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## Listed Property vs. Buy-to-Let Property

Prepared by:

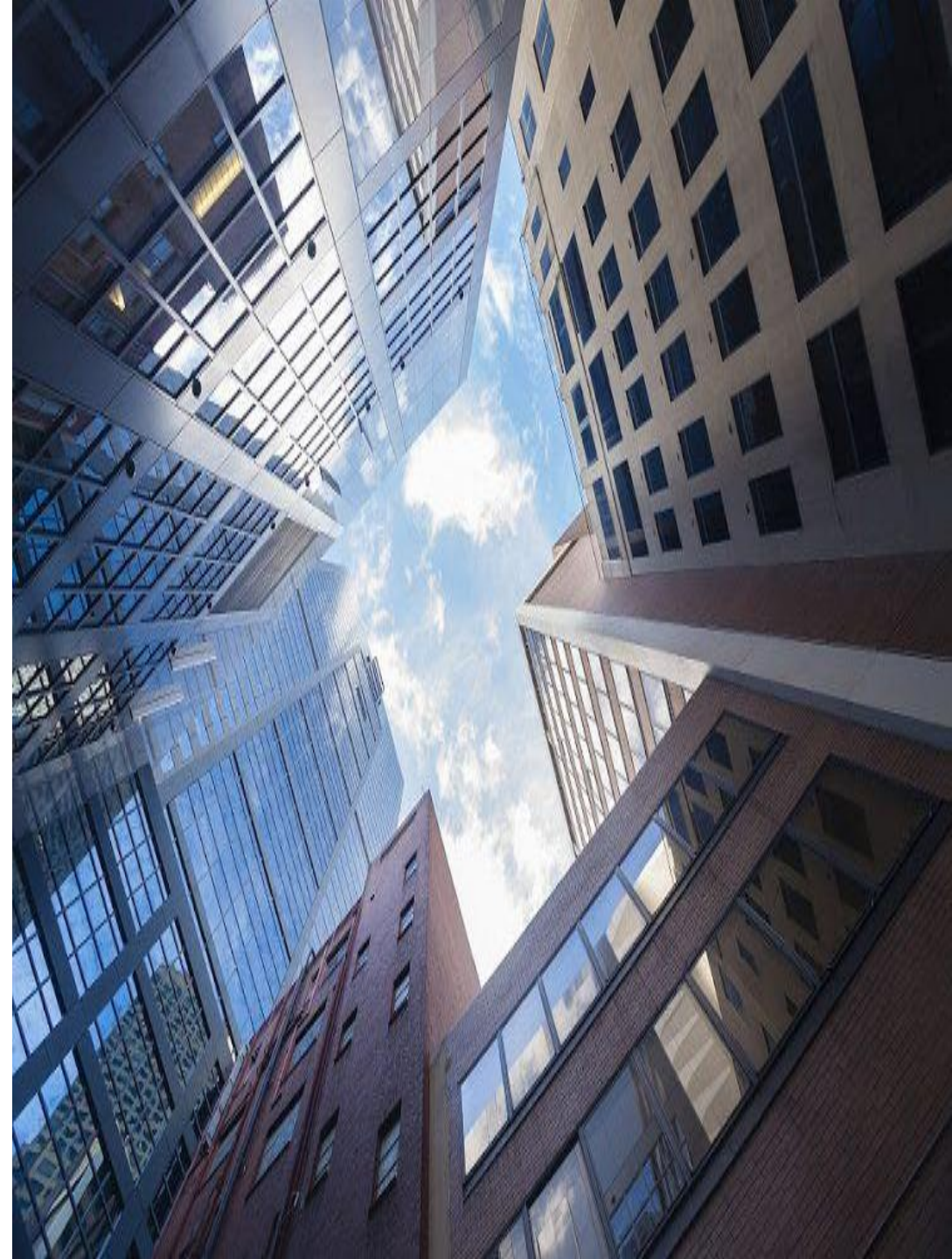
Magnus de Wet

Date:

20 November 2017

Event:

