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Growthpoint's strong liquidity and balance sheet drive healthy dividends for investors

Growthpoint Properties Limited (JSE: GRT) delivered 6.2% growth in revenue and R5.1bn in distributable income for its financial year to 30 June 2021.

Compared with FY20, distributable income decreased by 7.8%. On a per share basis, however, it declined 19.1% to 148.1 cents per share, mainly due to 408m new shares issued through the oversubscribed equity raise of R4.3bn in November 2020 and the December 2020 dividend reinvestment programme which raised an additional R577m.

The new equity combined with strategic South African asset sales of R559m and R864.8m being retained for FY21 after income tax, in line with an 80% pay-out ratio, added R6.3bn to Growthpoint's liquidity. This significantly strengthened its balance sheet.

Norbert Sasse, Group CEO of Growthpoint Properties, comments, *"Growthpoint's diversification by geography, sector and income stream has buffered performance in an unprecedented environment, supported by our deliberate prioritisation of liquidity, balance sheet strength and quality of earnings. These results show a very healthy and stable business with lower gearing and R6bn-plus of new liquidity, enabling us to pursue our strategic initiatives and declare a dividend of 80% of distributable income. We are committed to retaining our REIT status and paying dividends twice a year of at least 75% of distributable income."*

The positive outcomes of Growthpoint's focus on liquidity and balance sheet strength are evident in the decrease of its consolidated SA REIT loan-to-value (LTV) from 43.9% to 40.0% during the year, with its SA LTV reducing from 39.8% to 35.1% and interest cover ratio (ICR) of 3.2x.

Growthpoint achieved these healthy loan-to-value levels despite a further 7.4% devaluation of its SA portfolio, which has decreased in value by 16.2% since COVID-19 first appeared in SA. Over the past two financial year-ends, Growthpoint's SA portfolio value has been written down by R12.5bn as a consequence of poor property fundamentals driven mainly by income uncertainty from the country's economic challenges.

As the largest SA primary listed REIT, Growthpoint is the most liquid and tradable way to own commercial property in SA. It is a FTSE/JSE Top 40 Index company, a constituent of the FTSE EPRA/NAREIT Emerging Index, has been included in the FTSE4Good Emerging Index for five successive years and the FTSE/JSE Responsible Investment Index for twelve years. Growthpoint has also maintained a level 2 B-BBEE rating.

Growthpoint's group property assets are valued at R152.8bn. It owns and manages a diversified portfolio of 431 property assets across SA valued at R68.8bn, a 50% interest in the V&A Waterfront, Cape Town, with its assets valued at R8.8bn, and has R11.7bn in assets under management via its funds management operations. Growthpoint owns 55 properties in Australia valued at R49.5bn through a 62.2% holding in ASX-listed Growthpoint Properties Australia (GOZ) and seven community shopping centres in the UK valued at R10.5bn through its 52.1% investment in LSE- and JSE-listed UK REIT Capital & Regional (C&R). Through its 29.3% investment in LSE AIM-listed Globalworth Real Estate Investments (GWI), it owns an interest in 66 properties in Romania and Poland, with Growthpoint's share valued at R15.2bn.

Its SA portfolio performance improved slightly in FY21, mainly due to fewer COVID-19 discounts and deferrals and the reversal of R85m bad debts previously provided for. Performance in SA was hindered by the substantial disruption to economic and social activity by the extended COVID-19 lockdown periods, changing restrictions, and forced work-from-home. Growthpoint has given R475m in discounts and R191m in rental deferrals since the beginning of COVID-19 in April 2020- a massive contribution by Growthpoint in order to sustain its tenant base and support the SA economy.

Growthpoint achieved a 99.7% average rental collection rate for its SA portfolio, and recovered R173m, or 90.1%, of total rental deferrals granted since the onset of the pandemic. It let more than 1.2m square metres of space and maintained a renewal success rate of 65.4%. Arrears decreased from R512.0m to R308.2m over the year, with the bad debt income statement charge reducing to R29.9m from R236.5m. Notwithstanding these successes, portfolio fundamentals continued to erode in a challenging market, with vacancies rising from 9.5% to 11.6% and average rental reversions moving from -6.7% to -14.9%.

Despite a lack of liquidity and demand, Growthpoint remained committed to right-sizing its portfolio through the strategic sale of non-core assets, a programme which it commenced in its 2017 financial year and has since sold R7.5bn in properties. During the year it sold eight properties for R559m and held eight valued at R181.2m for sale at year end. It completed strategic acquisitions of R309m and incurred development and capital expenditure of R1bn.

The SA retail property portfolio recorded a 1.9% increase in trading densities driven by strong performance from supermarkets, home décor, electronics, and value fashion stores. Smaller and community centres outperformed others in the portfolio. However, it saw a 3.7% decrease in like-for-like net property income due to higher vacancies, significant negative rental reversions, COVID-19 rental relief of R147m in discounts and R4m in deferrals and lower parking revenue. Business rescues, particularly Ster Kinekor and CNA, are adding to the challenges. Demand for online retail surged from retailers and online delivery aggregators, with some services supporting in-store trading, such as Checkers Sixty60, Woolworths Dash, Dis-Chem, and OneCart. Growthpoint's centres are adapting and providing facilities to support online retail.

