Catch-22 of non-core property investments

Weak market conditions are preventing companies from heeding the calls of eager investors to sell properties that are not core to their business.

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Corporate SA is sitting with billions of rand worth of properties that have accumulated value over the past few years, while the growth-hungry, largest, listed property funds have run out of takeover targets among the existing counters on the JSE.

Local and international institutional investors have said they would like to see more large liquid and also specialised funds come to market. Companies that do not run property businesses but see property as fixed investments are only likely to look to sell when economic conditions improve.

Grindrod Asset Management's chief investment officer, Ian Anderson, says most large companies with sizeable property investments on their balance sheets are reluctant to sell them because they appreciate the straight investment value of those assets - that their capital value should rise over time.

"Hence, they do not sell their properties often and deals take time," he says.

But the challenge in a weak economic environment with annual gross domestic product growth projected at less than 2% and business confidence at its lowest point in years, for a company looking to offload these assets, would be working out the most profitable way of doing so, according to Anderson.

"Selling them to the listed property companies on a saleand-leaseback basis would make the most economic sense. If the location of the properties is not strategic, then it makes no sense for a company to carry that sort of asset on their balance sheet.

"Obviously they would need to identify a home for the capital released through the sale of the properties and in the current South African economic climate, that might not be that easy to do," Anderson says.

Estienne de Klerk, MD at Growthpoint Properties, says the listed property sector has managed to finance acquisitions of other listed property counters and develop properties from scratch quite cheaply since the recession in a low interest rate climate.

"Various companies own significant property portfolios and over the years we have seen some of these enter into sale-andleaseback transactions, but it is not that common. Some of the names that come to mind who have actually done so are Investec Bank, Business Connexion and Macsteel," de Klerk says.

"Generally South African companies have been reluctant as they are mostly short of investment opportunity, and with exchange controls many have not been able to aggressively seek investments abroad. Meanwhile, many overseas entities prefer an asset-light strategy and use most of their capital within the specific business they operate in," he says.

South African companies have also not struggled to finance capital over the past few years.

"When this changes and the cost of capital becomes more expensive and scarce, more companies sitting on property piles may seek the benefits of sale-andleaseback deals with real estate investment trusts," he says.

Nevertheless, one property sale from a company with a noncore property has taken place this year. In February, Accelerate Property Fund, which listed at the end of 2013 with nearly R6bn worth of assets, bought auditing advisory company KPMG SA's property service holding company with six office property assets across various centres in the country, for R850m.

The head of listed property funds at Stanlib, Keillen Ndlovu, says a sell-off of unlisted property should happen gradually as conditions are not ripe for merger and acquisition activity.

"We will not be surprised if some of the assets sitting outside the listed property sector are brought in over time.

"We have seen the trend already over the last 10 years or so: life companies and big private owners selling their properties and converting some of the proceeds to equity," he says.

Potential sellers will have noticed the formation of development funds that have listed with sizeable property portfolios, which are seeking capital growth exclusively and not paying income distributions, he says.

"Some like Attacq and Pivotal (Property Fund) have listed their portfolios. They have used the listed property sector to grow or complete their development pipeline," says Ndlovu.

Source: Business Day