JSE Power Hour



# Background

- Client wanting advice between BTL or investing in markets
- Amortisation loan and cashflows for BTL over 20 years
- Formula to compare between BTL and LP returns
- Article published in Finweek magazine in January 2017
- JSE Power Hour in April 2017

# LP vs. BTL Power Hour Agenda

- Comparing listed property to buy-to-let property
  - The BTL model
  - The Listed Property index
  - Outcomes from the comparison
- General
  - How to gear your listed portfolio
  - Listed property instruments: Stock picking, Unit Trusts, ETFs
  - The downgrade
  - Articles

# The BTL Model

- BTL definition:
  - Residential property which an investor buys with a small deposit and mortgage from the bank
  - The investor then gets a tenant to rent it and receive monthly payments from the tenant

# The BTL Model - Continue

- Following variables taken into account

BTL variables description	Used in model
Initial BTL investment value	R1 million
Mortgage loan period	20 Years
Deposit on mortgage loan	10%
Average Interest rate for mortgage loan	10%
First year rental income as percentage of investment value	10%
Annual rental escalation percentage	6%
Annual property value increase percentage	10%
Annual property maintenance as a % of property value	0.2%
Levies, rates/taxes and other expenses (e.g. domestic effluent, garbage removal, etc.) as a % of property value	2%
Buying transaction cost (Conveyance, Bond registration, etc.)	5.8%
Selling transaction cost (Estate agent fees, etc.)	5.3%
Individual income tax rate	41%

# The BTL Model - Continue

- Following risks were excluded from BTL model:
  - Non-paying tenants
    - Tennant Profile Network (TPN) - 15% of BTL rental income not received
    - Legal cost for evicting non-paying tenant
  - External factors
    - Rising interest rates
    - Degrading area
  - Non-diversification
  - Rent escalations at an all-time low
- Technical benefits not included in BTL model
  - Working in the industry
  - Tax efficiency
  - Undisciplined savers
  - Running the BTL as a business

# The Listed Property Index

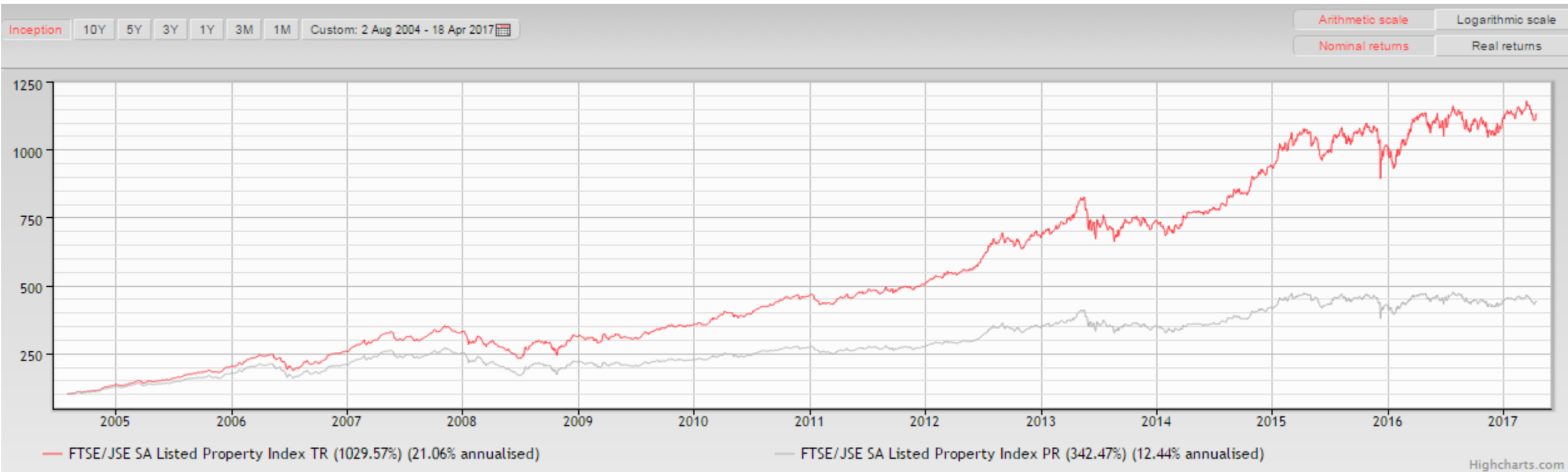
- Listed Property Index definition
  - The FTSE / JSE Listed Property Total Return Index
  - Comprises the top 20 liquid companies by full market cap
  - Real Estate Investment & Services Sector and Real Estate Investment Trusts Sector
  - Primary listing on the JSE

