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Opportunity despite bad start

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GROWTH OF R10,000 INVESTED OVER SEVEN YEARS

Graphic: RUBY-GAY MARTIN Source: IRESS

SA listed property has been by far the most successful asset class over the past 15 years.

It has given an average return of 18.9% since 2004, more than double that from both nominal and inflation-linked bonds and ahead of the 16.5% from equities. It has enabled the sector to grow from R20bn to R450bn. And portfolio managers have a substantial choice, from giant diversified businesses such as Growthpoint to highly specialised funds such as Stor-Age and logistics group Equites.

The industry has catered for increased investor demand by moving into other territories, owning a big chunk of the market in Poland and Romania, and more recently Macedonia, Montenegro and Serbia.

Investors had got used to lower pullbacks from property than from equities. But the year began poorly, with a total loss of close to 20% in the three months to March. Property yields looked demanding at about 5.9% relative to 8.2% from the 10-year RSA bond. But the catalyst for the slump turned out to be stock-specific issues around the Resilient group, with its complex web of cross-holdings. It was criticised for including nonrecurring profit, on derivatives and foreign exchange, in its annual profit declaration. And the trauma has caused other property businesses to examine their own income statements. In the long run this should lead to cleaner, simpler results.

SA property used to consist of some small domestic counters and the huge UK-based Liberty International. At the time it made sense to exclude Liberty International from the SA listed property index. Now, the successors to Liberty International, Intu and Capital & Counties, are not the largest property shares on the JSE or even in the top three. It makes no sense to keep them out of the index but treat Nepi Rockcastle or Echo Polska Properties as "domestic" shares.

> "The sector will have a much cleaner benchmark when the more inclusive all property index is introduced

The sector will have a much cleaner benchmark when the more inclusive all property index is introduced, which is also expected to cap the weighting of shares, reducing Growthpoint's "Naspers-style" dominance of the sector.

The industry won't turn around overnight after the Resilient crisis. There has been limited capital raising this year, the largest being R4.5bn from Growthpoint, barely 5% of its market cap. And there are concerns about the concentration of SA property development, particularly in offices. Ten out of 53 recognised nodes account for 92% of development. Sandton alone accounts for 31%.

There has been a spread of returns in the first half. The star managers in the previous years, Metope and Absa, declined by about a quarter. The five managers selected this month did rather better. The more index-focused, low-tracking-error funds, Momentum and Stanlib, shed about 15%, but Coronation, Sesfikile and the Discovery Flexible Property Fund were down about 10%.

Sesfikile's relative success has allowed it to grow into one of the largest BEE managers in SA. It is ideally suited as the property component of a multi-manager portfolio. It does not have the risk profile or Icarus-like approach of high-octane managers such as Liliane Barnard at Metope or Fayyaz Mottiar at Absa, so it should be attractive.

Note that the mandates of the funds are the same with the exception of Discovery Flexible Property. It is run by the same team as the Property Equity Fund under Peter Clark, but it can also invest in shares that do not trade on the JSE. Its main offshore holding is Globalworth, which, like many of the JSE shares, invests in Poland and Romania, but primarily in offices, taking advantage of the outsourcing of Western European back offices eastwards. ●

DISCOVERY FLEXIBLE PROPERTY FUND

	Return %	Rank
6 months	-17.39	16 of 54
1 year	-6.28	13 of 52
3 years*	1.74	12 of 40
5 years*	7.7	8 of 30
7 years*	11.92	10 of 24

*annualised return

Fund size (Rm): 2 495
Total expense ratio (TER): 1.43%

Source: ProfileData Fund Analytics

The fund is run for Discovery by Peter Clark of Investec Asset Management, who took over when Neil Stuart-Findlay emigrated to Australia last year.

Investec has a team of six property specialists, divided between London and Cape Town. There is a Chinese wall between the fund and the Investec Property Fund, run out of Johannesburg. Over the past 10 years, the fund has been in the top three unit trusts, beaten only by Absa Property (which had a poor start to 2018) and the Coronation Industrial Fund.

The Flexible Property Fund has a wider mandate than the usual vanilla SA funds as it can invest across the world and not just on the JSE. It is a supporter of German commercial property group Aroundtown as well as Globalworth (which invests in offices and industrial property in Poland and Romania), giving a different opportunity in a region where SA-based funds are fixated on retail, as well as Unibail-Rodamco-Westfield, which has a huge retail portfolio in Europe, the UK and US.

Though size comes with its own problems, it will be hard for anyone to replicate its footprint. Clark says he can even take advantage of the mandate to buy Intu shares in London and not on the JSE when there has been a pricing mismatch.

He says the fund went into the new year with zero Resilient, based on its premium to NAV at the time, and is holding off until the inquiries are finished. But he does hold Fortress A, which offers fixed dividend growth, as well as Nepi Rockcastle.

