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OPINION

BOTTOM LINE

CHRIS REDDY: SA key for Reit success, but how will fundamentals play out?

Real estate investment trusts are the best performing asset class on the JSE this year

BL PREMIUM

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by CHRIS REDDY

Picture: UNSPL/

It is often said the most important factors when investing in real estate are “location, location, location”! Over the past three months, it has become quite clear that SA is an essential location. Whether this remains the case will depend on fundamentals.

SA real estate investment trusts (Reits) are the best-performing asset class on the JSE in 2024 with a year-to-date total return (at end-August) of 24%. This is almost double the return of the next best asset class, being bonds at 12%, followed by equities (11%) and cash at 6%. Within this performance, the best-performing shares were mainly SA-focused companies such as Fortress, Resilient, Attacq, Fairvest and Redefine.

The sector has come a long way from Covid lockdowns, work-from-home, protests in KwaZulu-Natal, severe load-shedding, and historically high interest rates. We have gone almost 170 days without load-shedding, which has lifted consumer and business confidence and is expected to boost GDP.

Looking ahead, there are several key tailwinds that should support the fundamentals driving SA Reits. These include:

- Greater political certainty and impetus for structural reform that SA has so desperately needed over the past decade, coupled with infrastructure funding to fix our ailing ports and rail networks;
- Improving SA’s operational metrics of lower vacancies, positive rent reversions in retail and industrial sectors, and a declining rate of negative reversions in office, along with improving trading densities and some offset of electricity and water costs given the push for renewable solutions;
- Reduced load-shedding, which will support sentiment and growth as mentioned above;
- Positive monetary outlook, with interest rates globally likely to be reduced starting next week;
- Two-pot pension reform, which will drive turnover growth in retail-focused Reits.

Another factor that could support the sector is a continuation in the rerating of SA bonds. We have seen locals and foreigners buying SA bonds since the elections, which has driven yields from 12.5% down to 10.4%. Should bond yields continue to fall, it will be a further tailwind to the sector. The SA 10-year government bond yield before Covid was mid-9%, for example.

We are seeing the return of capital raises as some management teams are able to tap capital markets at relatively attractive equity and bond yields. Investors will be keeping a watchful eye on the uses of proceeds to ensure they are spent on accretive opportunities.

We believe the next move higher will need to be driven by improving earnings growth, which will justify the rerating that we have seen across the sector. There is some evidence of this occurring, for example, in Attacq, which recently reported results and guided for distributable income per share growth of 17%-20% for the 2025 financial year, though this is mainly due to a deal done with the Government Employees Pension Fund that significantly reduced interest costs.

Apart from a step-up in demand for space, the next driver is likely to be rate cuts, which will filter into higher earnings once interest rate hedges roll off. This is likely to happen only in the next 12-18 months.

We are still finding attractive investment opportunities in the small- to mid-cap space, some of which are not included in the property benchmarks, which tend to place them off the radar of many larger funds.

Our top picks at present are Dipula Income Fund and Spear Reit. Both are run by experienced management teams that have shown excellent asset management skills in recycling assets in the portfolio and both are only domestic-focused strategies, which have proved to be defensive in the post-Covid era.

The sector trades at a forward dividend yield of 8.2% and a 15% discount to net asset value, which seems to imply that the easy money has been made as general equity and balanced fund managers added property exposure and reduced their underweights.

We will get a sense of how much more buying could be expected in upcoming surveys. We are yet to see the return of foreign investors in the sector except for some buying in liquid names such as Growthpoint. Once the buying slows down it will be a true test of fundamentals moving the market on the next leg.

While we are still positive about the sector in the medium to long term, we are cautious in the near term given the rapid rerating that has occurred as investors front-loaded the future catalysts.

As I close, I would like to leave you with one of my favourite quotes by Howard Marks: "It is not what you buy, it is what you pay. And success in investing does not come from buying good things, but from buying things well. And if you do not know the difference, you are in the wrong business."

• Reddy is an analyst and portfolio manager at All Weather Capital

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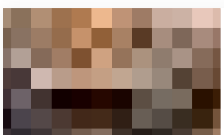

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