

## PORTFOLIO MANAGER COMMENTARY

Listed property experienced a very strong quarter on the back of much lower bond yields as well as a results season which did not spring too many negative surprises. The sector delivered a total return of 9.9% as both the 50bps interest rate cut (and the accompanying downward movement in the rolling 10-year bond) as well as less bearish guidance from management teams in their results releases. From a forward yield perspective the sector rerated strongly from 9.2% to 8.6% on a weighted average basis, reflecting both strong share price movement and the impact of large index constituents like Growthpoint moving out of lower distribution growth reporting periods.

The fund marginally underperformed the SA Listed Property Index (SAPY) for the quarter, but continues to outperform the spliced benchmark over one year. However, it marginally underperformed the benchmark over three years. The underperformance for the quarter can mainly be attributed to the limited exposure to stocks like Sycor, SA Corporate, Redefine and Vukile, while the relative positioning in Liberty International, Acucap and Hospitality A further detracted from performance. Positive relative return contribution occurred through the exposure to Hyprop and Foord Compass.

The main activity within the fund during the quarter was the disposal of its entire holding in Hyprop. This disposal does not reflect a potential derating in retail assets within the property sector or a weakness in Hyprop's portfolio. At the time when the negotiations started regarding the sale of Coronation's entire stake in Hyprop, the 7.0% clean forward yield achieved with the sale compared very well with the sector clean forward yield at that stage of 9.0%, as well as the underlying valuation yield within Hyprop's portfolio of 7.3%.

This disposal resulted in the cash position of the fund increasing substantially to 20%. However, with only a few days between the effective date of the transaction being 19 March and the end of the quarter, the cash position was decreased to 8.3% into a rapidly rising market. This was achieved by increasing exposure to Capital, Pangbourne, Resilient, Growthpoint, Redefine, Acucap and Liberty International. In addition, the fund participated in a private placement of NEPI at a discount price to the market trading levels. NEPI was established to invest primarily in the high quality office, retail and industrial property market in Romania and has a secondary inward listing in South Africa since April 2009. NEPI has the strong support of the Resilient group of companies with direct and indirect shareholdings and access to management skills. The portfolio has a retail bias with 66% exposure to this sector. The prospects of these properties seem positive with strong international and national Romanian tenants as well as a gradually improving consumer base.

Liberty International released full year results in March. The focus of the results fell less on the actual underlying performance of the company and more on the announcement regarding the demerger into Capital Shopping Centres (CSC) and Capital & Counties (CapCo). CSC will remain dual listed (similar to Liberty International at present) and contain the shopping centre assets, while CapCo will be an inward listed company on the JSE housing all the Central London assets, which include Covent Garden, Earls Court & Olympia, the Great Capital Partnership and the Empress State building. Despite the anomalies with the new listing structure we remain positive on both the demerged entities. The upside for CSC lies within the conversion of short-term rentals signed during the last 18 months to fill vacancies left by retailers going into administration as well as further positive yield movements. In turn, the upside for CapCo lies within the repositioning of Covent Garden as a premier Central London retail destination as well as the potential in the redevelopment of the Earls Court site.

Many local companies also reported during the quarter. Excluding Redefine, which delivered a year-on-year increase of 28% in its quarterly distribution, the weighted average distribution growth delivered by the sector was 6.5%. This ranged from -36.1% in the case of the combined Hospitality unit through to the 14.4% delivered by Capital. Key themes which came through with the results released were the defensiveness of industrial and regional retail assets. The cyclical nature of the office sector has started to rear its head and could continue to put pressure on rental reversion, specifically in nodes where an oversupply is gradually being created. In addition, developers have hopefully learned the importance of quality line shops in smaller retail developments and that, despite having a food retailer as anchor tenant, consumers are sophisticated enough to differentiate between good and bad tenant mix. Tenants remain under pressure, with an increase in vacancies and subsequent vacancies taking longer to fill given increased incentives (either broker commission or subsidies to tenant installations). From an operating point of view, I expect the next 6 months (at least) to remain tough for tenants. The lower interest rate cycle should by then have had sufficient time to filter through the system. Tenants will however continue to experience headwinds with electricity costs and municipal rates increases. Going forward the key for operating success within the listed sector will be the successful managing of costs and vacancies and negotiating favourable funding margins when funding facilities need to be renewed. From a landlord perspective knowing your tenant is very important.

The sector seems to have run ahead of itself early in the quarter. However, with the subsequent movement in bond yields the strong quarter seems justified, although a bit unexpected taking the underlying property risks into account. Things seem to be improving on the ground, but commercial property is not entirely out of the woods yet (although the 2009 Investment Property Databank numbers point to the momentum turning positive in the second quarter of 2009 for direct commercial property). In the short-term inflation may surprise on the downside as the currency remains strong, government borrowing may be less than anticipated and GDP growth may surprise on the upside. This leads me to believe that the positive momentum in the sector should remain, although this call is marginal as there are so many variables that could impact the macro economic environment.

**Portfolio manager**  
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