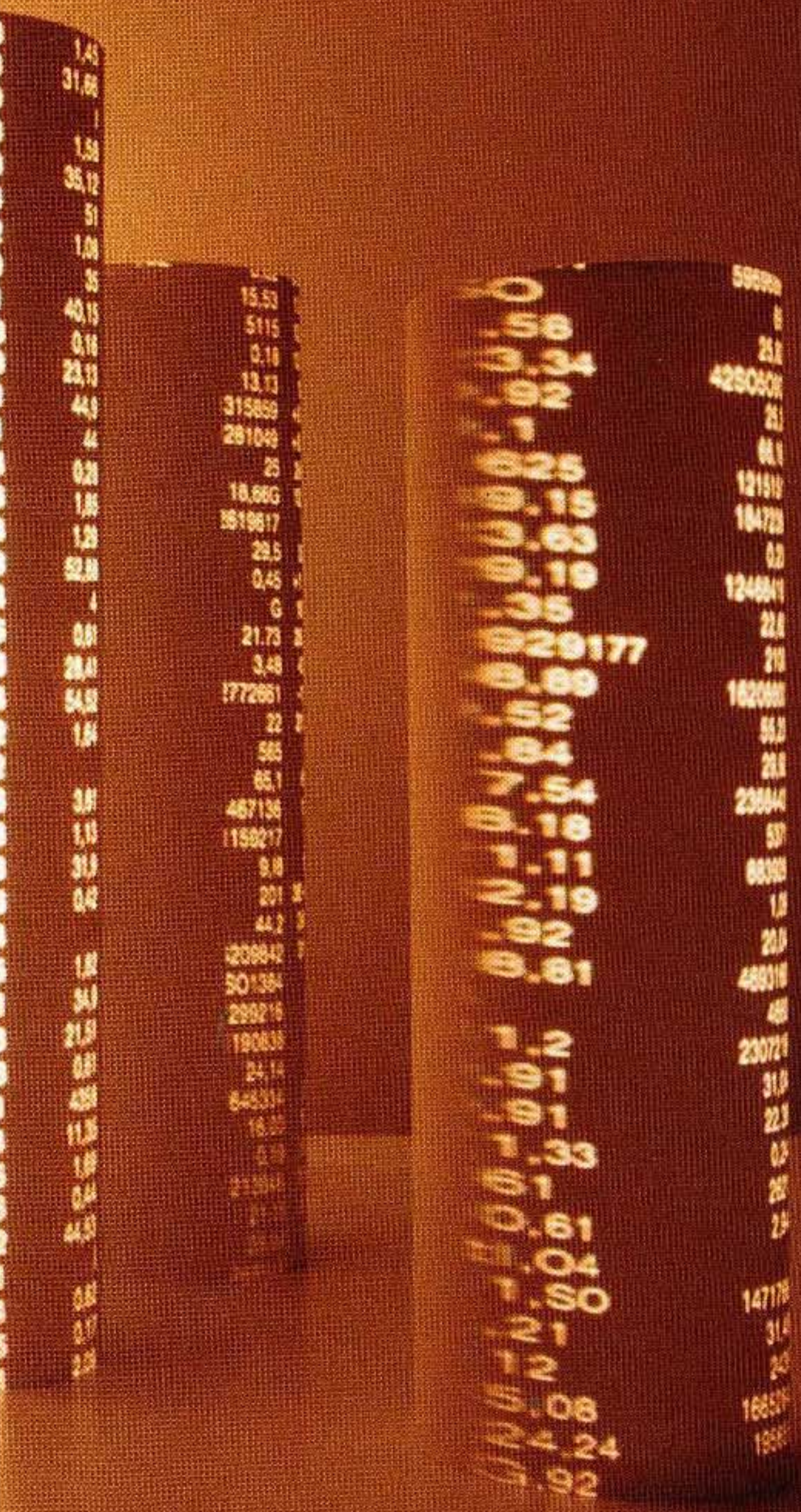


REACHING FOR THE SKY

Although the economy is slowing and markets are performing poorly, there are still areas of value for investors. Listed property, although often overlooked, may be just such an area.
By Felicity Duncan



Over the past 12 months, investors of every stripe have watched helplessly as the value of their assets has collapsed. Even those holding well-balanced portfolios including equities, bonds, property and cash have suffered.

The JSE All Share Index (Alsi) has fallen from its early 2008 high of around 30 000 to 18 000 – a 40% decline that represents a R2-trillion drop in the value of SA stocks. Adding to the misery is the fact that many companies are reducing or suspending their dividends, including Old Mutual, Anglo American, Nedbank, Bidvest, and Mutual & Federal.