Clark says managers have to be at least benchmark-aware in such a narrow sector. The fund owns 15 of the 20 shares in the SA property index and he says there is limited liquidity at the lower levels of the index and of course in those shares outside. He has still been prepared to build a position in the off-benchmark Atlantic Leaf.

The big three make up 46% of this fund and Hyprop is in fourth position. Its most aggressive off-benchmark position is 7.2% in mid-cap Vukile. The 3.6% holding in Attacq also stands out. Clark says the fund benefited from its underweight holding in Fortress B, but missed the recovery in Greenbay, another Resilient share. ●

SESFIKILE BCI PROPERTY FUND

	Return %	Rank
6 months	-16.15	14 of 54
1 year	-3.94	7 of 52
3 years*	4.58	2 of 40
5 years*	10.67	2 of 30
7 years*	-	-

*annualised return

Fund size (Rm): 1 571
Total expense ratio (TER): 1.28%

Source: ProfileData Fund Analytics

This fund is run by a niche property asset manager with about R18bn under management.

There are three portfolio managers: Mohamed Kalla, once an award-winning property analyst at BJM Securities; Evan Jankelowitz, previously part of the pioneering Stanlib; and Kundayi Munzara from the Investec Property team.

The team adopts a "4D approach": passion for direct property, getting stuck in the detail, understanding the drivers of property investment, and taking views on corporate action deals. This is a benchmark-aware fund that aims to beat the listed property index over three to five years.

Its portfolio looks less like a closet tracker than many of its peers. The big three – Growthpoint, Redefine and Nepi Rockcastle – take the top slots, but Vukile is ahead of regular number four Hyprop.

Munzara says Growthpoint's diversity has come through, and it will be able to achieve 6% rental growth. It has turned its largest asset, its half share of the V&A Waterfront, into a much stronger, more relevant destination.

The fund is overweight in some less prominent names, such as Echo Polska Properties, MAS Real Estate, Equites and Arrowhead, as well as Fairvest and Stor-Age. Investec Property Fund is the only other more mainstream fund in the top 10.

Kalla says the fund will look closely at the re-formed Capital & Counties if it splits the Covent Garden and Earl's Court assets. Sesfikile's main UK exposure has been through Hammerson. It strongly opposed the takeover of Intu, which would have diluted the value of some of Hammerson's quality European properties. Intu also has a poor, highly geared balance sheet.

Jankelowitz says it is important that the fund only invests in shares that behave like property counters. The revamped Hospitality – which will soon include the Tsogo Sun casino assets – barely qualifies as a property company.

Munzara says there is limited overlap with the Sesfikile Global Property Fund's universe, other than the JSE-listed UK-headquartered businesses and Investec Australia. The global fund focuses on developed markets, looking at Western not Eastern Europe. The UK makes up just 5% of the benchmark and North America almost two-thirds. It has 48 shares right now. ●

Stanlib Property Income Fund is the largest fund in the sector, with R10bn under management, and the team under Keillen Ndlovu manages a further R10bn for institutional clients and R5bn in offshore property.

With the sector market cap of more than R450bn there is no pressure to cap the fund just yet. But Ndlovu says its size does not force it to act like a closet index manager.

More than 40% of the portfolio is invested in three shares – Growthpoint (17.6%), Nepi Rockcastle (14.1%) and Redefine (10.8%). Yet this is an underweight position against the index. It went into the current crisis overweight in Resilient Group shares, and after taking pain hopes to benefit from some recovery, with a 6.8% weighting to Resilient itself and 4.8% in Fortress B.

Its overweight positions have been in offshore-focused shares like Hammerson and Sirius Real Estate, and specialist businesses such as Stor-Age. Fairvest and Stor-Age were the main contributors to performance in the first quarter. After Nepi Rockcastle, its largest pure offshore exposure is MAS Real Estate (2.4%). There is an eclectic selection in its top holdings, including sector ugly duckling SA Corporate (4.5%), the low-key Investec Property Fund (3.5%) and the increasingly popular Vukile (3.2%).

Ndlovu says there is a focus on income as long as the opportunity works on a risk-adjusted basis. When it comes to high-quality retail funds, Ndlovu is betting on Hyprop (8.9%) over Stanlib's sister compa-

STANLIB PROPERTY INCOME FUND

	Return %	Rank
6 months	-24.58	51 of 54
1 year	-14.95	49 of 52
3 years*	-0.96	34 of 40
5 years*	5.92	28 of 30
7 years*	10.57	21 of 24

*annualised return

Fund size (Rm): 10 456
Total expense ratio (TER): 1.48%

Source: ProfileData Fund Analytics

ny Liberty Two Degrees, which doesn't even make the top 10.

Ndlovu will take a look at Capital & Counties if it splits between a residential share centred on Earl's Court in West London, and a retail share consisting of the Covent Garden estate.

