INTUITION

12 NOVEMBER 2021

A Year from the Bottom

The J253 is the ticker symbol for the JSE Listed Property Index. The index bottomed at 206.6 points at the end of October 2020 after peaking at 694.6 on the 29th of December 2017. This was almost a 70% decline over the 3 years from the peak. The initial decline was led by concerns around oversupply, muted GDP growth, and excessive balance sheet debt by SA commercial property companies. As asset managers, we had sought to mitigate this risk by purchasing companies that had significant operations beyond the borders of South Africa – in countries such as Romania, Poland, Germany, Australia, Spain, and the UK. These efforts were cruelly thwarted by the Covid-19 virus lockdowns that started in China but spread quickly to Europe and the rest of the globe. This proved to be an existential threat to property investors globally. The Pandemic is still not over but we are one year on from the nadir of the property index collapse. We explore our rationale and behaviour through the crisis.

Robin Gibson

Property has always been a big part of how Harvard House generates income separate from being reliant on capital growth. The benefits of property have always been the higher than average yield together with a growing income and consequently the prospect of capital growth over time. For Harvard House, these characteristics tick all the boxes of an investment for a retiree who is going to require an inflation-adjusted income over a 20-year (or longer) time horizon.

Of course, investing in property has never been without risk. Some risks are very obvious, others less so. Commercial property is no different from residential property in the sense that it's all about location, location, location. All things being equal from a location point of view, commercial property has other characteristics, like specifics of use – warehousing, logistics, office, retail, industrial and then some of the newer aspects such as cell towers, storage, student residential, data centres and in places like the US even prisons. Each has its very own economic profile and risk associated with them.

Commercial property also faces interest rate risk. Since yields on commercial property are largely driven by the supply and demand characteristics of the tenants they seek, the price of the property is the only way to adjust an entry yield to be in line with other income-producing assets such as Bonds, Money Market and Preference Shares. This was particularly evidenced in the late '90s when the prime rate rose above 20% which relegated property to be the most unloved asset class among investors. While our listed property sector did not exist to any great degree at that stage (most of the commercial property was held by pension funds directly or via property syndications financed with participation bonds), those who held their heads through that time despite the grave outlook have been richly rewarded.

I have a family link via marriage to a gentleman who grew exceptionally wealthy in the furniture retail business along with Jonathan Beare (South Africa's most reclusive billionaire, founder of Beare stores and the money behind

SPEED READ

- **The J253 has risen to 330 points over the last 12 months. This represents a recovery of 60% from the low. Many companies have improved their balance sheet positions and are resuming dividend payments.**
- **The Work-From-Home (WFH) phenomenon, while here to stay, is not the panacea to all ills and many firms are returning to the office on a 2 to 3 days a week basis. The property sector is not as dead as many suspected.**
- **Investors are prone to panic in chaotic events, but a good asset manager will manage his fear with facts and sober assessment. While by no means have the effects been benign for investors, patience has certainly been rewarded especially relative to the alternatives.**

Aspen's early success, and who is also reputed to be the biggest owner of physical property in SA). When he retired he started to invest in commercial property in Botswana and Namibia. At a family function, he commented to me, "I wish I had never wasted all that time with retail and just went into property right in the very beginning!" However, I digress.

Listed Property took severe strain under an excess of supply, aggressive financing options and declining GDP growth. The sector as a whole drifted off from its 2017 year-end high and accelerated after allegations of impropriety in the Resilient Group, one of South Africa's flagship operations (later dismissed as false news). Then Covid hit and governments responded by introducing strict lockdowns. The double whammy of potentially having bankrupt tenants and no foot traffic burst any optimism regarding commercial property as an asset class. Prices tumbled and the decline accelerated as firms pivoted to work from home (WFH). What started as a small trend grew exponentially. Location was now completely irrelevant (and ironically in many cases a hindrance – think V&A Waterfront as a prime example). Even areas that had very high GDP growth and were expanding aggressively were not spared. Dividends ceased as rentals dried up and property became the pariah of the investment markets. This of course is all history that we are familiar with. Initially, the local property index (J253) bottomed in early April and then staged a small recovery, but as the European second wave started to emerge a second vicious plunge plumbed a new depth at the end of October 2020, followed by a glorious relief rally as Johnson & Johnson announced their vaccine breakthrough in early November.

> "Much like jumping off a fast-moving train, this would have implications for them for the rest of their lives."

Mortified by the evaporation of value within their portfolios many investors reacted with panic. In some cases, we could not convince investors that they were taking destructive action by crystallizing losses and moving into asset classes that were not likely to compare in recovery in the years ahead. Much like jumping off a fast-moving train, this would have implications for them for the rest of their lives. From 31 October 2020 to 31 December 2020, the J253 Index recovered by 32%. Year to date (to the end of October 2021) the index is up a further 16%. Money Markets on the other hand have averaged 3.5% this year and Income Funds are slightly better at 6.5%. Clients who fled to the safety of cash and income funds have destroyed their chances of recovery. Sadly we have also experienced external advisers preying off clients fears and concerns, to the client's detriment. One such example follows.