# The Listed Property Index - Constituents

Alpha	Instrument	Weight	Dividend Yield		Return		Tier
			Dividend Yield	Weighted Yield	Last Y Return	Weighted Return	
GRT	Growthpoint Prop Ltd	19.2%	7.37%	1.41%	2.5%	0.48%	1
RDF	Redefine Properties	14.8%	7.74%	1.15%	-10%	-1.48%	1
NEP	New Europe Property Investment Plc	9.1%	4.13%	0.38%	-23%	-2.11%	2
RES	Resilient REIT Ltd	8.8%	4.54%	0.40%	-16%	-1.38%	2
HYP	Hyprop Investments Ltd	8.5%	5.36%	0.46%	0%	0.00%	2
FFB	Fortress Income Fund Ltd. (B)	6.9%	4.53%	0.31%	-7%	-0.50%	4
FFA	Fortress Income Fund Ltd. (A)	5.3%	7.77%	0.41%	5%	0.24%	2
SAC	SA Corporate Real Estate Fund	3.7%	7.79%	0.29%	9%	0.32%	3
ROC	Rockcastle Global Real Estate Co Ltd	3.5%	4.23%	0.15%	-12%	-0.43%	3
VKE	Vukile Property Fund	3.4%	7.94%	0.27%	11%	0.39%	3
ATT	Attacq Limited	2.8%	0.00%	0.00%	-18%	-0.51%	3
AWA	Arrowhead Properties	2.3%	9.48%	0.22%	4%	0.10%	3
IPF	Investec Property Fund Ltd	2.1%	6.05%	0.13%	9%	0.20%	4
REB	Rebosis Property Fund	1.6%	9.12%	0.15%	7%	0.11%	3
EMI	Emira Property Fund	1.5%	10.39%	0.15%	-11%	-0.16%	3
DLT	Delta Property Fund	1.3%	10.66%	0.14%	40%	0.52%	4
MSP	MAS Real Estate Inc	1.3%	0.00%	0.00%	1%	0.01%	4
APF	Accelerate Property Fund	1.2%	8.22%	0.10%	4%	0.05%	4
OCT	Octodec Investments	1.1%	8.48%	0.09%	1%	0.01%	4
EPP	Echo Polska Properties NV	1.0%	0.00%	0.00%	-15%	-0.16%	4
L2D	Liberty Two Degrees	0.5%	0.51%	0.00%	-9.5%	-0.05%	4
			<b>6.20%</b>		<b>-4.35%</b>		



# The Listed Property Index - Past performance



Source: Profile Data

# The Listed Property Index - Past performance



Source: Profile Data

# Comparing BTL and LP Returns - Annualised returns

- Let's imagine you have invested in the stock market for 5Y, and your returns each year were 90%, 10%, 20%, 30% and -90%
  - Arithmetic average = 12%  $[(90+10+20+30-90)/5]$
  - Geometric average annual return = -20.08%  $[(1.9 \times 1.1 \times 1.2 \times 1.3 \times 0.1)^{1/5} - 1]$
- Annual investment returns are not independent of each other
- If you lose money in one year, you have less capital to generate returns the following year, and vice versa
- Geometric average annual return formula corrects this problem

# The Listed Property Index - The comparison model



- Financial and retirement planning
- Unit trust investing
- Stockbroking and derivative trading
- Personal and business insurance
- Money management
- Tax, trusts and estates planning

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## Buy-to-let (BTL) vs. Listed property (LP) investments

