Please note that the commentary is for the retail class of the fund.

The listed property sector delivered a total return of 8.3% for the quarter, outperforming the All Bond Index's (ALBI) 2.2% and the All Share Index' (ALSI) 7.4% return. The correlation between bonds and listed property was not that strong during the quarter: the SA 10-year government bond yield increased to 8.8% at end-December from 8.7% a quarter earlier, while the forward yield of the SA listed property sector saw a compression to 7.9% from 8.2% at the end of September. The historical yield of the SAPY decreased to 5.8% at the end of the quarter, from 6.2% three months earlier. This saw the historical yield gap relative to bonds move out to 304bps at the end of December from 248bps at end-September. Listed property's total return for the 2017 calendar year came in at 17.2%, ahead of bonds at 10.2% but behind the ALSI's 21%.

The fund's return of 7.2% during the quarter was less than the 8.3% delivered by the benchmark, however the fund's performance over periods between five and 10 years compares favourably to peers and the benchmark. The underperformance during the quarter was due to value detraction from the fund's relative exposure to Nepi Rockcastle, Growthpoint, Resilient, Fortress B and Greenbay. These were enough to offset the value-add coming from the fund's relative positioning in Investec Property Fund, Capital & Counties, Stor-Age and Attacq. During the period, the fund increased exposure to Fortress A, Liberty Two Degrees, SA Corporate and Stor-Age, while reducing exposure to a handful of names, including Growthpoint, Resilient, Fortress B and Redefine.

As is usual in the listed property sector, the quarter saw just over R9.1 billion in primary capital raises across three companies. Nepi Rockcastle saw outsized appetite for its capital raise, which in the end saw R5.2 billion raised compared to an initial target of R3 billion. Stor-Age was another company to tap equity investors for capital during the quarter; a total of R1.3 billion was raised towards the company's acquisition of the UK self-storage business, Storage King. MAS Real Estate was the third company to issue equity, raising R2.6 billion during the quarter. These brought the total amount of capital raised by the sector during 2017 to R35.5 billion.

On the corporate action front, following numerous months where UK-listed property names traded at substantial discounts to their Net Asset Values (NAVs), Hammerson announced its intended takeover of rival Intu Properties. Some shareholder support has already been received by each company for the deal, which if successful would result in one of the largest pan-European retail landlords. In other activity, Emira announced its foray into the US market with the establishment of a partnership in which it will have a 49% stake. As it stands, the US business will amount to 2% of the company's asset base and will take total offshore exposure to 8%. Meanwhile, EPP announced a three-tranche acquisition of a portfolio of shopping centres and retail parks in Poland from a consortium comprising Oaktree, PIMCO and Redefine. The portfolio is being acquired for just under €700 million or a 7% yield, and represents a further move in strengthening EPP's pure retail focus subsequent the disposal of their office portfolio to Globalworth.

Meanwhile, Nepi Rockcastle acquired four shopping centres across three countries – Poland, Bulgaria and Hungary – in a period of two months for a total of €870 million, funded in part by the equity issuance mentioned above. Greenbay, in the meantime, made an offer (which lapsed in the end) to acquire Group Five's offshore concession assets which would have represented the company's first direct infrastructure holdings. Remaining in Eastern Europe, Accelerate announced the acquisition of a portfolio of five single tenanted, light industrial properties in Poland for €40.2 million. In management changes during the quarter, Attacq announced the departure of its CEO Morné Wilken, who assumed the reins at MAS Real Estate from January 2018. In the interim, Attacq CFO Melt Hamman will be interim CEO until a more permanent appointment has been made by the Attacq board.

SAPOA released its quarterly office vacancy survey for the third quarter of 2017 during the final quarter of the year. The release showed that office vacancies decreased to 11.2% in September 2017 from 11.8% a quarter earlier. All four office grades saw improved vacancy trends, with P- and C-grade space in particular seeing large reversals in the deterioration recorded in the prior quarter. All five metropolitan areas registered improvements in occupancies. Growth in asking rents over the last 12 months recorded a slowdown to 2.7% versus 4.1% recorded in the previous quarter. Office space under development amounts to 3.6% of existing stock (with 69.9% of this pre-let). A high degree of concentration remains – with 10/53 nodes accounting for 91% of all developments. 45% of this space is in the Sandton node.

The past quarter also saw the conclusion of the last reporting period of the year. The results confirmed the trends coming out of the sector in the earlier reporting season and were in line with the broader economic backdrop. In general, while DPS growth for the past reporting period was in line with expectations, for a number of counters it was the lower end of guidance that was realised. Furthermore, a few counters' management guidance for the upcoming year was below expectations, with the likes of Arrowhead guiding to negative growth in distributions (in part due to no longer paying out once-offs), while Octodec, Accelerate and Delta (the latter two confirming previous guidance) guided to flat growth for the upcoming year. The retail sector continues to exhibit a weakening trend with regard to trading density growth and renewal growth; the office sector remains in the doldrums; while logistics continue to hold up in line with global trends. Inner city residential portfolios have also come under strain as oversupply in some nodes, coupled with bumping against affordability thresholds, diminish rental growth. Suburban residential stock within other portfolios, however, appears to be holding up better (but not immune to the downward pressure on rental growth).

Following the outcome of the ANC's elective conference in December 2017, early indications point to an improvement in general sentiment in the economy. With the reaction of listed property already pricing some of this improvement in, the sector has rerated somewhat from previously cheap levels. Notwithstanding, there remain some SA-focused companies that continue to trade on high single-digit initial yields, with distribution growth prospects that should at least equal inflation over the medium term. These are underpinned by high-quality portfolios and excellent management teams that deliver good quality earnings streams. As a result, we still see the sector providing double-digit total returns that should exceed those coming from cash and government bonds through the cycle.

Portfolio manager
Anton de Goede
as at 31 December 2017