He says the market has normalised over the past year, with SA shares now rarely trading at a premium to NAV (as Resilient once did) and UK shares trading at a discount of 30% or even 50% to NAV. He says property as an asset class now has yields closer to bonds, with the bonus that it has considerable built-in inflation protection.

Across the sector on the JSE there is expected to be distribution growth of 6% over the next 12 months. Ndlovu says the fund offers a balance between defensive SA property exposure and strong offshore distribution growth exposure. Strong physical property fundamentals underpin both parts of the fund. ●

MOMENTUM REAL GROWTH PROPERTY FUND

	Return %	Rank
6 months	-22.19	46 of 54
1 year	-10.51	35 of 52
3 years*	0.96	23 of 40
5 years*	6.9	18 of 30
7 years*	11.34	15 of 24

*annualised return

Fund size (Rm): 1 978
Total expense ratio (TER): 1.43%

Source: ProfileData Fund Analytics

It is hard to know which Momentum funds will be preserved now it has gone the multimanager route. But the official word is that this one has a long-term future.

Fund manager Nesi Chetty is one of the few remaining members of the old RMB Asset Management team still in the organisation. Momentum refused to sell its listed property manager to boutique managers hoping to get into the sector, even though it had attractive offers.

> "The fund focuses on shares trading below their long-term intrinsic value

Chetty's number two is Pelo Manyeneng and the team recently added Madibana Letsoalo, a quantity surveyor who worked at commercial broker JLL.

The team manages R7bn, of which R2.4bn is in unit trusts. Chetty says the forward yields of property stocks are attractive in a sector with gearing of just 36%. Fund managers can take their chances with anything from MAS Real Estate on 5.3% to Rebosis on 17.3%. The average is nudging 10%.

Chetty says the aim is to provide sustainable risk-adjusted returns over the investment horizon. The fund focuses on shares trading below their long-term intrinsic value. That can't have been easy in listed property, a hyped asset class for years.

No less than 83% of the portfolio is in the top 10, which includes four Resilient group shares: Resilient itself, Nepi Rockcastle and Fortress A and B.

MAS Real Estate and Sirius Real Estate are the two most substantial overweights, alongside domestically focused Octodec. There is a close to full allocation to Growthpoint (22.4%) and Redefine (16%), but it does nothing to hide the fact that it is a low tracking-error fund.

Chetty says the outlook for property is better than it was a year ago. He expects a total return for the fund and the sector of 14%-15%. To maximise this he has minimised exposure to what he calls the weakest sector, offices, which is just 10% of the fund. It has 25% offshore and 45% on local retail, and 15% in industrial and storage.

The fund has been building an overweight position in both Fortress A and B, as Chetty believes Fortress has the strongest industrial portfolio in the sector, a strong development pipeline and low vacancies. ●

One of the oldest funds in the sector and now run by Anton de Goede and Kanyane Matlou, this fund got through the traumatic first quarter comparatively well, losing 12.7% when the benchmark was down 19.6%.

CORONATION PROPERTY EQUITY FUND

	Return %	Rank
6 months	-14.86	11 of 54
1 year	-4.69	10 of 52
3 years*	2.08	6 of 40
5 years*	7.69	9 of 30
7 years*	12.5	4 of 24

*annualised return

Fund size (Rm): 2 089
Total expense ratio (TER): 1.43%

Source: ProfileData Fund Analytics

The fund remains fully invested in property, with less than 1% in cash, and it holds 30 of the 50 shares in its universe. Many of the shares outside the Resilient stable held steady. The fund did not hold Resilient in its top 10, and within the stable it only held Nepi Rockcastle (10.7%), and Fortress A (4.1%) and B (2.1%). It has relatively large positions in Attacq (5.8%) and Investec Property Fund (4.2%). It has a slight preference for Redefine (14.6%) over sector giant Growthpoint (13.4%), as Redefine has a 1.5% additional yield. In line with most of its peers, it has Hyprop (6.9%) in fourth place.

De Goede says it has been a stockpicker's market, with returns varying from a negative 50% for Fortress B to a positive 20% for Emira. But investors should expect muted growth from the sector, as rental growth is low.

There are few pure SA shares. One of the closest is SA Corporate, in which the fund has a 4.1% holding. The share has a large residential portfolio, which adds to its defensiveness. Though UK-focused Intu, Hammerson and Capital & Counties look cheap, De Goede says there is still too much risk in the Brexit-driven environment.

The team also looks at international property shares for multi-asset funds such as Coronation Global Managed, but the trust deed of the Property Equity Fund restricts it to JSE-listed shares. Within these, investments stretch from Australia to Serbia to Spain, with a chunk in Poland and Romania. De Goede likes Vukile's exposure to Spain – one of the more promising economies. ●