20 April 2017

### Contact details:

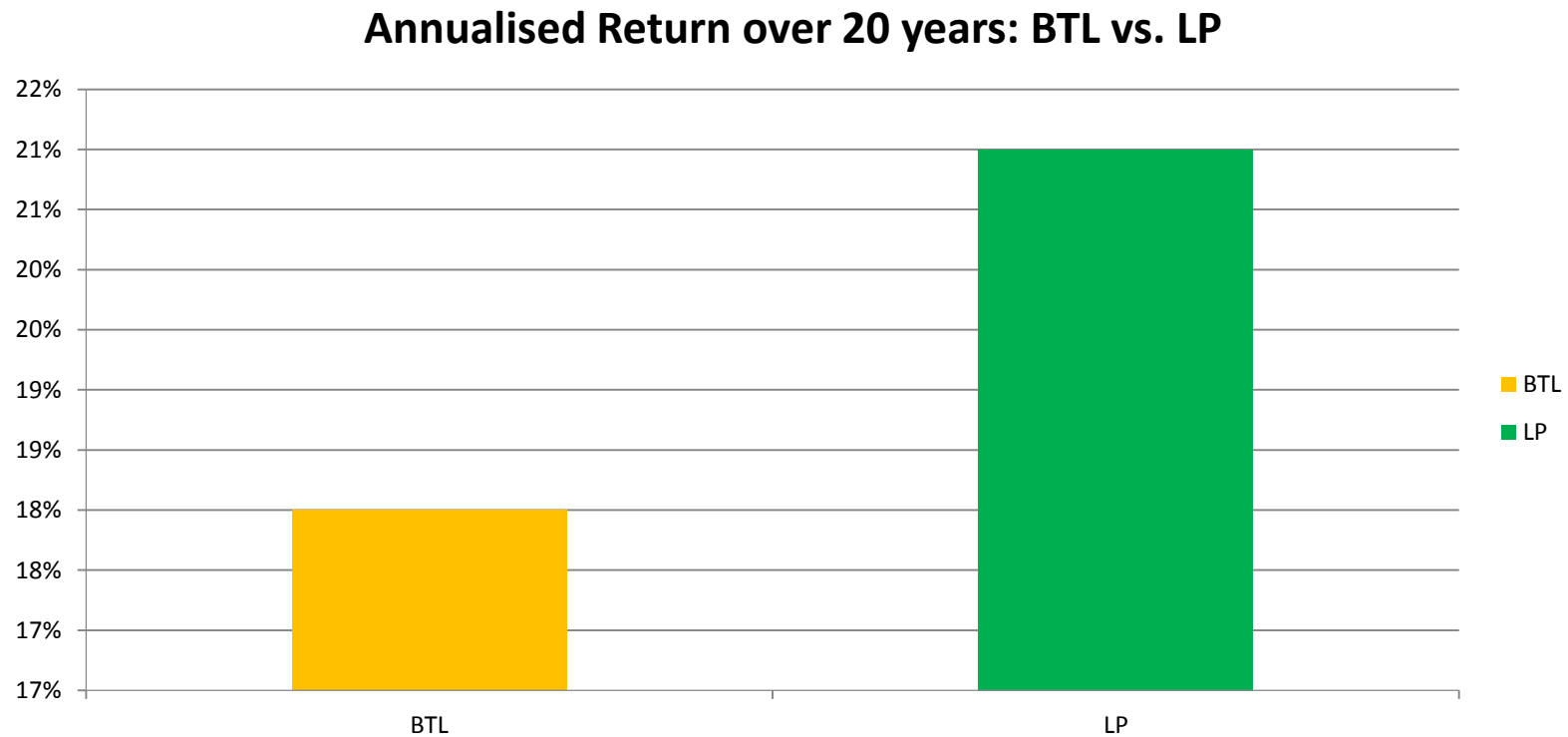
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Variable Description	BTL		LP	Variable Notes
	Actual	Percentage	Percentage	
- An investment is made into a buy-to-let property OR Listed property worth R7m on 1 Jan 1996	1,000,000	N/A		Initial LP investment is deposit of the BTL
- Loan Period or investment period in years		20	N/A	
- A deposit was placed with the bank for the property		10.0%	N/A	
- Prime interest on the home loan was on average a % per annum		10.0%	N/A	See SA Prime Interest Rate tab
- Property maintenance is a % of property value per annum		0.20%	N/A	
- It is assumed tenant pays electricity but investor pays levies, rates/taxes, dom eff, garbage		2.0%	N/A	
- Property value increases a % per annum		10.0%	21%	LTB: See SA House Property Index tab
- Initial rent per month from tenant is a % of BTL value		10.0%	0.00%	LP: See SA Listed Property Index tab
- Annual Inflation rate used as annual increase in rent		6.0%		LP: Total Return Index used so div is zero
- Income tax rate of individual		41.0%	41.0%	
- Transaction cost (incl. VAT) consisted of the following items upon buying:	58,000	5.8%		
Execution or trade cost	-	0.0%	1.00%	
Conveyancing/Transfer fees:	20,000	2.0%	N/A	
Transfer Duties: 3% on value above R750k	7,500	0.75%	N/A	
Bond Registration Fees:	20,000	2.0%	N/A	
Bank initiation fee:	7,500	0.75%	N/A	
Post, petties, FICA and other fees:	3,000	0.30%	N/A	
- Transaction cost (incl. VAT) consisted of the following items upon selling:		5.3%		
Execution or trade cost	-	0.0%	1.00%	
Beetle, Electrical and Gas Conformity Certificates	500	0.05%	N/A	
Estate Agent Commission	50,000	5%	N/A	
Bond Cancellation Costs	2,000	0.20%	N/A	
- Capital gains tax on selling at an inclusion rate of 40% for individuals. NB! 1st R40k gain is tax free!	16.40%	16.40%		NB! This is for now ignored for both the LTB and