The contraction of SA's economy has had a significant impact on the office sector. Growthpoint's SA office portfolio saw renewal successes improve somewhat, but vacancies rose from 15.4% to 19.9%, primarily in Gauteng and the Sandton area specifically, due to business failures, space downsizing and slow letting stemming from uncertainty. Offices recorded a 9.8% decrease in like-for-like net property income due to the increased vacancy level, an oversupply of space, negative rental renewal growth, and COVID-19 rental relief of R33m in discounts and R8m in deferrals. Government mandated work from home was prolonged by the third wave, but many tenants are keen to return staff to their offices, with a renewed appreciation for the role that offices play in nurturing culture, values, collaboration and leadership, while recognising the need for flexibility.

Growthpoint's industrial portfolio continued to outperform relatively, delivering steady performance with slightly improved like-for-like net property income of -0.9% (FY20: -3.1%), and arrears halved. Despite vacancies increasing from 7.1% to 9.4%, mostly due to an upward trend in business failures, it reported steady escalations but renewal success and growth rates decreased. Growthpoint remains focused on modernising its industrial portfolio and selling non-core industrial assets, especially as there is currently market demand for industrial properties.

"Growthpoint's strong balance sheet gives us great comfort to face what is likely to be a frustratingly gradual economic recovery in SA, especially as the property sector performance lags behind most other sectors. After a 7% contraction in 2020, the economy is expected to grow at 4% in 2021. Real GDP is projected to grow at just less than 2% each year from 2022. So, a multi-year recovery to pre-pandemic levels is inevitable, and the full extent of structural changes in office working are yet unclear. We expect further pressure on operational metrics and more business rescues and liquidations, a lack of liquidity in the market and pressure on valuations. The diversification of our investments across sectors, geographies and income streams, with our improved tenant relationships and commitment to service excellence will serve us well in this environment," remarks Sasse.

Development expertise continues to be a competitive advantage for Growthpoint. It creates opportunities to generate profits and supports Growthpoint's disposal strategy by unlocking the best value from its non-strategic assets. While it doesn't distribute non-recurring income, Growthpoint's trading and development activity proved very profitable this year, earning R193m of third-party trading profits, development fees and rental income.

Considering market conditions, speculative development was temporarily suspended and projects were tenant driven. However, this function is not limited to the three traditional commercial property sectors of Growthpoint's core business and can respond to diverse demand and opportunities, including those in healthcare and residential property. Accordingly, Growthpoint completed the development of the specialist surgical Cintocare Hospital in FY21 and commenced the development of sectional title residential apartments for sale called The Kent, La Lucia. In keeping with its environmental sustainability drive, Growthpoint approved several solar power projects and expanded existing PV installations in response to new electricity generation regulations.

The V&A Waterfront was severely impacted by various lockdown restrictions, the absence of foreign tourism, its cruise terminal's closure, and leisure limitations. Although rental collections have now increased to around 90%, they averaged 69% during the year and net property income declined by 32%. Visitor numbers dropped from 21.6m to 13.7m. Retail sales steadily increased until the harsher lockdown restrictions were imposed from June 2021 due to the third wave of COVID-19 infections. Retail vacancies remain a low 2.5% with strong demand. The V&A's robust office portfolio proved resilient, occupied by around 65% blue-chip tenants supporting low vacancies of 3.4%. All hotels except the Commodore have reopened but occupancy rates remained low. The fishing industry traded and paid rental throughout the period. Casual shipping and yachting remained strong. The V&A's contribution to Growthpoint's income decreased by 40% in FY21.

"*The return of international tourism, events and leisure travel is critical for the Waterfront, which remains a strong asset with solid property fundamentals,*" says Sasse.

Growthpoint's capital light funds management strategy allows it to access third party capital and leverage its management strength in the unlisted, co-investment environment. Growthpoint continued building its first two funds. During the year, this strategic focus earned Growthpoint R132.1m in dividends from the healthcare fund and R32.9m for its role in managing this fund. It also received a total maiden dividend of R6.6m from Lango Real Estate, its Africa fund, which Growthpoint elected to reinvest, and management fees of R14.0m

Sasse explains, *"Our funds management business is a core strategy. The co-investment and co-management model are effective and particularly attractive in this market, and we are focusing on growing this business. We are excited to be launching our third fund focusing on purpose-built student accommodation in October 2021."*

The healthcare fund, Growthpoint Healthcare Property Holdings (GHPH), in which Growthpoint increased its shareholding to 62.2%, closed the year with a R2.8bn property portfolio of six hospitals and a medical chamber. Post year-end it took transfer of the R515.6m Cintocare Hospital, developed by Growthpoint in Menlyn Maine, Pretoria. A USD80m equity and convertible debt package from the International Finance Corporation was concluded to finance development and acquisition opportunities, for which the healthcare fund has a good pipeline of around R5bn. This investment is an endorsement of the fund's robust ESG credentials, which are key considerations for investment by development finance institutions (DFIs) and other institutional investors.