On the bond market, yields have come under pressure as investors' appetite for debt has withered. Inflation, at double digits for most of 2008 and above target so far in 2009, has eaten away at the value of the money market and cash savings.

Even the private home is no longer the asset it once was. According to Standard Bank's February 'Residential Property Gauge', house prices across the country decreased by 2% between February 2007 and February 2008 – in some areas the decline was much greater.

It's hard to imagine finding any bright spots amid all the bad news, but there may just be a few hidden opportunities out there.

One of the areas worth exploring is the listed property sector. The 28 actively traded JSE-listed property companies have a combined market capitalisation of around R107 billion. While the Alsi was down 40% over the last year, and the JSE Top 40 Index was down 43%, the JSE Real Estate Index was down just 35%, an indication that listed property outperformed general equities over the last 12 months.

THE LISTED PROPERTY SECTOR

Listed property comes in many forms. First, there are the property unit trusts (PUTs), which include Emira, Fountainhead Property Trust and Sycom Property Fund.

PUTs, which are similar to the internationally popular real estate investment trusts (REITs), are collective investments focused on property. They hold a portfolio of properties and investors buy linked units in the PUT (roughly the equivalent of shares in a unit trust) and are rewarded with both rental income payments (which resemble dividends) as well as capital appreciation on the underlying properties. Over the last year, the JSE Property Unit Trust Index has fallen just 12%.

A more common form of listed property is the Property Loan Stock (PLS) company, which is similar to any other company, but invests only in property. The main difference between a PLS and any other company is the method whereby the owners fund the company.

When an investor purchases a linked unit in a PLS, it comprises part share and part debenture (or loan). The debenture portion of the linked unit earns interest, derived from the PLS's properties' rental streams, and the share portion earns dividends. Over the last 12 months, the JSE Property Loan Stock Index has fallen just 9%.

These impressive numbers for listed property entities are out of step with global trends. Internationally, investment property, usually in the form of REITs, has generally underperformed the broader stock market.

In the UK, for example, the FTSE UK Commercial Property Total Return Index was down 25.75% over

the 12 months to January 2009, while the FTSE 100 was down 25.6%. It's a small difference, but a significant one.

In the US, the difference is much starker. The FTSE NAREIT US Real Estate Index Series Daily Return returned -40.5% for the year to February 2009, while the S&P 500 delivered -23.99%, indicating a dramatic underperformance from property.

So why is SA's listed property sector performing relatively well?

There are three main factors that explain SA listed property's outperformance compared to the rest of the world: leverage, the global recession and liquidity.

According to Barnard Jacobs Mellet Securities' property analyst Mohamed Kalla, 'The impact of the global recession has been far more severe in developed markets as a result of the subprime crisis and banking sector collapse. The freezing of credit markets has resulted in offshore property funds being unable to refinance their loan facilities with banks/credit markets, resulting in "fire sales" of their properties.'

'In addition, the large supply seen in global markets, coupled with a severe slowdown in economic growth has seen vacancies increasing, thereby having a negative impact on income growth.'

Zayd Sulaiman of Catalyst Fund Managers agrees. 'Internationally, REITs geared up significantly relative to their SA counterparts,' he says. 'While we were in a bull market with rising property prices this was not a problem and banks were happy to lend as their loan-to-value (LTV) ratios were declining. However, since the collapse in the credit markets and resultant decline in property valuations, these LTV ratios have increased and numerous companies are close to breaching their loan covenants. In addition, credit is not as easily available and has become quite expensive (in terms of interest rates) due to lenders "hoarding" capital.'

'Furthermore, property income streams are declining due to higher vacancies and declining market rentals and companies are cutting dividends and/or issuing shares/units in lieu of dividends.'

It's a grim picture, but happily things have been very different in SA, as Vuyani Bekwa of Investec

“ SA property companies continue to pay out higher dividends, with growth of around 10% in the past six months ”



