Foreign investors support listed property rally

It seems that the run in property stocks is being supported by an influx of foreign yield chasers and index tracker funds. The sector has notched up a 38% total return over the past 12 months, despite recent volatility. That compares to the JSE all share index's 18% total return over the same period...

© paulpaladin – 123RF.com

Though it was expected that the sector would lure more foreign money when the JSE adopted the globally recognised real estate investment trust (Reit) structure in mid-2013, at the time no meaningful offshore flow into property counters materialised.

However, industry players say global fund managers are finally starting to develop an appetite for the high yields on offer from SA Reits relative to those indeveloped markets. SA's R453bn listed property sector, now with more than 40 counters - up from fewer than 25 two years ago - is trading at a forward yield of around 6,5%. That is attractive to the sub-4% yields typically available from UK, European and US-listed Reits.

In addition, a number of local counters have significantly increased their size and liquidity on the back of ongoing merger and acquisition activity, which makes it easier for offshore funds to buy and sell SA-listed property. Meago Asset Managers director Jay Padayachi says this has also led to the inclusion of more local stocks in a number of global real estate indices in recent months, which places SA on the radar of international index tracker funds.

Over the past two years alone, Redefine Properties, the JSE's second-largest counter, has grown its market cap from R30bn to R44bn. Redefine CE Andrew Konig says the percentage of offshore shareholders has risen markedly in recent months. Today 23% of Redefine's shares arein foreign hands, up from 1,4% in 2008. At the same time, the value of Redefine's foreign ownership has grown from R86m to R10,7bn.

Konig says there was a big inflow of money from European fund managers in April, no doubt on the back of Redefine's inclusion in the FTSE Nareit US real estate index. He believes quantitative easing has released lots of European money looking for a home. "And SA property stocks offer an attractive option for offshore investors searching for better yields."

Sector heavyweight Growthpoint Properties' foreign shareholding also recently breached 20%, up from around 3% five years ago. The company's market cap recently surpassed R70bn, up from R44bn two years ago.

Mall owners Resilient Property Income Fund and Hyprop Investments have recorded equally impressive market cap growth over the past two to three years. Both Hyprop and Resilient's foreign shareholding sit at 14%. Hyprop is likely to see a fresh round of foreign buying when it is included in the MSCI emerging markets index from 29 May.

Analysts say the outperformance of listed property vs general equities in recent years has prompted more local general equity fund managers to broaden their exposure to Reits.

However, the super returns achieved by property stocks over the past year are unlikely to be repeated, with some counters now looking overvalued. According to the latest figures from Catalyst Fund Managers, the top five performing counters have all delivered a total return exceeding 63% in the 12 months ending April. They are Fortress B, offshorefocused Rockcastle Global Real Estate Company, Resilient, Hyprop and Romanian-based New Europe Property Investments (Nepi).

Fortress B, which hasa sizeable exposure to commuter malls that serve lower-income shoppers as well as to rand-hedge sister funds Rockcastle and Nepi, achieved a hefty 237% total return over the 12-month period.

Sesfikile Capital director Evan Jankelowitz says the yield premium at which listed property is currently trading vs that of bonds - 6,5% against 7,95% - may not be entirely justified.

"This is the time when exuberance must be replaced by caution as we believe thatthe second half of the year will result in global yields pushing higher and a knee-jerk reaction to all income-bearing instruments."

Jankelowitz says while listed property can still deliver a healthy 10%-12% total annual return over the medium to long term, there is likely to be shortterm pressure on share prices. "We do not advocate that investors try to time the market by selling now and buying back in later. However, we do caution that cheaper entry points will be apparent shortly."

Asset manager Allan Gray has an even more bearish view. The fund manager concedes that it has in the past been too negative on property, missing out on the 22%/year total return generated by the listed property sector over the past decade.

However, in a research note to clients, Allan Gray says while the past decade's performance has been "fantastic", it is unlikely to be repeated, given that property share prices have already risen about 70% over the past 10 years.

Allan Gray says while property companies have managed to grow dividends at a faster rate than inflation over the past 10 years (an average 8%/year vs 6%/year) that's below the 16%/year dividend growth recorded by the average JSE-listed company over the same period. "Even the relatively modest 8% is an overstatement of underlying growth, since it has been boosted by acquisitions and by property companies paying less interest on their debt."

Allan Gray argues that low interest rates provided a valuation uplift that allowed property companies to benefit from earnings-enhancing acquisitions in SA and overseas. They believe this tailwind won't repeat itself. "Right now, we think that investors are paying a premium multiple for property stocks that is not justified by the fundamental prospects."

Source: Financial Mail