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

The All Property Index (ALPI) delivered a total return of 1.2% in the fourth quarter of 2019 (Q4-19). Despite the positive quarter, the sector ended the year with a negative 0.4% return. It underperformed both the FTSE/JSE All Share Index and ALBI over the quarter and for the year, with investor confidence towards the sector not yet returning. The South African rolling 10-year government bond yield, usually a good indicator of the trajectory of property yields, remained fairly stable over the quarter and moved only 6 basis points (bps) out to 9.0%, while the forward yield of the ALPI saw an increase to 9.6% from 9.4% as at end-September 2019. The historical yield of the bellwether index edged higher towards 11.0% at the end of Q4-19, up from 10.7% three months earlier. This saw the historical yield gap relative to bonds expand once more, albeit marginal compared to previous quarters, moving closer to 200bps at the end of December from 187bps as at end-September 2019.

The fund's return of 0.9% during Q4-19 was marginally lower than that of the benchmark; this was the main driver of the 0.5% underperformance relative to the benchmark for 2019. However, the fund's performance over periods between three and 10 years compares favourably to peers and the benchmark. The fund's relative positioning in Growthpoint, Fortress A, Equites, Attacq and MAS added value during Q4-19, while value detraction came from the relative positioning in Hyprop, Redefine, Liberty Two Degrees and Resilient. During the period, the fund increased exposure to Growthpoint while reducing exposure to Capital and Counties, Resilient, Stor-age and Vukile.

For those that reported their August or September results during this past quarter, the average dividend per share growth rate came in at 0.5% compared to distributable earnings per share growth of 2.4%. Excluding offshore-focused companies, the respective growth was -0.1% and 2.7%. Preliminary calculations show that, for 2019, the average dividend per share growth rate came in at 1.3% compared to distributable earnings per share growth of 1.6% (still awaiting the final few companies with December 2019 year-ends). This compares to the historical 10-year average dividend growth per share of 8.3%, which is the lowest sector dividend growth since 2001/2002. As alluded to in last quarter's commentary, dividend payout ratios continue to be the most topical issue in the sector at present, which is why differentiation between the two growth measures is required. In principle, Coronation supports the concept of holding back funds to ensure that there is a buffer from which defensive capital expenditure can be partially funded. However, in our interaction with management teams, there is a clear difference in view from companies within the sector. Those not keeping back income argue at present that their balance sheets are strong enough to absorb any capital spend required to maintain their portfolio quality.

During the quarter, both SAPOA and the MSCI released some relevant physical property industry data. The MSCI provided some indication of the direction of SA direct property returns based on its half-yearly survey. Noticeable trends are increasing repairs and maintenance spend by landlords; better cost recoveries assisting like-on-like net rental income growth; an increase in lease cancellation fees; and valuation risks. Total return for direct property for the first half of 2019 (H1-19) is 3.9%, split between 4% income and -0.1% capital. This compares to a total return of 10% for 2018. Both the income and capital return component have been decreasing over the last three years and one should expect a negative capital return for 2019 (vs. 3.1% in 2017 and 1.6% in 2018).

SAPOA released its quarterly office vacancy survey for the third quarter of 2019. Vacancies improved by 30 basis points to 11.0% compared to the second quarter's figure of 11.3%. While the level of new office development has slowed since 2015, demand for space has slowed at a faster pace. Development activity is at the lowest level since 2005, at 320 000m², or 1.7% of overall activity. SAPOA also published its retail trends report, based on data gathered by MSCI. Shopping centre trading density growth (annualised; sales per square meter) came in at 4.3% year-on-year to September 2019; a marginal improvement in momentum. The growth number, however, masks many anomalies. The growth is driven by smaller format convenience shopping centres where space consolidation (of food retailers, in particular) is resulting in stronger growth. Larger regional shopping centres have not experienced trading density growth above 2% since 2017; this is in line with the numbers being reported by most listed retail landlords and a better reflection of the challenged state of cost of occupancy and the affordability of rentals for retailers. These numbers speak to the key themes playing out in the sector, namely convenience, lower footfall, the rise of mixed use and the need for entertainment and experiential retail. Space growth of the past 20 years is now catching up to the sector. Some reprieve for landlords is second-tier retailers, especially discount fashion players, and, selectively, online-only retailers starting to take up space previously occupied by nationals.

Landlords continue to face one of toughest operating environments since the early 2000's, with the economic backdrop (GDP growth again disappointed in the third quarter) not supporting business confidence and tenant growth ambitions. In general, rentals continue to go backwards, and cost pressure, mostly from increased administered pricing, is not abating. Affordability, with overall occupancy costs as the main determinant, is driving tenant decision making at present, which, on the office and industrial side, also includes space consolidation and in-office user densification. The uncertainty created by the return of load shedding towards the end of 2019 is adding to the current woes of landlords. Balance sheet flexibility and capacity are becoming key considerations in investment decisions. Portfolio quality and defensive lease expiry profiles, portfolio positioning and relative rental levels versus the market will continue to play a key role in how companies weather the current storm. With all of this as a backdrop, we foresee the current cycle of distributable earnings growth pressure (and dividend growth pressure as payout ratios are potentially adjusted) to continue. Despite the improvement in returns experienced this last quarter, we do not foresee this as the start of a meaningful recovery, but rather an environment of selective stock-specific opportunities.

Portfolio manager
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as at 31 December 2019