We have managed the portfolio of a retired couple who moved up from the Coast to Hilton and subsequently for the widow after the husband died. Now in her nineties, the widow lives in a retirement home in Johannesburg and is cared for by her daughters. As time has progressed and the client has become frailer, I have dealt with the daughter more frequently, yet she is not a client. After Covid hit and the lockdown was implemented she phoned me concerned about her Mom's portfolio which held substantial property

Cape Town continues to have some of the best property assets in the country.

to meet a demanding income requirement. (This initial call was during April 2020). I advised that acting amid a pandemic was unwise and the best advice was to be patient. She countered, commenting that her own adviser had contacted them and switched everything out of the market, and why had we not done the same? It took me some time to demonstrate to her that her adviser had not protected her from the crisis but had acted post events and in so doing, had created a perception of pro-activity, but which was not necessarily in her best interests. We had multiple conversations during which it was very clear that the alternative adviser was casting doubt on a "be patient and wait" strategy. Eventually, she could not be convinced and sold out a good portion of the portfolio in October and moved it to the new adviser to be invested in a low-risk income fund. The table above reflects the shares sold, the actual price of the transaction, and the subsequent events.

"Those who took our repeated calls to not abandon their property-filled portfolios have been rewarded"

The Cost of Injudicious Decisions

Share	26 Oct 2020 Sale Price (c)	31 Oct 2021 Closing Price (c)	Price Change	Income paid since sale (c)	Yield on Sale Price	Forecast next full year dividend (c)	Yield on Sale Price	Weight of Value Sold
Hammerson	415.8	670.0	61.1%	0	0.00%	30.5	7.34%	8.0%
Fortress A	1,289.6	1,330.0	3.1%	74.7	5.79%	126.3	9.79%	12.0%
Growthpoint	1,175.0	1,296.0	10.3%	118.5	10.08%	138.1	11.75%	22.0%
Redefine	227.1	450.0	98.2%	0	0.00%	45	19.82%	9.0%
Resilient	3,469.2	5,600.0	61.4%	428.8	12.36%	452.3	13.04%	0.5%
Storage	1,210.9	1,397.0	15.4%	54.1	4.47%	112	9.25%	19.0%
Vukile	535.3	1,215.0	127.0%	101	18.87%	97.9	18.29%	11.0%
NepiRocastle	6,847.6	10,240.0	49.5%	0	0.00%	654.7	9.56%	18.0%
Total Value in Rands	**1,065,731**	**1,518,980**	**42.5%**	**63,722**	**5.98%**	**124,859**	**11.72%**	**100.0%**

The actual position of the client's share sales one year on. The lost opportunity in income, but more importantly price recovery, is substantial.

It may be helpful to talk through one example in the table for complete understanding. Let us take Growthpoint as our example – shown in Line 3. The client sold out at 1175 cents per share on the 26th of October 2020. The share price closed at 1296 cents per share at the end of last month, a recovery of 10.3% over the year. (Columns 2,3 & 4 illustrate this). During the period Oct 2020 to Oct 2021, the client would have banked 118.5 cents in income for every share they held (Column 5). This is the same as earning 10.08% interest on the proceeds of the shares that were sold on 26th October 2020 (Column 6). However, a number of the shares have not paid full dividends or passed on paying them completely to repair or bolster their balance sheets so we reflect the expected dividend payment in the next full financial year (Column 7) - in Growthpoint's case 138.1 cents per share. We then calculate what this full year's payment would be compared to interest earned from the proceeds of the share sale in October 2020 (Column 8).

The point here is that the client - in following the poor advice offered - sold assets at the bottom of the crisis to seek security in a money market or fixed-income portfolio returning on average 3.5% to 6.5% over a full year. On Growthpoint alone the 12-month return is 20% (10% income, 10% capital change). Vukile was 140% (18.9% income, 127% capital change).

While we in no way minimize the destruction caused by Covid on property portfolios and the stream of dividends paid, we trust this example illustrates that those who took our repeated calls to not abandon their property-filled portfolios have been rewarded relative to pursuing a flight to safety approach. There is much to happen in the property sector in the coming months, but management teams have acted quickly to settle debt and secure their balance sheets and we expect dividend payments to resume for a large portion of the sector in the coming months. This continued recovery is also likely to underpin share prices. At Harvard House, we continue to believe that property represents a valuable asset class in building retirement income portfolios. This pandemic has tested the notion, but on the whole, it has weathered the storm better than feared.

Now that we have moved back to Level 1, we are delighted to once again be able to host clients at our Insight Seminars. We will hold our next seminar in December, which will focus on the outlook for 2022 amd the key themes that we expect to unfold. For those based in the Midlands, please note the change of venue. The presentation will be followed by drinks and snacks. Seating is limited and subject to regulation, so please ensure that you book.
.

[Harvard House is on Facebook](#)

[Harvard House is on YouTube](#)

Topic: **2022: a brighter year?**

Natal Midlands	
Date:	2nd of December
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	13th January 2022
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

CONTACT DETAILS:

For more information on the range of products and services offered by Harvard House Investment Management and its associated companies (including Harvard House, Chartered Accountants), or for any financial advice, please contact the Company at:

HARVARD HOUSE GROUP

3 Harvard Street, Howick, 3290, South Africa

P.O. Box 235, Howick, 3290, South Africa

+27 (0) 33 330 2164

+27 (0) 33 330 2617

@ admin@hhgroup.co.za

W www.hhgroup.co.za