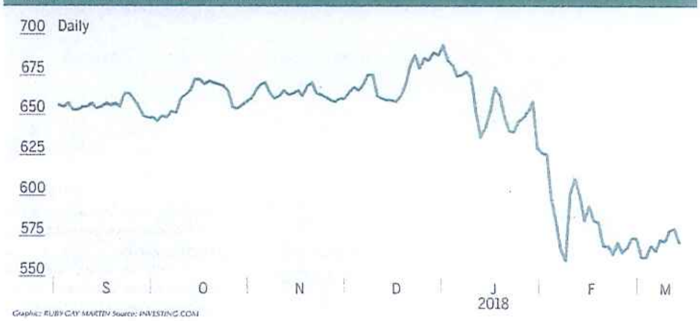
Craig Smith ... growth intact

Ian Anderson, chief investment officer at Bridge Fund Managers, is betting on a strong recovery in South African-focused property stocks over the next 12-18 months. He says while the current operating environment continues to present challenges for local property companies in the form of high vacancy rates, low economic growth and the continuous addition of new supply, the local operating background is set to improve.

The prospect of lower interest rates, higher economic growth due to a restoration in consumer and business confidence and a better outlook for global growth will lead to improved property fundamentals, which Anderson believes isn't yet reflected in the share prices of many South African-focused property stocks.

Anderson favours smaller and medium-sized property companies, most of which he says are trading at substantial discounts to net asset value and dividend yields north of 10%. He singles out Safari Investments, which owns a high quality portfolio of malls that cater to lower income shoppers in areas such as Mamelodi and Atteridgeville, and Fairvest, which also has a retail-biased portfolio in high-growth nodes close to commuter networks. He also likes residential-focused property companies such as Indluplace and Octodec.

JSE SA LISTED PROPERTY INDEX



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