

## Listed property has limited upside left

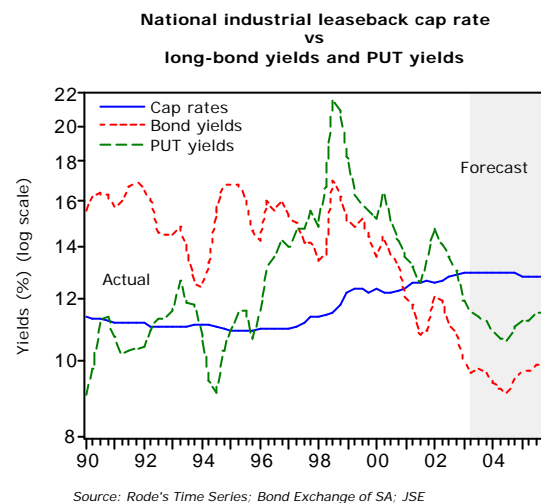
This chapter reviews the prospects for the listed property market using property unit trusts (PUTs) as a proxy. Choosing property loan stocks, which are subject to the same forces as PUTs and therefore follow similar trends, would have given us more or less the same results. The forecasts cover PUTs' income ("dividend") yields, prices and income ("dividend") streams.

Before we analyse the forecast results, it is important to remember that the listed property market has experienced a structural change since 1998, which eliminates the use of earlier data for the purpose of doing the forecasts. Thus, we felt it prudent to refine the *Rode* econometric model so that this structural change can be reflected in the model. Furthermore we used quarterly, rather than annual, data in specifying our new model, thereby ensuring an adequate number of observations as well as greater accuracy.

In essence, the structural change rests on the close correlation that has developed between long-bond yields and PUT income yields since 1998 (see accompanying graph). Hence historic bond-yield data since 1998, as well as *Rode's* panel of economists' forecast for long-bond yields, were central in forecasting PUT income yields. The result is that PUT yields are predicted to continue tracking long-bond yields religiously over the forecast period. In effect, this implies that investors are expected to continue viewing bonds and listed property in a similar light, which of course emanates from the secure nature of their respective income streams.

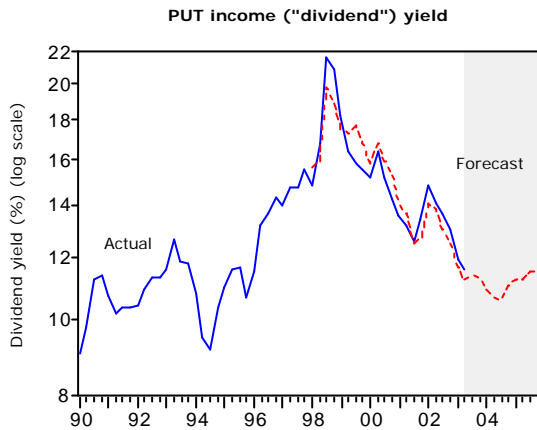
The accompanying graph also shows how PUT income yields dropped below cap rates recently. The last time this happened was for a brief period at the end of 1995. This implies that PUTs are now trading at a

premium relative to directly-held property. At the end of March 2003, our calculations showed that this premium stood at 17%. Hence correctly-valued directly-held property portfolios would realise an instant capital profit if they were to be listed on the JSE, which could lead to a flurry of new property listings. Already the listed property sector has been a hive of activity, with the size of the PUT and property loan stock sectors combined increasing from about R5 billion to almost R18 billion in under five years.



PUT income yields are forecast to continue their downward trend up to the third quarter of 2004, before following bond yields upwards again. This makes sense, as bond yields must surely be close to their cyclical bottom after coming down (strengthening) since 1998. This implies that there is limited upside left for listed property over the short term.

The graph portraying the forecast for PUT income yields, shows the closeness of fit between the solid (historic performance) and dotted line (forecast performance), which implies a solid model.

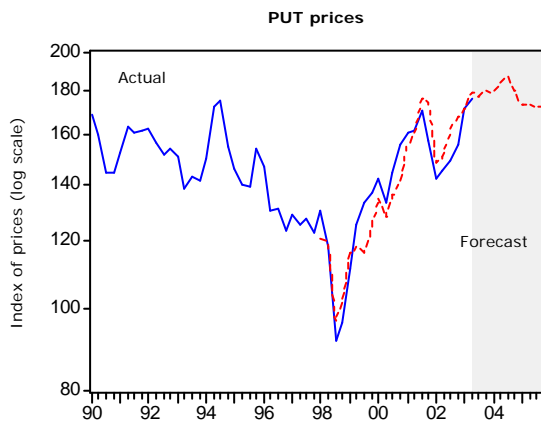


Source: Rode's Time Series; JSE

naturally, led to higher PUT prices. Hence, the increase in PUT income yields from the last quarter of 2004 should lead to PUT prices declining again.

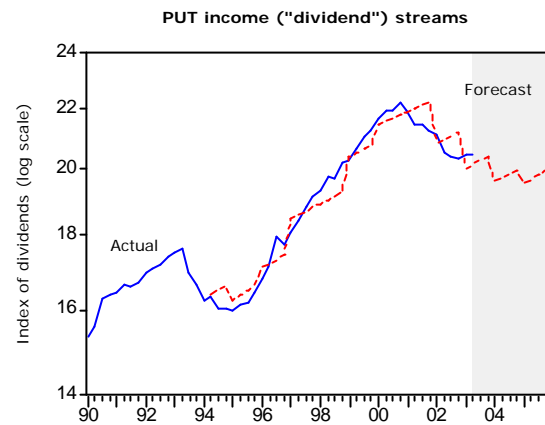
The sad news is that the drop in PUT income streams, which has been evident since the start of 2002, is predicted to continue over the forecast period. The decline in PUT income streams, of course, reflects the pressure on market rentals, in turn the result of the current cyclical oversupply of non-residential space.

The forecast for listed property is done only until 2005. The reason for this is that players in this market are not interested in the longer time horizon because of the high tradeability of listed assets.



Source: Rode's Time Series; JSE

As for PUT prices, our model forecasts that the upward trend will continue to quarter 2004:3 before turning negative. As already mentioned, the positive re-rating of PUTs (lower PUT yields) started in 1998, which,



Source: Rode's Time Series; JSE

The accompanying table summarises our forecast performance (averages for the year) of PUTs until 2005.

**In sum...**

To summarise, PUT income yields are forecast to continue their positive re-rating (strengthening) until quarter 2004:3, whereafter a correction is expected. This forecast is based on PUT yields' continued

Forecast of property unit trust performance (averages for the year)					
	2001	2002	2003	2004	2005
Growth in income	-2,0	-4,3	-1,0	-3,0	-0,2
Growth in PUT prices	13,0	-8,9	19,5	3,2	-5,3
Trailing income yield	13,2	13,9	11,6	10,8	11,4

tracking of bond yields, as has been the case since 1998. Hence, PUT prices are forecast to remain in their upward trend to quarter 2004:3 before declining. PUT income streams are predicted to come down further over the length of the forecast period, struggling under the weight of lower

market rentals, which, in turn, are the result of the oversupply of non-residential space.

This concludes our section on listed property. ■