# The Listed Property Index - Outcome





# General slides



# How to gear your listed property investment?

- Derivatives like CFDs and SSFs
  - Tier 1 and 2 instruments definitively. Tier 3 maybe
  - Remember margin calls
- Share based loans
  - Not as aggressive as derivatives
  - Pledge shares which will provide you with loan to buy more shares
  - Well diversified portfolio will provide you with a loan-to-value of up to as high as 60%
  - Interest rate on share based loans are the Prime Interest rate



# Listed property investment ideas?

- JSE listed shares
  - Resilient REIT Ltd – Well diversified offshore. It owns a portfolio of dominant **regional malls and shopping centres** tenanted predominantly by national retailers. Good dividend growth
  - Greenbay Properties Ltd – Global real estate assets and listed companies, predominantly in the retail sector. High dividend yield growth. Still small and not overly geared
- Unit trusts
  - PRUDENTIAL Enhanced SA Property tracker fund
  - ABSA/Nedgroup Global Property feeder funds



# Listed property investment ideas?

- Exchange Traded Funds (ETFs)
  - STANLIB SA Property Exchange Traded Fund tracks the FTSE/JSE SA Listed Property Total Return Index
  - CORESHARES Proptrax Ten tracks the FTSE/JSE SA Listed Property Top 10 – custom index that consists of the Top 10 **equally weighted** most liquid JSE primary listed property companies
  - CORESHARES Global Property ETF tracks the **S&P Global Property 40 index** – 40 largest global property companies in developed markets that have earnings and dividend stability

# How does the downgrade affect BTL property?

- Physiological impact – Potential new home owners will rather rent as oppose to buy. Demand for BTL will increase as supply decreases
- Interest rate uncertainty – Again rent rather than buy, increase demand for BTL. Supply decreases allowing BTL owners to increase rent
- Semigration to Western Cape – Workforce move family and commute for work in Gauteng
- Opportunity if you can stomach it – Focus high income dense areas where investment is still happening: Melrose Arch, Rosebank, Gautrain Stations, etc.

# How does the downgrade affect Listed Property?

- Rising yields – More expensive for listed property companies to finance their projects/investments
- Less disposable income for consumers – Shopping centre and malls will be hit first causing less occupancy and demand
- Physiological impact – Investors are going to be very cautious to invest in property in South Africa
- Weaker currency – While some will benefit others will be affected. Share/company specific

# Articles

## marketplace investment

By Rupert Glessing

### LISTED PROPERTY

## Why your investment portfolio needs exposure to listed property

Those with a long investment horizon should consider this asset class, which is characterised by strong yields and historical capital appreciation.

