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

The listed property sector delivered a total return of 5.7% for the quarter, outperforming the All Bond Index's 3.7% but lagging the All Share Index's 8.9% return. The correlation between bonds and listed property recovered somewhat from the prior quarter: the SA 10-year government bond yield decreased to 8.7% at end-September from 8.9% a quarter earlier, while the forward yield of the SA listed property sector saw a compression to 8.2% from 8.3% at the end of June. The historical yield of the SA Listed Property Index (SAPY) was unchanged at 6.2% from three months earlier. This saw a compression in the historical yield gap relative to bonds, ending the third quarter at 248 basis points (bps) from 269bps at end-June.

The fund's return of 4.4% for the quarter was less than the 5.7% 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, Fortress, Resilient, Greenbay, Growthpoint, as well as Capital & Counties and Intu. These were enough to offset the value-add from the fund's relative positioning in MAS Real Estate, Equites, Attacq, Stor-Age and Hammerson. During the period, the fund increased exposure to Hyprop, Vukile, Investec Property Fund, Hammerson and Liberty Two Degrees, while reducing exposure to a handful of names, including NEPI Rockcastle, Growthpoint, Octodec, Resilient and Fortress B. As is usual in the listed property sector, the quarter saw just over R12.7 billion in primary capital raises across eight companies. The largest of these was Greenbay, which saw outsized appetite for an initial R2 billion target, eventually raising R4.5 billion. Resilient also came to tap the market for capital, issuing R2.5 billion worth of shares during the quarter, followed closely (in terms of size of capital raise) by MAS Real Estate with a R2 billion scrip issue. Other companies raising equity during the quarter included Hospitality (R1 billion rights issue), Equites (R1 billion), Atlantic Leaf (R815 million), Vukile (R578 million) and Sirius Real Estate (R375 million private placement).

On the acquisitions front, Investec Property Fund's annual report revealed that the company had made its first direct entry into the UK with the acquisition of a 10% stake valued at £10 million in an unlisted fund with a predominantly supermarket focus. The entity is said to likely list once a scale of £400-500 million has been reached. Staying with the UK, Stor-Age announced the proposed acquisition of Storage King, a portfolio comprising 13 self-storage assets in the UK valued at £77 million, which will take the company's UK exposure to 35% of the total asset base. The transaction will be subject to shareholder approval. Another company that also increased its offshore exposure is Equites, which announced the acquisition of its fourth distribution centre in the UK, taking offshore exposure within the fund to around the 25% targeted by management. This latest acquisition is a 20 000m2 distribution centre in Coventry, and will be let to Kuehne & Nagel. At a 4.8% acquisition yield, the pricing for this latest addition to the portfolio came in tighter than for the prior three acquisitions, which were bought at yields of between 5.7% and 7.2%. Meanwhile, Rebosis announced that it had reduced its stake in UK-focused New Frontier to 36% from 67%, having sold the difference to a BEE consortium chaired by Nkosi Gugushe. The acquisition by the consortium will be vendor financed by Rebosis.

In other activity, Hyprop announced the acquisition of a 53 000m2 centre in Sofia, Bulgaria via its 60% owned subsidiary, Hystead. This latest acquisition takes the size of the Hystead portfolio to €460 million – comprising four centres across South and Eastern Europe. NEPI Rockcastle announced two sizeable acquisition to the tune of over €500 million. First was the acquisition of the 66 000m2 Arena Plaza, the second largest shopping centre in Budapest for €275 million at a yield of 6.2%. Shortly afterwards, the company announced the purchase of the 82 000m2 Paradise Center, the largest retail centre in Sofia, Bulgaria. The centre was purchased for €253 million, equivalent to a yield of 7%. As far as management changes are concerned, Texton announced the appointment of Inge Pick as the company's new CFO. Meanwhile, Greenbay saw Paul Simon resign as CFO, with Kobus van Biljon announced as his replacement. One of Kobus's former roles was CFO of Resilient Africa.

The group of companies with June/December year-ends, representing just under two-thirds of the sector's market capitalisation, reported results during the quarter. Distribution growth including offshore counters this reporting period came in at 12.6%. Excluding the offshore-focused counters, distribution per share (DPS) growth was little changed at 10.9% versus 11.3% by the same group of companies six months ago, but this was supported by Resilient and its sister companies. Excluding these, average DPS growth saw a slowdown to 6.4% from 7.6% six months prior.

The core message coming from management teams is that conditions on the ground remain tough, with this past year having been among the most challenging in the past decade or so. While distribution guidance was generally met, management teams are softening their outlooks, with distribution guidance going forward being adjusted towards the bottom end of previous guidance in some instances or expected to match this past year's outcomes. On the underlying portfolio metrics, vacancies were in general mixed, with prime retail showing an uptick (albeit from low levels) after some resilience for a number of years. Trading density growth has also remained under pressure on the back of challenging trading by mainly the apparel retailers, with super-regional centres (which are mostly exposed to these players as tenants) taking strain as a result. This does not bode well for retail reversions going forward. Meanwhile, industrial and office portfolios continue to reflect the conditions on the ground; office rentals are under pressure, with intense competition amongst landlords seeing a drive for increasing incentives and negative reversions. The industrial market continues to see a cap on rentals, though logistics tenants still appear to be faring better than traditional manufacturing tenants.

As this past reporting period has shown, the slowdown in the broader macroeconomic environment continues to be a headwind for property fundamentals. Notwithstanding, within the SA-focused listed property universe are good quality companies with great portfolios and excellent management teams that deliver high quality earnings streams. Some of these trade on high single-digit initial yields, with distribution growth prospects that should at least equal inflation over the medium term. 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
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as at 30 September 2017