

## **Listed property round-up**

Price weakness offers the income seeking investor opportunities to increase exposure

By Anton de Goede, Coronation Property Fund manager

Compared to other asset classes, local listed property has exhibited its defensive qualities since the start of the year. Given the stellar 33.5% total return in the second half of 2008, one could easily forgive returns for losing some momentum. While underperforming equities for the month of March, the -6.9% return on listed property for the year to mid-March compares very favourably with the -10.4% return on equities. In addition, considering the 70bps upward movement in the yield of the benchmark R157 government bond, listed property investors can be relatively satisfied with what the sector has delivered year-to-date.

### **Distribution growth still strong**

One major supporting factor for the sector has been the continued strong distribution growth seen in recent company results. The majority of results met market expectations, with the average year-on-year distribution growth still coming in above 10% at 10.7%. There was, however, a rather big disparity between distribution growth from as high as 19% to close to 0%. Pressures from both a funding and tenant perspective are weighing on future distribution growth prospects resulting in guidance for future results being muted, in line with the global and local economic environment.

### **Cost of funding remains stable**

Despite the prospects of lower interest rates, funding rates within the sector should remain fairly stable. Counter to lower interest rates, any newly negotiated borrowing would probably be granted at higher margins than that of the last two to three years, with margins having shifted out by between 100bps to 150bps. The viability of the securitisation market as an alternative funding source has also decreased substantially, with limited capacity at higher spreads. For any new development, bank requirements for an equity capital portion and percentage pre-leasing have also increased, making speculative development, which is debt funded, unlikely. Fortunately, the favourable swap curve at the end of 2008 has made it possible for many funds to refinance expiring swaps at rates very similar to fixes achieved at the previous bottom of the interest rate cycle.

### **Focus shifts to brownfield projects**

Capital commitments have, however, decreased as greenfield developments are becoming less viable despite building cost inflation coming down to single digits. In addition, weak council infrastructure is making developments more costly as it involves the upgrade of these services as well. The focus has shifted to brownfield projects to upgrade and extend older shopping centres and office buildings. After many voiced their concerns regarding the office development pipeline, specifically in Sandton, during 2008, these concerns seemed to have fizzled out. There may be opportunities to acquire land due to higher holding costs with rezoning becoming quicker and easier with the lower level of activity. Little desperation selling has been seen, although average asking yields have moved out to between 10% and 10.5%, albeit more in Gauteng than the coastal areas. With this limited opportunity to acquire properties locally many funds are considering offshore opportunities as assets can be acquired at similar yields; the highest in the last 15 years, compared to local assets.

### **Possible rental and trading density plateaus**

At present, occupancy costs seem to be the biggest single issue for many landlords, specifically smaller retailers taking strain as a result of higher electricity costs and rates. Second to smaller retailers, smaller industrial tenants, followed by office tenants will take the strain. Therefore, rentals have probably peaked for the next year or two.

In addition, retailers may also have reached trading density plateaus. Trends coming through in the results of both landlords and retailers show that value retailers are gaining market share, with increased spend on

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basic goods, resulting in specifically rural retail holding up well. In terms of the industrial market, demand for >20 000m<sup>2</sup> warehouse boxes has dried up, while pressure has started to come through in the mini-industrial market. Office tenants have remained fairly resilient, although SAPOA vacancy numbers point to upside risk in increased vacancies.

Landlords have become much more risk averse over the past few months. The focus has shifted to tenant retention rather than portfolio expansion. Retaining tenants is key to limiting the foreseeable increase in vacancies, thereby also sidestepping the payment of letting commissions to acquire new tenants or tenant installation costs.

**Opportunity to increase exposure**

The current weakness in listed property prices, closely correlated to the performance of the equity market, has created the opportunity for income seeking investors to increase their exposure relative to other income yielding asset classes. Locking in yields of above 10% for the next 12 months is possible and despite guidance being muted the potential for growth in these income streams remains strong. To manage the prevailing economic risks, investors will need to differentiate between quality portfolios, management teams and transparency in conjunction with more certain rental flows.

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