If I was to ask you what you thought the best-performing asset class in South Africa was over the past 10 years, what would your initial thoughts be? I'm pretty sure you would not guess that it is listed property.

And if I was then to ask you what you thought the annualised total return on this asset class was, compared to the total return of the JSE All Share Index (ASI), I'm sure you wouldn't have guessed that it is 14.87% for listed property and 10.53% for the ASI. Listed property has also significantly outperformed bonds, which showed an annualised return of 8.14% over the past 10 years.

Historically, listed property performance has also had a relatively low correlation with the equity market, making it a good way of diversifying an investment portfolio.

### But what exactly is listed property?

The JSE SA Listed Property Index comprises the "top 20 liquid companies, by full market capitalisation, in the Real

Estate Investment & Services Sector and Real Estate Investment Trusts Sector, with a primary listing on the JSE". (See table on page 23.)

One of the biggest reasons to have exposure to the asset class is the attractive yield (income derived from the rental of the properties) offered to investors. For example, if one was to compare the total return (price plus yield) of the index to only the price return over the last decade, one would see that on an annualised basis, the total return is almost 8 percentage points more. (See graph below.)

To put the numbers in perspective, without taking capital appreciation into account, one would have already outperformed in flat on an investment in listed property.

According to statistics from the Association of Savings and Investments South Africa (Asisa), the percentage of assets invested in real estate

funds make up only 4% of the total assets invested in the South African collective investment schemes (CIS) industry. Even if you go back 10 years, the percentage was 3%, indicating that it hasn't increased over the last decade, despite the good returns delivered by this asset class.

Listed property is also a small part of the overall market cap of companies in the ASI, and at R370bn it makes up only 5.7% of the net market cap as at 7 March 2017, according to JSE data. This could also explain why listed property is such a small percentage of the overall holdings of some of the bigger multi-asset collective

investment schemes

that have to comply with regulations 28 of the Pension Funds Act.

These funds are restricted with regard to how much of each asset class they can hold overall (currently 25% of the total portfolio for listed property), but also how much they can hold of specific underlying shares. With the

listed property sector being so small, it can be difficult for these bigger funds to have a more substantial holding.

### Investment options

From the above we can get a better understanding of the benefits of having listed property in one's portfolio as well as why most investment portfolios perhaps don't hold enough of this sector. If we are looking to increase exposure to the asset class in a portfolio invested in collective investment schemes specifically, it can be done through a listed property CIS. Looking a bit wider, exposure can also be gained by investing in listed property exchange-traded funds (ETFs) or real estate investment trusts (REITs)/listed property shares on the JSE, of course.

As we are all well aware, past performance is no guarantee of future

## marketplace investment

By Magnus de Wet

### PROPERTY

## Listed property vs buy-to-let: Where should you invest?

There are a number of factors to consider before you should try to build your own property empire.

With US president-elect Donald Trump on everybody's lips, our office has been flooded with property investment questions again. Although it is true that Trump made his billions from real estate, our research has found that one is not likely to achieve these returns through the buy-to-let (BTL) property market, which South Africans are obsessed with.

I explain in this article why you would have been better off (with much less risk) investing your money in a portfolio of listed properties on the JSE or through a listed property unit trust investment.

### Buy-to-let and listed property defined

A BTL property investment in this article is a residential property that an investor buys with a small deposit and mortgage from the bank. The investor then gets a tenant to rent it and receives monthly payments from the tenant.

A listed property investment, on the other hand, represents a basket of real estate investment companies listed on the JSE. Examples of listed property companies include Growthpoint and Redefina. Listed property can also be a unit trust investment managed by a property investment specialist.