LISTED | PROPERTY

COMPANY	% CHANGE 3 MONTHS TO MARCH 2009	% CHANGE YEAR-TO-DATE TO MARCH 2009	% CHANGE 1 YEAR TO MARCH 2009
ACUCAP PROPERTIES	-2.14	-8.36	-13.10
AMBIT PROPERTIES	6.09	-8.50	0.27
APEXHI PROPERTIES-UNIT CLA	-1.94	-8.00	-5.60
APEXHI PROPERTIES-UNIT CLB	-4.00	-6.97	-5.07
APEXHI PROPERTIES-UNIT CLC	-0.63	-7.88	-6.10
CAPITAL PROPERTY FUND	3.70	-5.88	6.67
COLLIERS SOUTH AFRICA HLDG	-30.77	-30.77	-73.68
EMIRA PROPERTY FUND	1.17	-2.16	3.17
FOUNTAINHEAD PROPERTY TRUST	-7.14	-8.93	-9.09
GROWTHPOINT PROPERTIES	-7.47	-12.00	-4.36
HOSPITALITY PROPERTY FUND-A	0.91	-6.33	-14.62
HOSPITALITY PROPERTY FUND-B	1.58	0.78	-3.26
HYPROP INVESTMENTS LTD-UTS	-4.58	-10.71	-9.64
LIBERTY INTERNATIONAL PLC	-43.56	-35.97	-71.88
MADISON PROPERTY FUND MANAGERS	0.78	0.78	-24.56
MERCHANT & INDUSTRIAL PROPER	-4.44	-21.82	-22.52
OCTODEC INVESTMENTS	5.20	-4.71	-26.94
ORION REAL ESTATE	-11.77	7.14	-49.15
PANGBOURNE PROPERTIES	-2.33	-8.95	-11.65
PREMIUM PROPERTIES LTD-UTS	-2.13	1.15	-14.00
PUTPROP	-1.27	-4.88	-2.50
REDEFINE INCOME FUND	7.20	0.00	-6.58
RESILIENT PROPERTY INCOME	1.09	-7.33	-7.10
SA CORPORATE REAL ESTATE FUND	-1.25	-8.85	-28.18
SABLE HOLDINGS	0.00	-0.07	-31.82
SYCOM PROPERTY FUND	-2.37	-10.49	-13.61
VUKILE PROPERTY FUND	-12.64	-13.12	-24.36

OUTLOOK

The last few years have been good for listed property. The economy has been growing for several consecutive years, putting upward pressure on rentals in desirable locations. Interest rates have been relatively low, especially before rate tightening started in 2006, when many of the big property developments were financed and credit was widely available. Property stocks have also experienced very few lease defaults.

But while the heydays may be over, Kalla says he still sees value in the sector. 'The property sector is trading at a discount to bonds as the market remains jittery about income growth prospects. In addition, some funds are offering initial yields higher than cash, so we see value in the sector. Industrial property is still tracking well due to limited supply, while lower quality, B- and C-grade office space offers value as rental levels are well below market, in our view. Large, super-regional shopping centres are also likely to be quite defensive, while shopping centres at the lower end of the LSM scale still appear to be trading well.'

For Allison, the sector may be cooling, but will by no means turn cold. 'The SA listed property sector experienced peak fundamentals six to 12 months ago, so looking forward we expect tenant defaults and vacancies to increase, off a very low base. In the short term, the completion of projects started six to 12 months ago will result in over supply in certain areas.'

'So 2009 is going to be a challenging year for the sector, the same as for the overall economy. That is why we are forecasting 7-8% distribution growth for the sector in the next 12 months, compared to 12% in the past 12 months, resulting in a cash yield or income return of about 10%,' explains Allison.

'Compared to other sectors and asset classes, this is still a reasonably good result and the sector is viewed as relatively defensive. There is capital risk for the sector, as there is for all equities and even bonds. But SA property earnings lag behind the economy and most other sectors, so the declines are not as sharp and take longer to come through. That is why results will still look decent in the next six to 12 months. Similarly, the sector lags in the up cycle. When confidence returns and the credit crunch abates, SA property will underperform equities and global property as these recover off much lower earnings and price bases.'

Although the distributions may be down next year, the share prices have fallen to levels that make yields look attractive. If the big listed property companies manage to grow their distributions again this year, the sector could offer great value, especially at current prices. **JSE**

Property explains. 'The local market is in a very different position [to its international peers] as LTV ratios are relatively low at around 25% and property asset values have fallen modestly at worst. Refinancing risk is also low because the local banks have largely agreed to extend debt facilities to the local property unit trusts and property loan stock companies.'

Leon Allison of Maquarie Securities echoes these sentiments: 'Gearing ratios for SA property companies at about 25% (LTV) are significantly lower than their international peers.'

'Asset values are holding up for now as rental income growth is still being experienced. SA banks also seem to have stronger balance sheets and higher capital adequacy ratios than their global peers,' he says.

'As a result, SA banks are still lending to the SA property sector, albeit at higher margins than before. SA property companies continue to pay out higher dividends, with growth of around 10% in the past six months.'

Allison warns, however, that this could slow as fundamentals weaken. Whether he's right in anticipating a slowdown in distribution growth at the PUTs and PLSs is a matter of contention. After all, SA's biggest listed property company, Growthpoint Properties, announced a 10.6% increase in its distributions for the six months ended December 2008, and number three property group Apexhi Properties announced an 11% distributions increase for the same period. Surely such growth can't continue forever.