Growthpoint has a 16.1% shareholding in Lango (formerly Growthpoint Investec African Property Fund), which grew significantly during the year with NAV reaching USD320m. It now owns a USD600.9m quality portfolio comprising 11 prime office and retail income-producing properties in Ghana, Nigeria and Zambia, after acquiring minority stakes in several of its assets during the year. It has commenced its second fundraising period for an exciting pipeline of investment assets.

The strategic focus of Growthpoint's international investment approach is being refined. Its offshore investment remained at steady levels of 39.9% of its property assets by book value and 29.1% of earnings before interest and tax. Its overseas investments bolstered Growthpoint's performance this year, but the income received from these investments was materially lower.

GOZ, with its defensive portfolio of quality office and industrial assets with strong tenancies, is a core investment for Growthpoint. Growthpoint received a dividend from GOZ in AUD of 20.0 cents per share for FY21 in line with guidance but down from 21.8 cents for FY20, reflecting a more conservative pay-out ratio to ensure liquidity and balance sheet strength. However an impressive 14.2% upwards re-valuation of net tangible assets - driven by leasing successes, yield compression on long weighted average lease expiries and industrial assets - benefitted Growthpoint and reflected positively on its balance sheet.

The impact from pandemic lockdowns in Australia was immaterial for GOZ in FY21 - 97% of its tenants are big corporates and government – and continued to perform well. It is in a strong capital position with gearing at a historic low of 27.9% with good liquidity of AUD387m available. Its portfolio metrics are in great shape. Rental collection rates remained at 99% throughout the year, and portfolio occupancy increased to 97%. Significant longer-term leases were signed in FY21 for an average of 8.2 years taking the portfolio's weighted average lease expiry to 6.2 years.

"GOZ is in the best shape it has ever been. Faster economic recovery is expected for Australia, and this market offers opportunities for property acquisitions, funds management and corporate actions. GOZ's quality portfolio is well positioned for pleasing performance," reports Sasse. GOZ has guided a 3.0% increased distribution of AUD20.6cents per share for its 2022 financial year.

Growthpoint's Central and Eastern European investment platform, Globalworth, comprises office and industrial assets, with little retail property. It has 37 assets in Poland and 29 in Romania. It delivered a solid performance overall, albeit that retaining EUR460 cash to reinforce balance sheet strength resulted in an opportunity cost and significantly reduced distributions to Growthpoint to EUR30 cents per share for FY21 from EUR49 cents per share for FY20. The consortium of CPI Property Group and Aroundtown now holds 60.6% of share capital of GWI, following the completion of a cash offer for Globalworth shares at EUR7.00 per share, which Growthpoint did not accept.

Globalworth proved defensive and relatively unaffected by the pandemic, with rental collections at 98.7% and a portfolio occupancy of 88.7% with the real estate market remaining challenging and the economic slowdown and associated uncertainty regarding the pace of future economic growth due to COVID-19 impacting demand for real estate space. Globalworth has a strong balance sheet and is conservatively geared with an LTV of 39.2%.

"Office demand and rental dynamics are likely to exert some pressure going forward, but Globalworth's strong balance sheet, cash available to deploy and a solid base of multinational tenants which favour the region, stand it in good stead," notes Sasse."

Capital & Regional in the UK, which owns seven dominant in-town shopping centres catering for needs-based shopping, faced the most prolonged lockdown period of any of Growthpoint's investments during the 12 months and was the most severely impacted of its international investments. The UK's extreme lockdowns and regulations that limited landlords' ability to collect rent, impacted income, valuations, and leverage. C&R breached some of its debt covenants and declared no dividends for FY21. It has signed wavers for all current income covenants with its funders and has high cash reserves of GBP75m - more than one year's gross rental income - on its balance sheet.

"Although this was a disappointing performance, we believe C&R is a great investment that stands to benefit from the UK turnaround. The easing of government restrictions from April and the UK's advances in vaccinations are fuelling the rapid re-igniting of one of the world's biggest economies, which provides the basis for return to more normal trading conditions for the rest of the year. Further, strategic opportunities for the C&R balance sheet are being considered," reports Sasse.

Amid extreme uncertainty, Growthpoint demonstrated the benefits of good liquidity, balance sheet strength, a conservative management approach and quality of earnings in FY21.

"We are cautiously optimistic about the potential for improvement in some of the geographies and sectors where we invest and will optimise these advantages. We remain committed to our clear priorities, which support our sustainable performance for all our stakeholders, and enable Growthpoint to continue advancing its strategic thrusts," says Sasse. *"In line with Growthpoint's new Board-approved ESG strategy, with integrity, ethics and our values guiding our governance, we will continue to provide space to thrive in environmentally-friendly buildings, while improving the social and material wellbeing of individuals and communities."*

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