STANLIB Multi-Manager

Property Fund

A trip down memory lane

There is a vast array of investment managers offering products in the property sector. As a multi-manager we research these managers to get an in depth understanding of their investment philosophy and to assess whether they are able to deliver alpha. We then blend managers to create a fund that is well-diversified and capable of delivering on expectations.

The STANLIB Multi-Manager Property Fund has a proven track record, displaying the effectiveness of its strategy, and is ranked number one among peers over 15 years

The property market - the ups and downs

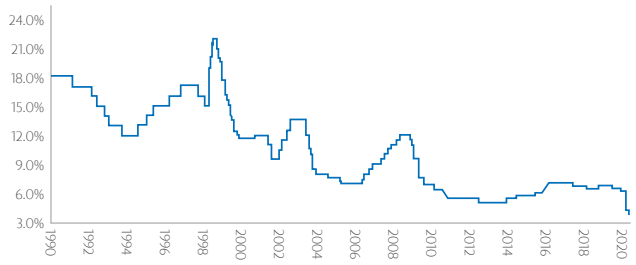
A few years ago the property sector was the darling of the JSE, attracting investors by offering high income and capital growth. At its peak the value of the sector was more than R600 billion. However, declining GDP growth in South Africa, Brexit and more recently, the COVID-19 pandemic, have placed pressure on property, with its market cap dropping to current levels of around R220 billion. Although there are structural shifts in the market and an uncertain outlook is being priced in, there are property companies with well-diversified portfolios and the ability to strengthen their balance sheets in order to weather this storm.

Property market – looking back 15 years

Over the past 15 years, SA-listed property companies had little exposure to offshore assets. As domestic growth opportunities reduced, companies expanded their horizons into offshore markets and, as the sector grew locally, foreign companies with no exposure to SA assets, listed on the JSE. According to the latest calculations by STANLIB, one of our specialist property managers, this resulted in the foreign exposure of SA-listed property company assets growing to around 45%. In order to make acquisitions offshore, companies issued new shares and increased debt levels. Despite this, balance sheets still looked good and raising capital did not prove an issue due to the ample demand from investors. These changes resulted in a more globally diverse sector with regards assets, revenue and growth.

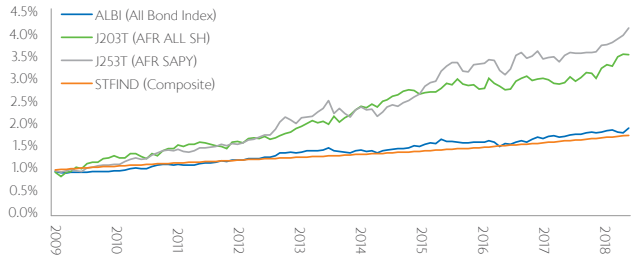
Listed property became attractive In the mid 2000s with the structural shift to a lower interest rate environment in SA (refer figure 1). The dividend yields of the listed property sector offered a compelling alternative to the fixed income sector. From the start of the Global Financial Crisis (GFC) in 2009 to the end of 2017, the SA Listed Property Index (SAPY) returned 17.3% per annum outpacing all local asset classes (refer figure 2).

Figure 1: SA Repo rate



Source: STANLIB, SARB

Figure 2: Cumulative returns of SA asset classes



Source: I-Net

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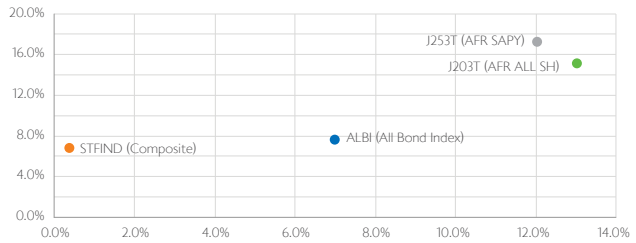
These stellar returns came to an end in 2018, triggered by the Resilient Group's scandal around share price manipulation and corporate governance issues. After the news broke investors carried out more in-depth analyses of the sector, uncovering material issues such as companies issuing capital to fund capex and entering into cross currency swaps to make acquisitions. Furthermore, Brexit sent the UK property market into a sell-off as a result of the uncertainty, resulting in the declining earnings of the sector.

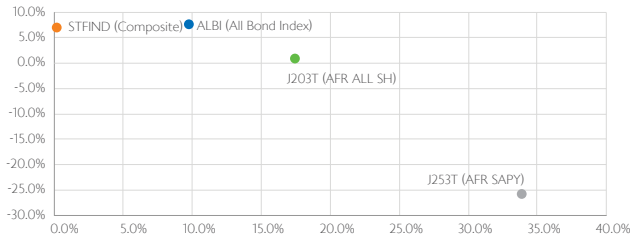
As the market changed, balance sheets became stretched and Net Asset Value (NAV) write-downs followed. As income growth turned negative, cash flow and dividends came under pressure and the sell-off in the sector continued. The sector went from being the best performing asset class since the GFC to 2017, to being the worst performer from 2018 to date (refer figures 3 and 4), with a considerable amount of volatility.

