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Listed property eyes bounce despite rate rise threat

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THE listed property sector should be able to perform better next year than it did this year, even with the threat of interest rates rising.

Raising interest rates would place downward pressure on property share prices but more economic growth may allow the opportunity for better business, according to Growthpoint executive director and this year's South African Property Owners Association (Sapoa) head, Estienne de Klerk. "We only see interest rates being increased in small increments and we can manage that.

"Yes, rising interest rates would affect our industry but we live with rate increases and falls. They are a part of the economy and we hedge for them using interest-rate derivatives and other tools," Mr de Klerk said.

"It is difficult to predict exactly what rates will do and when, but economists are telling us to expect rates to rise," he said.

The repo rate, which is the rate at which the Reserve Bank lends to other banks, is 5%.

It affects the prime lending rate from banks to consumers, which is 8.5%. The commercial interest rates are based on the prime rate. Property companies often borrow large sums for developments. Because of the low repo rate, interest rates in SA are at their lowest in about 40 years. However, stronger growth in the economy, spurred by an improved global environment, would give the Reserve Bank scope to raise interest rates late next year, according to analysts.

Given that investors typically view listed property as an interest-bearing investment, comparable to bonds and preference shares, rising interest rates usually result in falling capital values of listed property counters.

An interest-rate derivative is a derivative where the underlying asset is the right to pay or receive a notional amount of money at a given interest rate. This means property companies can borrow money at a set interest rate which will not change even if interest rates change in the future.

Emira CEO James Templeton said some companies' income payouts would be hurt by interest rates going up but there were cushioning effects for the property sector if rates did rise.

"Rising interest rates could also have a negative impact on the income paid out by listed funds if they fund their business with debt and they haven't fixed the cost of their debt out through interest rate derivatives.

"Ironically ... interest rates typically rise when the economic outlook is expected to be more buoyant, which will have a cushioning effect for listed property counters, as better economic times bode well for property fundamentals, where rentals are rising due to improved tenant demand," he said.

Short-term asset finance lender Paragon CEO Gary Palmer said he was concerned that banks which chose lending rates for small property businesses were not lending at low rates. "Rates may be low but actual rates that customers see are not. So, if the Reserve Bank raises rates next year, banks are only going to lend with bigger premiums attached," he said.