Joan Muller | 05 September 2013

**Image by:** Russell Roberts

**The better-than-expected 8,7% average growth in income payouts achieved by listed property companies which reported June results last month should provide some relief to investors who have been hit by a 20% knock in share prices since May 20.**

Around R17bn of the listed property sector's value has been wiped out over the past 3½ months on the back of a weaker rand and rising bond yields, which have a strong correlation with property yields.

Though there were no big surprises in the results, all the funds with June reporting periods either met or exceeded their distribution growth guidance. Most also managed to reduce vacancies (offices, in particular). That suggests property portfolios are generally in good shape despite a lacklustre economy.

"Though property share prices may still drift lower on lingering concern about the prospects of rising US and SA bond yields, the fact that property companies met their distribution guidance is positive for the sector," says Nesi Chetty, head of property at Momentum Asset Management.

Top performers in income growth were office-focused Vunani Property Investment Fund with an impressive 19,7%, Romanian rand-hedge play New Europe Property Investments (Nepi), with 15%, and rural and township mall owner Resilient Property Income Fund, with 12,8%.

Emira Property Fund was at the bottom of the pile with distribution growth of 3,5%. However, this was a marked turnaround on the 2,5% decline in distributions previously reported by Emira for the year to June 2012.

Funds that surprised on the upside in the performance of their underlying portfolios include blue chips Hyprop Investments and Resilient, as well as perennial underperformer SA Corporate Real Estate Fund, which looks like it is finally starting to turn around under new CE Rory Mackey.

Both Hyprop and Resilient own a large portfolio of regional shopping centres: Hyprop's malls are located in the big cities and cater predominantly to higher-income shoppers; Resilient is a dominant player in the rural and township retail property market with a bias towards lower-income consumers.

Chetty says it is encouraging that Hyprop achieved distribution growth of 7,6% despite the dilution suffered from the R932m redevelopment of Rosebank Mall in Johannesburg. The construction of the mall and planned vacancies resulted in a loss of R16m in potential income for Hyprop's bottom line for the six months to June. "Had it not been for the dilution, distribution growth would have been closer to 9,5%."

A recurring theme in results presentations is that the sharp drop in property share prices is making it difficult to grow portfolios with yield-enhancing acquisitions. Norbert Sasse, CE of sector heavyweight Growthpoint, says the company is now sitting on a cash pile of close to R2bn on its balance sheet. Though Sasse is pursuing various acquisition opportunities, he says they are battling to find value as acquisitions that would have made sense at yields of 6%-7% in early May, before share prices crashed, are no longer attractive. Says Sasse: "It will probably take 6-12 months for sellers to start adjusting their asking prices downwards in line with the drop in listed share prices."

Analysts say though property stocks are looking a lot cheaper than in early May - now trading at a forward yield of around 7,7% versus 6,2% - the sector still appears overpriced relative to bonds. Sesfikile Capital director Mohamed Kalla says he won't be surprised if property share prices weaken further in coming weeks. "According to our estimates, listed property share prices will have to drop by another 6% to move back in line with long-term bond yield levels."

However, Kalla says there is no doubt that the sector is starting to offer pockets of value. His top picks include Resilient, with its dominant retail focus and strong balance sheet; Dipula Income Fund (B units), which recently made good acquisitions in the township retail segment; Ascension Properties (A units), which owns mostly government-tenanted offices; and Redefine Properties, the sector's second-largest counter.

"At a forward yield of around 6,5%, Resilient is now looking cheaper than it has in a long time. We are particularly impressed with management's forecast distribution growth of 12%-16%, significantly ahead of the sector's average 8%."

Kalla says the fall in Dipula's share price since the recent capital raising has placed the stock on an attractive 10% forward yield while Redefine, which has been out of favour with investors over the past 12 months, is also starting to offer value at a forward yield of just more than 8%. "Redefine is the only large-cap stock offering yields at these levels."

Kalla singles out Ascension A as a good choice for investors with a low-risk appetite. "The stock offers a forward yield of 9,2% and virtually guaranteed growth of 5%/year."