Figure 3: Asset class risk return (2009 – 2017)



Source: STANLIB Multi-Manager, I-Net

Figure 4: Asset class risk return (2018 – 2020)



Source: STANLIB Multi-Manager, I-Net

In times like these, a multi-managed strategy can add value. As part of our ongoing manager review, we adjusted our fund by replacing one of the underlying managers that had a focus on high-yielding companies in terms of their portfolio construction, with a manager that has a bottom-up, fundamental valuation approach that was better suited for current market conditions. In doing so, we maintained our outperformance relative to the benchmark.

A perfect storm compounded by COVID 19

Just as the market was coming to grips with the issues relating to the sector, it faced a further blow this year as the COVID-19 pandemic swept across the globe. Countries throughout the world went into lockdowns and businesses were shuttered. This was a major setback for the property sector in SA where the main exposures are the retail and office sub-sectors. With businesses closing, companies had to offer concessions and rental deferrals.

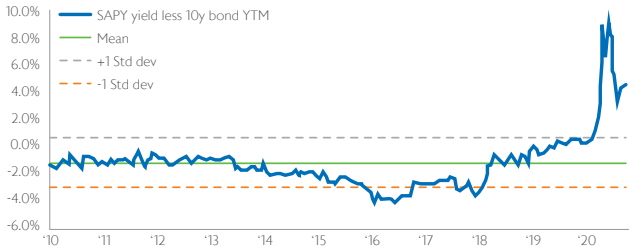
Companies reacted to the pandemic by strengthening their balance sheets. This is being done by selling non-core assets and withholding dividends. They also focused on rental collection and partnering with tenants to establish workable solutions. In addition, companies are applying more stringent capitalisation rates and writing down assets to realistic levels. On the investor side there was also a shift in valuation metrics for property companies. Historically dividends played a major role in establishing the value of property companies and since 2017, other metrics including NAV analysis and Discount Cash Flow (DCF) models became a more prominent part of the valuation toolset.

Future returns – coming from a low base

With the property market losing almost half of its value in 2020, questions have been raised about future returns. In their bear case scenario, one of our specialist property managers, *Catalyst Fund Managers*, expects a return of 19.5% p.a. over the next four years. This is made up of income and capital growth, as well as an expected re-rating of the sector.

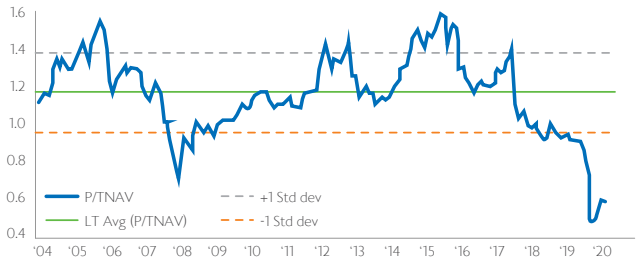
Listed property is currently trading at approximately 50% to NAV (refer figure 6) and while some companies are at risk of serious financial trouble, there are some that have balance sheets to weather the storm. When compared to bond yields (refer figure 5) the sector is looking attractive relative to its history. While there is an expected drop-off in dividends in the short term, dividend payments will start to normalise once we are through the pandemic and there is more clarity in the market. *Sesfikile Capital*, another one of our specialist property managers, is expecting an initial income yield of 9.1%.

Figure 5: Property DY vs SA 10y bond



Source: Sesfikile Capital

Figure 6: Property Price to NAV



Source: Sesfikile Capital

What lies ahead?

The COVID-19 pandemic has resulted in an acceleration in some structural shifts in the property market. Globally there is an increase in "work from home" policies and while this is expected to result in a lower demand for offices, it will be a more gradual change over several years. Consumers have increased their use of online shopping, resulting in a decline in footfall at retail shopping centres. Although retail activity is picking up as lockdowns are eased, the online shopping trend is expected to gain momentum with the beneficiaries of the downturn in retail being the storage and logistics sub-sectors.

Investors need to remain vigilant on property. While expected returns appear attractive, some property companies are at risk of failure. This is exacerbated by a weak SA economy and the lack of structural reforms that are desperately needed.

The STANLIB Multi-Manager blend of underlying managers has positioned the Fund with a quality bias and an underweight to high risk companies offering a diversified exposure to property. Our managers are constantly updating their models with the latest information and generating conviction in their stock picks. They are looking past the current crisis and taking a five-year view on the market with a portfolio of companies that have strong balance sheets capable of weathering the storm that the property market is facing.

Nadeem Hoosen
STANLIB Multi-Manager: Portfolio Manager
Nadeem.Hoosen@stanlib.com
www.stanlibmultimanager.com