

UK back on property buying lists

By [Joan Muller](#)

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SA investors are slowly but surely starting to climb back into UK-focused property stocks, which have been out of favour since Britain announced its exit from the EU in mid-2016.

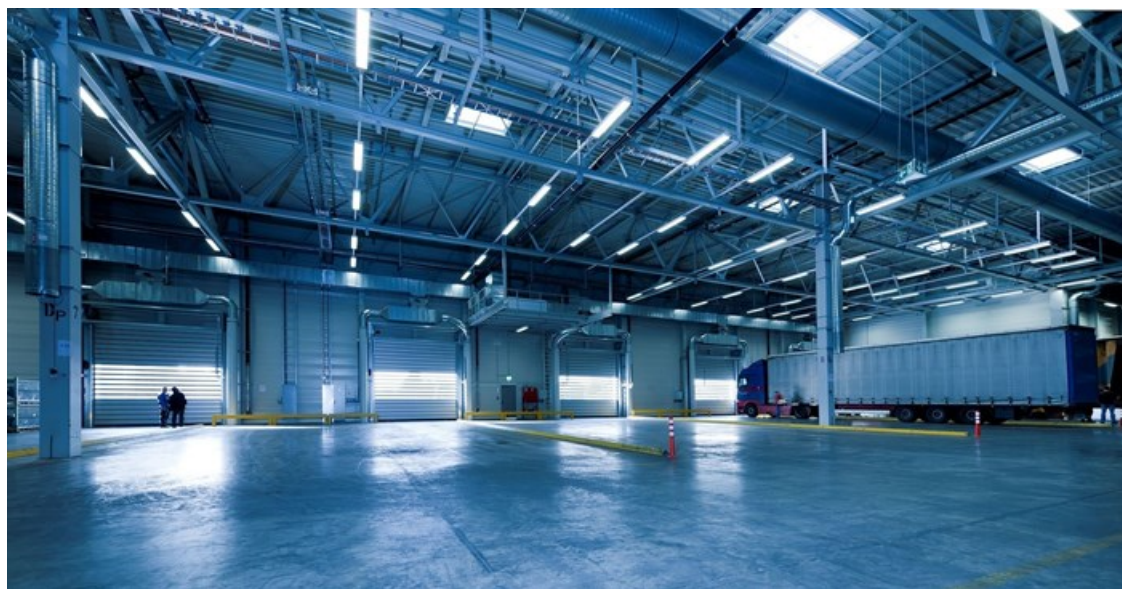


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Analysts agree that it is becoming hard to ignore the value proposition created by the stronger rand and the substantial discounts to NAV at which a number of the JSE's 12-odd real estate counters, with 100% or partial UK exposure, are trading.

For instance, former market darlings Covent Garden owner Capital & Counties Properties (Capco) and retail play Intu Properties are both trading around 52% below their 2016 share price highs.

That places the two companies at a discount to NAV of around 15% and 35% respectively.

Hammerson, which listed on the JSE in September 2016 and is the sector's largest UK-focused property offering, offers a 36% discount to NAV. Hammerson and Intu plan to merge later this year, which will create the UK's largest shopping centre fund.

With a combined market cap of around R115bn, the new entity will become the JSE's largest property counter.

But London-based Investec Asset Management portfolio manager Peter Clark says SA investors need to proceed with caution, given the uncertainty about how Britain's EU exit negotiations will play out and the potential impact on the country's economy. The UK also faces the prospect of higher interest rates.

Clark notes that the performances of UK property stocks have become increasingly divergent and are largely sector-driven. Last year, for instance, the industrial sector outperformed on the back of rising e-commerce while the office and retail sectors had a tough time amid more tenant failures.

That meant stocks with exposure to the UK's industrial and logistics sector (warehouses and distribution depots typically used by online retailers) such as SA-based Equites Property Fund and Atlantic Leaf Properties outperformed last year. So did MAS Real Estate, which has exposure to mixed use and student housing developments in the UK, as well as SA-based Stor-Age.

The latter expanded offshore for the first time last year via the acquisition of a R1.3bn self-storage portfolio in the UK.

In contrast, UK shopping centre and commercial property owners such as Intu, Hammerson, Capco, Redefine International (renamed RDI Reit), Tradehold and Texton underperformed in 2017.

Clark believes specialist sectors in the UK continue to offer the best growth potential.

"We still expect to see attractive returns from the logistics, student housing and self-storage sectors, while the outlook for retail and central London offices remains challenging," says Clark.

Catalyst Fund Managers global investment analyst Jonathan Kinnear agrees that UK mall owners will probably continue to battle weak consumer confidence amid rising food prices, weak pay growth and economic uncertainty. Kinnear says while pricing in the London office market has held up well, thanks in many respects to the insatiable demand of Asian-based institutional capital seeking to externalise its wealth, financial institutions have steadily gone about leasing space outside the UK to maintain a European presence in the wake of Brexit.

"The significant benefactors so far seem to be Frankfurt, Paris and Dublin," he says.

Kinnear expects the industrial sector, specifically well-located logistics facilities on the fringes of urban areas, to continue to achieve robust rental growth. "The sector will be supported by higher manufacturing demand and structural changes relating to e-commerce. Across the world, customer demand for everfaster delivery is reshaping last-mile delivery."

Stenprop is one JSE-listed property fund that SA fund managers believe could reap the rewards of buoyant growth in the UK industrial property sector.

The company, headed by former South African Paul Arenson, recently announced its intention to become a pure UK-focused industrial play.

That follows a £130.5m acquisition in mid-2017 of a multi-let industrial portfolio comprising 25 properties, as well as UK-based management business C2 Capital.

Until now, Stenprop hasn't been widely held by institutional fund managers - not only because of its relatively small R5bn market cap but because the company also seemingly lacked strategic focus, with assets spread across various sectors and countries, including Germany, Switzerland and the UK. Arenson says the intention now is to sell all Stenprop's non-UK and nonindustrial assets (worth around £655m) over the next few years and invest the proceeds in the UK multi-let industrial sector.

Stanlib listed property investment analyst Lawrence Koikoi says Stenprop's investment case has improved substantially, given management's shift in strategy.

"We favour companies that operate in niche sectors and the rental growth outlook for the UK's industrial sector looks particularly attractive. We like their story and there's no doubt that Stenprop has made the right move from low-growth to high-growth assets," says Koikoi.

He adds that the multi-let industrial sector is highly management intensive, however. Stenprop bought the multi-let industrial assets with a management platform that has a track record. Moreover, Stenprop plans to convert to a UK Reit and move its Bermuda Stock Exchange listing to the London Stock Exchange later this year, which should broaden its investor appeal and increase liquidity.

Koikoi says Stenprop offers good value at a current share price level of around R17, which places the stock on a decent 7.8% dividend yield. Dividend growth is expected to average 4%/year over the next three years, according to Anchor Stockbrokers.

Source: Financial Mail

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