

Offshore investment presents big opportunity for SA REITs

In the second half of 2018, the global sell-off in emerging markets, an intractably weak domestic economy, an oversupply of business space, and a focus on the quality of earnings are all set to be major drivers of the SA REIT sector.



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International investment remains a compelling opportunity for the sector. Over 50% of SA listed property is exposed to offshore markets and this, believes Catalyst Fund Managers' director and portfolio manager Zayd Sulaiman, will provide some cushion should the rand depreciate even further.

Head of research and property at Anchor Stockbrokers Craig Smith reports: "Currency (ZAR) depreciation expectations should result in more demand for offshore property, all things being equal. This could lead to further inward listings on the JSE of offshore-focused platforms, especially those with a proven track record."

Micro issues within the SA REIT sector which derailed its overall performance in the first half of the year are expected to have less impact on the listed property sector's rebased second-half showing, which is likely to be driven by a combination of domestic and international macro developments.

Global monetary policy shift

Bandile Zondo, equity research analyst for real estate at SBG Securities, says: "Global monetary policy shifts in developed markets have sparked a broad sell-off in emerging markets. Developed market central banks are rapidly pulling back post-crisis stimulus leading to a broad acceleration in yields, which has had a negative impact on sector returns."

Sulaiman, points out that global political and economic events - ranging from trade wars and EU stimulus tapering to Italy's debt worries and others - in a rising foreign interest rate environment, don't bode well for emerging markets in the short-term.

In addition, weak domestic macro variables persist. "After the euphoria of the ANC elective conference in December, reality has set in and it has become clear that any economic recovery will take time. We need decent GDP growth to stimulate demand for space and reduce vacancies. This is taking longer than expected," says Sulaiman.

Zondo adds: "In South Africa, the market has arguably discounted a weaker economic growth trajectory since the recent disappointing first-quarter GDP print. This could see any further incremental fallout being a lot more measured. That said, it is clear that near-term news flow will continue to fuel concerns around the trajectory of any economic recovery and keep any optimism about 2019 at bay. While we remain constructive around an expected 2019 recovery based on the consumer recovering, assisted by credit, we would arguably need to see a marked improvement in business confidence near-term."

Local property fundamentals remain weak

Recent sector company results show that local property fundamentals remain weak and companies have to focus on tenant retention, reports Sulaiman.

Smith believes that fundamentals in the property sector should improve following a decrease in speculative development. "The pace of this improvement will be gradual and will largely depend on local GDP growth."

Andrew Konig, CEO of Redefine Properties, confirms this, commenting: "Oversupply and persistently soft property fundamentals coupled with discerning and costly capital make for a challenging period ahead for the REIT sector. Remaining relevant to all stakeholders in this environment is key to emerging the better for it."

Oversupply of space

Sulaiman says the oversupply of space - especially in the office sector - and lack of demand, is a particular pressure point. "It is placing increasing stress on listed property companies to produce growth in dividends, even artificially by paying out once-off profits and non-rental income streams."

This comes at a time when some REITs are facing increased scrutiny into their quality of earnings and governance. Smith holds that the heightened focus on transparency and governance in the sector is likely to continue. "These items are firmly on the agenda of institutional investors and pension funds. Those funds with strong governance and a high level of transparency should be rewarded by the market and in a much stronger position to attract equity capital to support their strategies."