The outlook for property investors

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Intro
The performance of listed property remains closely correlated to bond yields and not necessarily underlying fundamentals.

On the latter aspect there is little doubt that a closer relationship is required to ascertain real value. However, exactly as to how these fundamentals will unfold is up for debate and depending on who you speak with, differences of opinion is not uncommon. Some uncertainty and risk is of course good for those seeking to gain `arbitrage' advantage.

Property funds are facing a plethora of challenges presently and most of these challenges are not things that can be easily wished away or controlled; rather they require astute management and attention. This attention is however being distracted by emerging `nuisances' like the billing debacle befalling our largest Metro. In general the perceived benefit of public taxation has dwindled and the feel good factor of sporting success is but fickle.

Also worth considering is that whilst for the past ninety years for which modern data sets are available, South Africa's GDP has grown by an average of 3.5% annually through many business cycle ups and downs, it is ultimately the ability to grow the black middle class that will change the course of the future and set a high road for above-the-mean growth. The other is job creation and the urgent creation of an overarching enabling and unambiguous policy and education environment. Over the past two decades for example, the public sector has apparently reduced its technically-trained cadre from 5500 to 1500 consulting engineers; this in an economy that has grown a third bigger. The implied inefficiencies are plainly observable, especially in public infrastructure efforts, partly hobbling overall fixed investment performance.

Probably of greatest immediate concern is around operating cost inflation in an environment where the interest rate cycle has bottomed. What with a barrage of above inflation costs and additional costs staring SA Inc in the face, the propensity for income growth is cut short by limited business and consumer spending (not to mention environmental dynamics playing havoc on agriculture and food production): the bottom line is that operating costs will continue to rise above income growth, weak or strong Rand issues aside.

The upside is that commercial property prices will remain flat and with yields increasing it is reasonable that buying opportunities will present themselves; that being said the selection of assets and upside opportunity will become incredibly important to establish such that acquisitions are not dilutionary.

On interest rates, the SARB is most likely going to resort to policy normalization in line with many of its overseas counterparts, albeit with an economy performing only modestly (and disappointingly so) at 3%-3.5% GDP growth. The timing of this cycle of interest rate hiking is up for debate and most property funds are relatively well hedged to mitigate this risk -- as such less cause for concern.

At the end of the day what investors must take into consideration are property's long term asset differentiating qualities primarily based on the unique income and capital appreciation characteristic. Those not too fazed by the shorter term challenges and structural incongruencies have generally always been pleasantly surprised by the investment portfolio diversification benefits.