ANNUALISED RETURN OVER 20 YEARS: BUY-TO-LET VS LISTED PROPERTY



SOURCE: Data Wealth Management

### PARAMETERS USED FOR THE BUY-TO-LET PROPERTY INVESTMENT

Buy-to-let parameter description	Value used in model
Initial buy-to-let investment value	R1 million
Deposit on mortgage loan	10%
Average interest rate for mortgage loan	10%
First year rental income as percentage of investment value	10%
Annual rental escalation percentage	6%
Annual property value increase percentage	10%
Annual property maintenance as a % of property value	0.2%
Leases, rates/taxes and other expenses (e.g. domestic effluent, garbage removal, etc) as a % of property value	2%
Buying transaction cost (conveyance, bond registration, etc)	6%
Selling transaction cost (estate agent fees, etc)	5%
Individual income tax rate	40%

### Measurement used for comparing buy-to-let to listed property

In order to do a comparison between a BTL investment and a listed property investment, we had to build a model and decide on a metric. It was decided the best comparison measurement would be the annualised total return formula (XIRR formula in Excel), as it is a very popular metric in the investment industry.

In short, it calculates the geometric average amount of money earned by an investment each year over a given time period. It is calculated as a geometric average to show what an investor would earn over a period of time if the annual return was compounded. Another reason for this formula is that the cash flows don't have to be periodic. (See box for a detailed explanation of the geometric average.)

### BTL parameters

For BTL investments the annualised return turned out to be a bit of a nightmare (as so many other factors associated with this type of investment). First, you have to build a model that takes into consideration many parameters. Below is a list of the most important parameters involved with this article's BTL investment (also see table):

**Initial investment value** – A R1m investment property was used in the model. The property was mortgaged and a 10% deposit had to be paid. Since the investor did not have the luxury of financing the listed property investment, the listed property investment was started with the same amount as the deposit placed on the BTL property, in other words an initial investment of R100 000.

**Interest rates** – The average prime interest rate in SA over the last 20 years is just over 13%. The November 2016 FNB Mortgage Barometer predicted the Reserve Bank will leave interest rates unchanged for the time being, and that the repo rate is expected to move sideways through 2017 to 2019.

In order to keep it simple, an average prime interest rate of 10% over 20 years was used in the BTL model.

**Rental income** – An initial rental income of 10% per year of the value of the property

## Risks excluded from buy-to-let model

The following risk factors were excluded from the buy-to-let investment model and comparison to listed property:

**NON-PAYING TENANTS** – According to the Tenant Profile Network's (TPN) monitor for quarter 2 of 2016, nearly 68% of tenants were in the "paid-on-time" category, while 6% paid during the "grace period" and 11% paid late – adding up to a combined 85.08% in good standing. This means almost 15% of the owners of buy-to-let investments did not receive rent at all.

It is worth remembering that the law is on the tenant's side. Evicting a non-paying tenant is extremely difficult in SA. These tenants can also break the "investment" down and steal all the fittings in the house. The risks are therefore not only a loss of rental income, but also possible damage to your property and the legal expenses you may need to incur in order to evict a tenant legally.

**EXTERNAL FACTORS** – The risk of rising interest rates that can't be passed on to the tenant can place the investor in a financial predicament. During 1998 the prime interest rate went as high as 25.5% and as recently as 2008 it rose to 15.5%.

Also, as property investors know, location is key to your investment. An area can become seedy overnight and unlike listed property, which you can sell and realise your return within four days, it can take months to find the right buyer at the right price. With listed property the price is very transparent with bid and offer prices regularly available on the stock exchange trading screens.

**DIVERSIFICATION IS THE ONLY FREE LUNCH IN INVESTING** – Investors think that owning a few BTL investments in different areas provides diversification. In reality they're all in the same industry and asset class. With listed property your portfolio could be diversified in residential or commercial property developments or rental, local or offshore, high and or low end.

**RENT ESCALATIONS AT AN ALL-TIME LOW** – The TPN monitor reveals that the national rent escalation average for 2015 was just over 4.5%. During 2016 this has drastically reduced to less than 3% for the first two quarters. ■

The model indicated that the buy-to-let investment, had an annualised return of almost 18%. The listed property investment had an annualised return of just over 21%.

F TSE/JSE SA LISTED PROPERTY INDEX



— F TSE/JSE SA Listed Property Index Total Return (R61,93%) (21.13% annualised)

SOURCE: Highcharts.com

## Technical benefits not included in buy-to-let model

The following potential technical benefits were excluded from the BTL investment model and comparison to listed property:

**Working in the industry** – Being involved (as a developer, real estate agent or renovator) in the property industry could lead to investors picking up BTL properties at bargain prices. It could also provide inside information about areas or properties that might surge in future due to certain developments. These advantages could make BTL a worthwhile investment.

