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

The listed property sector, through the All Property Index (ALPI), delivered a total return of -1.5% for the quarter, ahead of the All Share Index's (ALSI) -2.1% return but behind the All Bond Index's (ALBI) 0.8%. The correlation between bonds and listed property was once again in play following an emerging market sell-off during the quarter. The South African 10-year government bond yield increased to 9.2% at end-September from 9.0% a quarter earlier, while the forward yield of the ALPI saw an increase to 8.8% from 8.6% at the end of June. The historical yield of the bellwether index increased to 9.1% at the end of the quarter, from 8.2% three months earlier. This saw the historical yield gap relative to bonds narrow to 15 bps at the end of September from 79 bps at end-June.

The fund's return of -0.3% during the quarter was ahead of the -1.5% delivered by the benchmark. The fund's performance over periods between three and 10 years compares favourably to peers and the benchmark. Value add during the quarter came from the fund's relative positioning in Growthpoint, Redefine, Hyprop, Stor-Age and Nepi Rockcastle. These were enough to offset the value detraction coming from the fund's relative positioning in Attacq, Liberty Two Degrees, Hammerson and Investec Property Fund. During the period, the fund increased exposure to Intu, Capital & Counties, Sirius, MAS Real Estate and Hammerson, while reducing exposure to a handful of names, including Growthpoint, Redefine, Equites and Fortress B.

Though limited in terms of number of counters, equity issuance during the quarter came in at R2.7 billion. EPP raised R700 million on the back of its acquisition of King Cross Marcelin in Poland, which was fully underwritten by the main shareholder, Redefine. Vukile raised R1.63 billion related to its acquisition of ex-Unibail assets in Spain, while Stor-Age raised R400 million following its acquisition of the managed portfolio. Unlike in the past where equity issuance was the norm, the opposite was the case as Greenbay announced a return of €300 million in capital to shareholders, as well as a repurchase of shares in the market representing 3.2% of the issued share capital. The company has committed to realise profits on its listed equity holdings and have direct and indirect property holdings constitute the majority of its investments, a pivot from having shown keen interest in infrastructure assets in the past, following a declassification of the counter as a real estate company by the JSE.

In management changes during the quarter, Nepi Rockcastle announced that former Rockcastle CEO Spiro Noussis and COO Nick Matulovich would be leaving the company at the end of 2018. This follows the board appointing Alex Morar as the company's sole CEO in recent months following a joint-CEO setup since the merger. Meanwhile, Investec Property Fund announced that Nick Riley would be stepping down as CEO from 1st December 2018 to take up a broader role within Investec Bank, with current CFO Andrew Wooler and Darryl Mayers (from within the bank) taking over as co-CEOs. In other activity, Vukile announced the appointment of Elton Bosch, ex-CFO of Clover, as CFO designate. He will take over upon the retirement of current CFO Mike Potts, in the coming year.

Moving to acquisitions, Vukile acquired a portfolio of four shopping centres valued at €460 million in Spain from Unibail, taking the company's Spanish exposure to 43% of its asset base. In other activity, Redefine acquired a portfolio of nine logistics assets in Poland from a US fund manager. Redefine's 95% stake was bought for €185.8 million at an acquisition yield of 7.1%. Still in Central and Eastern Europe (CEE), Nepi Rockcastle announced its second acquisition in Hungary, this time a controlling stake in Mammut Shopping Centre in Budapest for €254 million. Meanwhile, after flagging it for some time, Stor-Age announced its acquisition of its managed portfolio of 12 assets that were in a state of infancy at the time of listing. These assets come with a rental underpin that reduces the dilution in the REIT. Stenprop continued its push into multi-let industrial with the acquisition of another MLI asset, this time a 32 622ft^2 estate acquired for £3.25 million at a yield of 8.15%.

The South African Property Owners Association released its quarterly office vacancy survey for the second quarter of 2018 during the quarter. Office vacancies decreased to 11.1% in June 2018 from 11.5% a quarter earlier. Of the four office grades, A-, B- and C-grade space saw improved vacancy trends, while P-grade space experienced a decline in occupancy. Three of the five metropolitan areas (Durban, Pretoria and Johannesburg) registered improvements in occupancies, while two saw vacancies deteriorate (Port Elizabeth and Cape Town). Growth in asking rents over the last 12 months recorded an improvement to 6.3% vs. 3.1% in the previous quarter. Office space under development amounts to 2.8% of existing stock. A high degree of concentration remains – with four nodes accounting for 69% of all developments, with a third of this space in the Sandton node.

The month saw the third reporting season of the year, with counters accounting for up to 60% of the sector's market cap releasing results. Distribution growth inclusive of the companies with full offshore exposure came in at 13.4%, on the back of the weaker rand in recent months. Excluding these offshore names, companies with a predominantly South Africa focus delivered dividend per share growth of 5.0%, while growth came in at 5.5% excluding the Resilient group of companies. The underlying environment remains tough, with very little new demand for rental space coming through. The retail sector has shown deterioration on the back of continued pressure on trading density growth, in turn limiting renewals to the low single digits, and even negative in some instances. The industrial sector is also seeing pressure on reversions as long-term leases which have escalated above market come to renewal in this environment. Offices, which were the first to be negatively impacted by the challenged macro, remain in the doldrums. Landlords have continued to sacrifice renewal growth to defend occupancy. On the expenses side, landlords have highlighted rates increases coming from the municipalities. While the bulk of these can be passed onto tenants, the increase in cost of occupancy isn't to the tenants' benefit.

The underlying economic backdrop remains challenged, as evidenced by the negative second quarter South African GDP number. While this weakened environment has started to show up in property fundamentals, it remains unclear to what extent this can still filter through. As a result, there remain selective opportunities within the South African listed property universe. While initial yields appear attractive, already under-pressure distribution growth could see further headwinds, making the attractiveness of the sector less than it appears.

Portfolio manager
Anton de Goede and Kanyane Matlou

as at 30 September 2018