

PROPERTY INVESTMENT

Residential sector is 'an attractive investment'

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Property Reporter

Rising interest rates affecting buyer affordability, along with growing demand for cheaper housing makes the residential property sector an attractive investment asset class.

Even though tenants remain under financial pressure, the affordable housing sector has recovered from the pandemic, with vacancies reducing and landlords being able to increase rentals in some instances.

While demand continues to rise driven by a chronic shortage of quality stock in well-located areas, some institutional investors and real estate investment trusts (Reits) with deep pockets are shying away from the asset class.

Unlike in the UK and the US, SA's residential listed property sector is small, accounting for about 3% of the whole sector.

There are three JSE-listed residential only Reits: Balwin Properties, Induplace and Transcend Residential Property Fund. Others such as Emira Property Fund, Octodec Investments and SA Corporate Real Estate have some exposure to residential.

At the inaugural Residential Investment & Development Conference last week, delegates said there is an investment case

for residential property; however, it lacks scale along with lag in investment data to attract big investors such as pension funds.

"There is a significant under-supply of quality stock in the affordable housing segment," Myles Kritzinger, CEO of Transcend Residential Property Fund, told Business Day.

Kritzinger said having few listed Reits focusing purely on residential property is a challenge, but as demand remains high it makes for a good investment case.

Transcend is focused on quality rental apartments located in lifestyle and secure complexes. It services the low to middle-income markets, with rentals of R4,500-R8,000 a month.

"SA has limited investable residential rental stock portfolios suitable to investors like pension funds – as such, there has never been a real incentive for asset managers at these institutions to understand residential as an investment asset class," said Carel Kleynhans, CEO of unlisted Divercity Urban Property Fund.

Divercity invests in affordable rental housing in well-located urban precincts with scale. Its R3bn portfolio consists of more than 6,500 apartments with complementary office, retail, and educational space and include Towers Main in the Absa

Precinct and Jewel City in the Johannesburg CBD.

Kleynhans said in most well-developed capital markets, a substantial portion of the property investment universe is in residential rental property.

"Affordable rental housing as an asset is proven to be an excellent addition to institutional investor portfolios worldwide, and we believe this is especially true in the SA context. To this end, we expect the sector to keep growing and maturing in the years ahead," he said.

He said due to SA's history of spatial segregation and that most affordable housing is developed at the urban periphery, there is insatiable demand for well-located affordable housing. "This is a huge growth opportunity for delivering a cost-competitive product in better locations."

Africrest Properties, which converts offices into residential apartments and targets middle-income earners with its affordable prices, said within its portfolio demand is high and it is not difficult to replace tenants.

Its assets are in localities including Sunninghill and Randburg.

Justin Blend, a director at Africrest said its product is still new, and performance is not comparable to the normal buy-to-let market. For example, where other landlords report high vacancies, their portfolio has about 3% vacancies, and recording growth of about 6% or higher in some instances.

"Though rising interest rates makes it tougher for business profitability, more people are turning to renting, making a case for investing in residential prop-

erty as it offers good stable income," Blend said.

Eileen Andrew, vice-president for real estate client coverage at MSCI, said despite hesitancy to invest in the sector it is an attractive asset class. "Demand is there. The challenge is the ability to provide the right affordable housing product at suitable localities."

In 2022 SA's residential sector recorded returns of 8.3% – the same figure recorded in 2019. Though vacancies are still high at 14.3%, base rental growth grew to 9.8% year on year during the same period.

Andrew said the sector's fundamentals were strong, recording better returns coming out of the pandemic, while no value writedowns are expected.

Kritzinger said since listing in 2016 the fund has delivered stable and consistent returns. The pandemic gave it a chance to demonstrate to the market the defensive and resilience of the asset class, with rental collections remaining strong.

"What has changed slightly is the shift in being an income yield fund to probably a more total return play. Though our objective as a Reit is to provide a strong consistent yield, over time, what we've seen in residential is that individual units carry value as do large portfolios," Kritzinger said.

In a property sector where

there has been significant asset devaluation, residential has always had value underpin, and individual units can be sold in the open market, he said.

For the 15 months to end-March, Transcend's portfolio of more than 4,000 residential units was valued at R2.22bn. Occupancy levels were nearly 98%, collections were above 95% with arrears as a percentage of revenue at just 0.5%.

Erwin Rode, CEO of Rode and Associates, said the residential property sector will grow in importance in SA, with rentals expected to increase.

"In a fast-changing economy, renting gives you flexibility, and with rising interest rates it is cheaper than buying," he said.

Data from the Rode Report for the second quarter of 2023, however, shows that in real terms, rentals are still declining after adjusting for consumer inflation.

Average rentals grew 7% in the first quarter of 2023, suggesting property owners have generally kept rental increases low to reduce vacancies, which reached 6.9% in the second quarter of 2023.

"Financially, it would be better to rent than buy – provided you save the difference of what you will pay on a bond – and you should do better in five years," Rode said.

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Investment case: Myles Kritzinger, CEO of Transcend Residential Property Fund, says demand for residential property remains high. /Denise Mhlanga