Listed property best performing asset class again

The listed property market in 2013 should be another good year, as this sector can predict its short-term performance with good levels of accuracy, because its performance is underpinned with rental income from contractual agreements.


Norbert Sasse, Chairman of the PLSA

In 2012, listed property outperformed cash, bonds and equities with returns of 36%, to become South Africa's best performing asset class for the fourth consecutive year.

Norbert Sasse, chairman of the Property Loan Stock Association (PLSA) and CEO of Growthpoint Properties, says investors can expect distribution growth from the sector to average between 5% and 8% in 2013. He anticipates listed property total returns between 10% and 16%. While still positive, this is well below the total returns of 2012.

"With tougher market conditions overall, companies that can manage vacancies and costs are better positioned to deliver performance for investors," says Sasse. "Sectoral portfolio composition will also influence performance. Weak demand will continue in the office sector. However, retail and industrial property will perform well off a base of low vacancies that should remain stable."

Head of listed property funds for Stanlib, Keillen Ndlovu adds that the sector will deliver decent growth numbers matching or above inflation, protecting investors' income against inflation. "Listed property income should grow by over 6% in 2013 and improve to 7% in 2014.

"Our base case for listed property total returns in 2013 is 9%. Our bull case forecasts 16% total returns and our bear case only forecasts 2.2%. The biggest driver of changes in total returns is movement in bond yields.

"Listed property is a great diversifier. It produces a regular source of growing income and capital growth over time."

High corporate activity

Expect lots of corporate activity from the sector in 2013. "Especially smaller funds merging to gain critical mass and taking a defensive position in a market where larger funds are pursing aggressive acquisition strategies," says Sasse. "Property acquisitions will remain robust, given low interest rates, the forward yield of listed property sector and the availability and affordability of funding. Newer funds and funds with ambitions to list will be keen to snatch up assets from the sector's larger players."

Ndlovu says, "Newly listed property companies will continue their growth strategies. However, they are beginning to step on each other's toes, as there is limited physical property stock out there. Most listed property funds are playing in similar territories. Limited stock means that listed property companies will start to eye each other. This could lead to mergers and takeovers."

New listings

Over the past 24 months, the sector saw a spate of new listings. While more companies are expected to join the sector, the number is likely decrease in 2013. Ndlovu says South Africa's first residential listed property fund could debut this year.

Equity raisings will remain prominent in the sector, but not to the same extent as in recent years. About R11 billion of equity came into the listed property space in 2012. In 2011, it was about R16 billion.

"Companies raised equity to fund property acquisitions," says Ndlovu. "Equity raisings and new listings were positive for the sector, increasing size, choice and liquidity."

Sasse adds, "While interest rates remain low, pricing yields on the listed property sector will continue to be low, which is good for capital raisings. Institutional investors continue to show good appetite for the sector."

New legislation

In April 2013, REIT (Real Estate Investment Trust) legislation will be introduced in South Africa. Spearheaded by the PLSA for its positive impacts on the sector, this legislation will provide tax certainty and align South Africa with global investment structures and established REIT markets like the US, Australia, Hong Kong, Singapore and the UK.

While adopting this best-of-breed international investment structure, the sector will also look beyond South African borders for growth.

"Given the local market is becoming increasingly competitive with more listed property funds, some will start focusing more on opportunities outside South Africa with property acquisition and developments," says Sasse. "However, investment into developed markets will be tougher with the current Rand weakness. In addition, most of these property markets rerated substantially, driving yields significantly below South Africa's. Investments in the US, UK and Europe are likely to be dilutive in most cases, but there are still some opportunities in Australia."

Ndlovu notes that while local funds have ventured into markets like Australia, UK, Germany and Romania, the focus is now shifting to the rest of the African continent.

"Investment in property up Africa is gaining momentum. Several SA property companies, listed and unlisted, are targeting countries such as Nigeria, Ghana, Kenya, Angola, Mozambique, Zambia and Mauritius," says Ndlovu. "Most projects are at infancy stages and it will take the listed property sector two to three years to see the benefit of this."

South African developments favour refurbishments

Listed property companies are also playing a larger role in new property development in South Africa. "This development will favour mixed-use, retail and industrial development in the present market. The rush of retail developments in smaller towns in recent years will slow, as retailers become more selective about new stores," says Sasse.

Ndlovu notes this increased role in property development will only come from a handful of the sectors' over 30 companies and not on a major scale. "We're likely to see more refurbishments and extensions, especially shopping centres that in some cases, respond to imminent competition. There are several huge retail developments going up across the country, which means more competition. This forces shopping centres to up their games."

Large shopping centres are still experiencing good demand for space. "Burger King has its sights set on opening stores in South Africa. H&M is another possible entry into our retail market. Zara, Burberry, Cotton On, Top Shop recently opened stores and most international retailers want to expand their footprint across South Africa," says Ndlovu.

Bond market increase

Funding new assets, more listed property companies will venture away from traditional bank lending into the bond markets. Ndlovu says, "More companies will seek ratings from agencies to participate in the bond markets and secure debt which is a cheaper than traditional bank debt. Banks are pricing their debt more competitively to keep some of their business with listed property companies."

Sasse also foresees an improvement in funding from the banking sector driven by recent changes to some of the Basel 3 requirements.

While the sector continues seek new ways of growing and new income streams, it is becoming increasingly focused on reducing the costs of occupancy for tenants. High operating costs increase tenants' cost of doing business, putting pressure on their ability to pay rentals. This also means lower economic growth and lower demand for space.

Energy efficiency paramount

Sasse says, "Introducing energy efficient measures to reduce energy consumption is one way property owners are giving occupants added benefit, without charging more fees. Companies are becoming smarter and more competitive with their tenant services and finding ways to differentiate their space besides building quality and location."

Green buildings are likely to get more attention as investors become more socially responsible. Ndlovu says, "Most asset managers, like Stanlib, must now show that they look at the social responsibility of investments for impact on environment, society and governance. This also means the governance of sector companies is likely to receive more scrutiny."

Like other sectors in the South African economy, a further downgrade of South Africa by rating agencies is a threat to listed property's performance.

"This would weaken the Rand with knock-on effects for the domestic banking and bond markets. The resultant spike in inflation and interest rates would lower listed property prices. The growing labour market tensions are bad for business and have an unsettling potential to impact the commercial property space," concludes Sasse.