Concern raised about future profitability of property stocks

BY JOAN MULLER, NOVEMBER 29 2013, 08:24

Picture: THINKSTOCK

DESPITE weaker retail sales, still-high consumer debt levels and a whopping 7-million square metres of new shopping centre space — equivalent to around 47 Sandton Cities — being built since 1996, developers continue to add new malls across urban and rural South Africa.

That raises questions about the future profitability of property stocks that are overweight in retail, traditionally the best performing sector of the commercial property market. The scramble among listed property funds to bulk up with larger malls that dominate their catchment areas has already seen the R260bn listed property sector's exposure to regional malls exceeding 30,000m² double since 2010.

Figures from Macquarie Research show that three years ago only 30%-35% of regional malls were owned or part-owned by listed funds. This has increased to between 55%-60%. That means retail now represent 51% of the sector's assets, with offices at 31% and industrial at 18%.

The listed funds with the largest exposure to regional malls exceeding 55,000m² are Hyprop Investments, followed by Redefine Properties/Fountainhead, Resilient Property Income Fund, Acucap Properties/Sycom Property Fund, Rebosis Property Fund, Growthpoint Properties, Attacq and Emira Property Fund.

Macquarie property analyst Leon Allison said there was no doubt the returns generated by mall owners will be negatively affected in the next few years unless there is a slowdown in the pace of new development.

However, some funds are better placed than others to maintain earnings growth in a challenging retail environment. Mr Allison singled out Hyprop, Resilient and Romanian-focused rand-hedge play New Europe Property Investments (Nepi) as the retail-focused stocks that would offer the best returns over the next three years.

Hyprop, whose assets including Canal Walk in Cape Town, Clearwater Mall on the West Rand and the Rosebank Mall in Johannesburg, may seem expensive at a forward yield of 6.4% versus the sector's 7.3%. However, Mr Allison maintained that the premium is justified given the fund's consistent outperformance in terms of rental growth.

"Hyprop is an established fund with good scale. It has sold some of its noncore assets such as hotels and offices in recent years, and is diversifying its retail portfolio into the rest of Africa through its tie-up with Atterbury Africa and its recent acquisition of an 87% stake in African Land Investments," he said.

"We believe it is well positioned to maintain higher growth at lower risk through the cycle."

Resilient, one of South Africa’s largest owners of dominant shopping centres in non-metropolitan areas such as Polokwane, Tzaneen, Secunda and Brits, is the only one of the larger, established funds to give income growth guidance above 10% (12%-16%) for 2014, said Mr Allison.

The stock has recorded average annual dividend growth of 13.6% in the 10 years since listing versus the sector’s 8.5%. Resilient is also expanding its portfolio to Nigeria and has stakes in offshore-focused counters Nepi and Rockcastle.

Nepi, which earns its income in euros, recently expanded its Romanian portfolio to Slovakia and is also looking to enter Bulgaria and Serbia. "We believe Romania and Bulgaria are attractive markets given that these countries have among the highest rental yields, GDP (gross domestic product) and retail sales growth rates in Europe."

Mr Allison says Redefine, which recently acquired a majority stake in Fountainhead, also deserves a second glance as it offers a cheaper entry point to regional malls than its blue chip counterparts.

For investors with a somewhat higher appetite for risk, Rebosis is likely to outperform over the next two years.

"Though the share price has risen strongly in recent weeks, the stock still offers an above-average forward yield of 8%."

Rebosis owns the Hemingways Mall and Mdantsane Mall in East London, and the Bloed Street Mall and Sunnyside Shopping Centre in Pretoria.