**Tax efficiency** – Investors with a mortgage on their own home can borrow from their BTL property and pay off their own home loan. By doing this they're shifting their interest expense

deduction, which in turn reduces the rental income profit earned, thereby reducing their tax burden.

**Undisciplined savers** – The BTL investment forces undisciplined savers to save. It's a fact that the bank will repossess your property if you do not pay every month. With this in mind, investors will make sure they pay their mortgages every month. A debit order on a listed property investment can however have the same effect.

**Running the rental property as a business** – This comparison did not take into account that investing in rental properties through a company legal structure could offer significant benefits from a tax and expense write-off point of view. ■

was used. According to the Tenant Profile Network, a credit bureau that specialises in vetting tenants for rental properties in Africa, the rent escalation average in SA for 2015 was just below 3%. The rent escalation from 2010 to 2016 however indicates an average of approximately 6.5%. It was decided to use 6% as the annual escalation rate, as it represents the higher end of the Reserve Bank's inflation target rate.

**Property value increase** – The Absa House Price Index is based on the total purchase price of all houses (including all improvements) in respect of which loan applications were approved by Absa. The data goes back as far as 1966. According to this index the average size house price (as the one used in our research) has increased by approximately 10% per annum over the past 20 years.

# End – thank you

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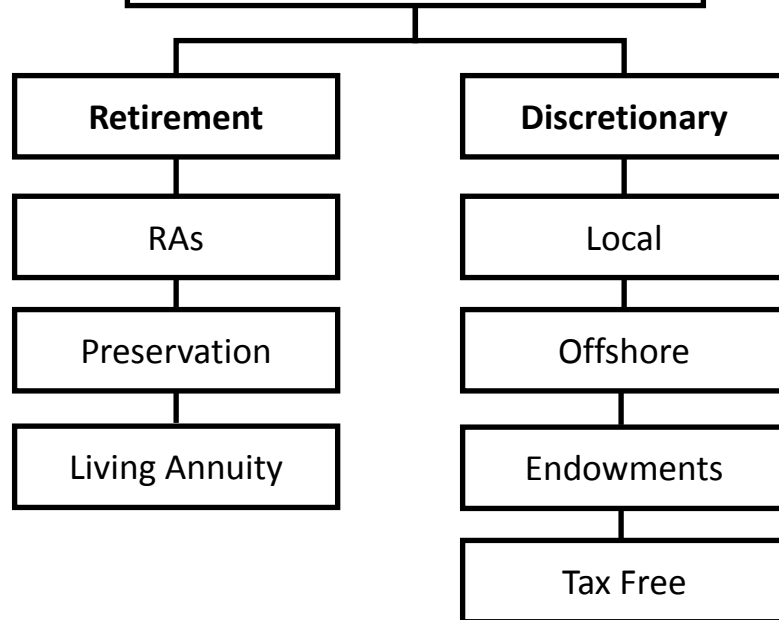
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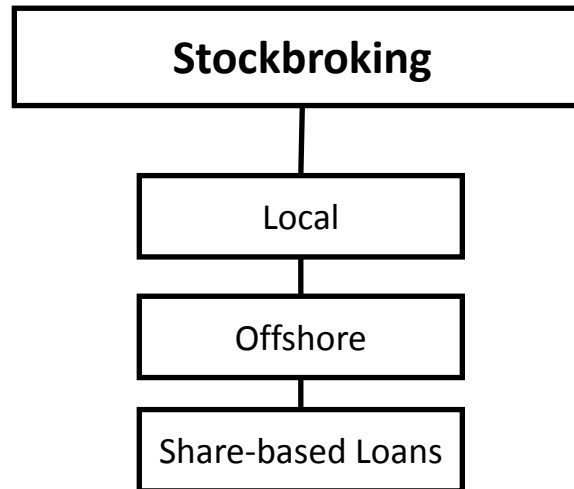
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## Unit Trust Investing



## Stockbroking



## Insurance

