

Property: Reviewing Results

With the property sector still reeling from the impact of the pandemic and the continuous change in trading conditions - whether it be retail, office, residential or industrial - we analyze the latest sets of results from the stalwart of the South African property industry to understand the actual impact it is having on distributions and the outlook going forward.



**Roy
Lamb**

Having endured a year unlike any other, results for the 6-month period to end December 2020 for the property sector were always going to be one of brutal declines to income distributions as landlords tried to retain occupancies by throwing a life-line to tenants in the form of reduced or deferred rentals. We review the results from the bell-weather of listed property in South Africa to get an indication

of what turnaround might lie ahead and to what degree the landscape has changed within the varying sub-sectors (retail, office, industrial, and residential).

SA's behemoth of the property sector, Growthpoint (with its portfolio value split 60% in SA and 40% overseas, and its earnings split 75% in SA and 25% overseas), published interim results which showed distributable earnings per

GROWTHPOINT DIVIDEND YIELD



Apart from the spike caused by all the upheaval over the past 12 months, Growthpoint is trading at the highest income yield in 10 years.

SPEED READ

- The tough operating conditions persist, with the office sector being worst affected.
- Balance sheet strengthening is a common theme as companies try to calm investors
- Guidance from management is generally lean given the fluid nature of the environment

share declining by 31% to 73.1c. The actual dividend per share fell by 44.8% to 58.5cps which represents an 80% payout ratio (above the minimum threshold of 75% to retain REIT status) versus the prior norm in South Africa which saw a payout ratio of 100% of earnings. This is now more in line with international standards where the difference in payout ratio is used for maintenance and refurbishment.

So where exactly was the pain felt? Unfortunately for Growthpoint, it was broad-based with vacancies increasing across all the SA sectors. The already-tough local operating environment was further exacerbated by Covid-19 which impacted heavily on the trading capacity of its prized local retail asset, the V&A Waterfront (50% owned), given its reliance on tourism, both local and international, which saw hotel, retail and restaurant trade come to an abrupt halt.

Nonetheless, the V&A still managed to keep vacancies down to 2.3% vs 1.5% at June 2020, whilst rental reversions slowed to an increase of 2.2% vs 7.6% previously, both metrics credible given the circumstances. Even though both metrics weakened, they were far stronger than those reported for the rest of its South African retail portfolio.

Unfortunately, the office and industrial sectors saw vacancies rise to 18% and 8.2% (vs 15.4% and 7.1% at June 2020) respectively yet rental reversions also fell by 14.3% and 11.8% (vs -8.9% and -4.7% at June) respectively. That is a tough combination, implying that there are few places to hide in the current environment. On their retail portfolio,

aside from the V&A, vacancies increased to 5.4% (5.1% prior) while reversions were -14.7% (-6.2% prior).

Moving to their offshore portfolio, there was pressure from all sides:

- A reduced dividend from their investment in Growthpoint Australia - GOZ (62% shareholding, owning 57 properties in Australia, 97% leased to government and listed or large corporates). The reduction was due to an increase in dividend withholding tax (from 7% to 11%).
- A reduced dividend from Globalworth (29.3% shareholding, 60 properties spread across Poland and Romania). The dividend was halved from €0.30 to €0.15.
- Capital & Regional - C&R (52.1% shareholding, owns 7 shopping centres in the UK). With the UK experiencing its third lockdown over the festive season, this materially affected all operations. Consequently, C&R also decided to forgo its dividend.

The introduction of new revenue streams from their fund management business looks set to gain further momentum over the next 2 years. They currently have assets of R12 billion across several healthcare facilities, which generated R16.3 million in asset management fees for the last reporting period. They will be launching a third fund focusing on purpose-built student residential accommodation as well as trading and development for third parties. Furthermore, the Board is considering further global diversification in areas where the company feels it has a competitive advantage.

The valuation for the entire property portfolio declined by 2.5% over the period (SA -3.6%, GOZ +2.5%, C&R -14.8%), which caused the underlying net asset value of Growthpoint to drop by 7.6% to R21.32. Based on the current share price, Growthpoint is trading at a 37% discount to its underlying assets. Considering that since 2009 Growthpoint has traded at a 10% premium to its net asset value, the current level is unprecedented, and implies that Growthpoint is screening very well on valuation grounds.

One area that investors have become increasingly concerned about since the outbreak of the Pandemic was the strength of the balance sheet, so how has Growthpoint

fared on this metric? Firstly, Growthpoint came to the market in November last year and raised R4.3 billion at R12/share which was well received (2.7x oversubscribed). Secondly, Growthpoint offered its shareholders a “dividend reinvestment option – or DRIP” (ie, an option to receive new shares instead of a cash dividend.) 43% of shareholders opted for the DRIP. Thirdly, the company has reduced its payout ratio from 100% to 80%, which implies that 20% of distributable earnings have been retained by the company. Finally, the company has sold non-core properties. Pleasing, prices received on those sales were very close to book value, further highlighting the discrepancy between the current share price and the company’s net asset value.

Combined, these have all contributed to a reduction in the Loan-To-Value Ratio (LTV) or gearing level to a comfortable 40.7% from 43.9% in June 2020. Furthermore, the interest cover ratio (a key metric for assessing how easy it is for a company to pay interest on the debt that it owes) increased to 3.2x from 3.1x in June. Growthpoint’s debt covenants include a maximum LTV of 55% - well above the current level - essentially giving investors additional comfort that property values could decline substantially before becoming worrisome.

“Growthpoint is trading at a 37% discount to its underlying assets ”

As far as the company’s outlook is concerned, they have committed to pay dividends twice a year of at least 75% of distributable earnings. Trading is expected to remain difficult in most regions although Growthpoint Australia and Globalworth are expected to recover faster than other regions given the lower pandemic impact and the strength of their tenancies.

This reinforces the necessity of having appropriate offshore exposure coupled with a strong balance sheet and dominant assets.

In conclusion, this statement from the results commentary sums up the situation:

“Our prospects are inextricably linked to our operating environment. As the world and the RSA economies recover gradually, we have a tough number of years ahead of us. We are a strong and diversified business and our conservative approach to managing the business will stand us in good stead.”



We are excited to announce the resumption of our seminar program in April. Our first seminar will remind investors of what we have endured over the past 12 months, and what lies ahead for the rest of 2021. Please save the date below. Please note that due to Covid protocols, numbers are strictly limited to 100 per session, and only drinks (no food) will be served. Booking is therefore essential. Please RSVP to Clare Mitchell on 033 3302164 or clarem@hhgroup.co.za.



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Topic: **Exiting the Recession: what lies ahead?**

Natal Midlands

Date:	Wed 21st April
Venue:	Fernhill Hotel Midmar / Tweedie Road Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	06 May 2021
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax. Performance fees do not apply to any funds managed by Harvard House. The manager does not provide any guarantee either with respect to the capital or return of the portfolio. A schedule of fees, charges, and maximum commissions are available on request from the manager.

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