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Listed property is South Africa's top performing asset class again in 2014

South African listed property delivered returns of 26.6% for 2014, outperforming all other asset classes for the year.

Despite tough macro conditions, listed property compared favourably with SA Equities and SA Bonds which delivered returns around 10% and cash returned 5.90%. According to Naeem Tilley, who heads up listed property at Avior Capital Markets, SA listed property has also comfortably outperformed all three other assets classes over 10, five and three years. This is also the sixth time in the past 10 years it has outperformed equities, bonds and cash.

SA REIT (Real Estate Investment Trust) Association Chairman, Laurence Rapp says: "Listed property exceeded market expectations in 2014, despite tough operating environment, to produce capital returns of 18.59% and income returns of 8.05%."

SA REITs also performed admirably when stacked up against global REIT markets, according to Avior. They outperformed the UK (25.3%), Developed Europe (20.4%) and Asia (10%). Tilley notes that the US was the best performing market with a 43.2% total return, or 30.4% in USD. Next best, just beating out South Africa, was Australia at 27.9%.

Curwin Rittles of Catalyst Fund Managers reports the local sector's trio of top performing stocks were Fortress B (100%), Rockcastle (82%) and Resilient (60%).

Keillen Ndlovu**,** Head of Listed Property Funds at Stanlib, attributes listed property's strong overall performance to better-than-expected results, with income growth largely boosted by counters with some offshore earnings and the benefit of a weaker Rand. In addition local property fundamentals remained fairly good, notwithstanding a weaker South African economy.

The sector also benefited from lower-than-anticipated bond yields, and when bond yields fall, listed property prices go up. An increased appetite for listed property, including from balanced funds and other non-traditional property funds, also contributed to its successful performance.

Rittles adds better cost management and the restructuring of debt as important performance growth factors for the sector.

Ian Anderson, Chief Investment Officer at Grindrod Asset Management, comments: "2014 marked another exceptional year for South Africa's listed property sector. On top of producing a 26.6% total return for investors - measured by the SA Listed Property Index - companies raised a record level of new equity capital, with SA REITs raising more than R33 billion through a combination of initial public offerings, issues of shares for cash to fund growth and dividend reinvestment plans."

Ndolvu estimates the capital raised in the listed property sector to be around R40 billion, compared to R18 billion in 2013, making it a record year. "Virtually all equity raisings were oversubscribed. This indicates the huge appetite for listed property stocks," notes Ndlovu.

Anderson also highlights that investor appetite for listed property has grown on the back of accelerating distribution growth despite a weak economic backdrop, the prospect of lower interest rates and yields for longer and the inclusion of SA listed property companies in a number of global indices tracked by fund managers throughout the world.

2014 was also the sector's busiest year for corporate action so far. Some were successful and others not, while a few deals are still being finalised.

Rittles notes that significant transactions include South Africa's largest REIT, Growthpoint Properties, completing the acquisition of the Abseq and Tiber portfolios and being in the process of finalising the takeover of Sycom and Acucap. Redefine acquired Annuity Property Fund during the year, but was unable to acquire the remaining stake it does not already hold in Fountainhead Property Trust, after failing to gain sufficient shareholder support to conclude the deal.

The year also saw the failed merger of Delta, Ascension and Rebosis. Delta sold its stake in Ascension to Rebosis after the parties agreed not to merge and Rebosis is currently in merger talks with Ascension. Arrowhead acquired Vividend Income Fund and also took a stake in Dipula Income Fund. Vukile Property Fund grew its strategic stake in Synergy Income Fund. Two of the longest standing property counters, Octodec and Premium, also merged during the year.

Ndlovu anticipates the amount of equity raised will slow down in 2015, as will the number of new listings and mergers. "We believe the residential market will gain more traction. Arrowhead is looking to list a pure residential fund. A few other REITs are exploring this space. The sector's offshore and Africa story is likely to continue given limited opportunities locally."

When it comes to the increased investor appetite for listed property, Ndlovu adds that after years of doubt and lack of conviction, generalists have really started to recognise listed property as a separate asset class.

"We have said this before and we'll say it again. What makes listed property stand out is the stable and defensive nature of the income. It is easier to predict compared to equities. It is less volatile compared to equities," says Ndlovu.

Ndlovu points out that, since 1994, the average income growth from the listed property sector has never been negative. "As a result, listed property has a weaker relationship compared to equities. Listed property has a stronger relationship with bonds, mainly due to the stable nature of the income. Yet listed property will outperform bonds over time because listed property provides growing income whereas bonds do not."

Anderson confirms the sector has also done a fantastic job in showcasing the benefits of listed property to institutional investors. "A structural shift is currently underway which should result in higher allocations to property in retirement and other institutional portfolios," says Anderson. "This shift should provide some support for current valuations, although one or two companies are currently trading on unsustainably low initial yields."

Looking to the dynamics defining the market as the listed property sector enters 2015, it faces challenges from global markets volatility, particularly emerging markets, and South Africa's credit rating concerns. Ndlovu believes the Eskom power shortages could slow down trading in shopping centres and increase operating costs if there is a need to install generators. The sector's prospects will also be influenced by the slowing economy, oversupply in the office space and increased competition in the retail space.

Rittles explains the direct real estate fundamentals will remain challenging and SA publicly traded real estate companies are likely to continue to deliver inflation-type income distribution growth over the next 12 months. "This will largely be driven by annual rental escalations and support from offshore earnings," says Rittles, who calculates that the SA listed property sector offers a forward yield of approximately 7%.

Ndlovu believes that income will be a bigger component of listed property's total returns in 2015. He says: "We foresee income growth of around 8.5% over the next 12 months. This results in a forward yield of 6.9% for listed property, which is below 10 year bond yields (7.6%) and cash (7.1%). Listed property however, provides the benefit of a growing income stream in comparison to cash and bonds."

Over the next 12 months, Ndlovu expects listed property to deliver a total return in the region of +5% to + 11.5% in Stanlib's base and bull case assumptions respectively. "Based on our bear case, this may however deteriorate to -1% if bond yields weaken to over 8.5% from the current 7.6% levels," says Ndlovu.

The SA REIT Association represents South Africa's listed REIT sector. SA REIT members comprise all listed SA REITs and represent more than R300 billion worth of real estate assets. The quality of these SA REITs influences our economy and the quality of people's lives. REITs may be part of investment portfolios for a broad range of investor types and are most suitable to investors who want exposure to property investments, without the large initial capital outlay.

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