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

The All Property Index (ALPI) delivered a total return of 1.5% in the second quarter of 2019 (Q2-19). This return lagged that of the FTSE/JSE All Share Index (3.9%) and the All Bond Index (3.7%). The correlation between bonds and listed property held up for the better part of the quarter, but dissipated somewhat in the latter part. The South African 10-year government bond yield compressed to 8.7% from 9.0% in the first quarter, while the forward yield of the ALPI saw a marginal uptick to 8.9% from 8.8% as at end-March 2019. The historical yield of the bellwether index increased to 9.9% at the end of Q2-19, up from 9.5% three months earlier. This saw the historical yield gap relative to bonds widen to 126 basis points (bps) at the end of June, from 51bps as at end-March 2019.

The fund's return of 1.1% during Q2-19 lagged the 1.5% delivered by the benchmark, while performance over periods between three and 10 years compares favourably to peers and the benchmark. The fund's relative positioning in Nepi Rockcastle, Liberty Two Degrees, Echo Polska Properties and Redefine added value during Q2-19 – though not enough to offset the value detraction coming from the relative positioning in Growthpoint, Hammerson, Fortress A and Resilient. During the period, the fund increased exposure to Hyprop, SA Corporate Real Estate and Equites Property Fund, while reducing exposure to Growthpoint, Fortress A and Investec Property Fund.

Companies with March/September year ends, representing just under 40% of the sector's market capitalisation, reported financial results during Q2-19, with dividend growth coming in at 2.0% for the domestic names. When including offshore-focused but locally-listed counters, dividend growth sat at -1.4%. The trend coming out of the reporting season continues to be one showing that net property income growth remains under pressure. While vacancies have held up, pressure on escalations and reversions remains and lease incentives are increasing. The cost of replacing a tenant is therefore high, with landlords adopting a 'whatever-it-takes' approach to retain existing tenants. Longer void periods in this environment are having a negative impact on the recovery of municipal charges. On the cost side, pressure emanating from increased rates expenses are seeing an upward trend in cost-to-income ratios.

Vukile was the third counter to come to the market with a capital raise in the year to date. The company raised R700 million in an accelerated bookbuild and a further R400 million in private placements, bringing the total capital raised by the sector this year to R2.4 billion. In corporate activity during the quarter, Gemgrow and Arrowhead announced that Gemgrow would undertake a reverse take-over of Arrowhead to leverage off Gemgrow's dual-class share structure. The boards of these two companies are of the view that there is no longer a clear rationale to retain two separate listings and believe that, in the current challenging operating environment, a simplified group structure would be more efficient and create synergistic benefits for all shareholders. In addition to Arrowhead's support for the merger, Vukile, being Gemgrow's second largest shareholder, has provided an irrevocable undertaking to support the merger.

In other activity, after announcing that Cromwell had made an offer to acquire all outstanding shares in RDI REIT, this offer is now off the table. According to RDI REIT, since the initial unsolicited approach from Cromwell, the Board actively engaged with Cromwell in order to facilitate its due diligence requirements. Following this engagement, the Board received a conditional proposal from Cromwell. However, the RDI REIT Board found that the proposal undervalued the company and its prospects and took the unanimous decision not to support a further period of due diligence. Bolstering this view, RDI REIT received confirmation from its largest shareholder, Redefine, that the proposal was unacceptable.

Meanwhile, there were some management changes during the period. Intu appointed its former CFO, Matthew Roberts as the company's new CEO, while his old role has been filled by Robert Allen; SA Corporate announced that MD Rory Mackey and FD Antoinette Basson had tendered their resignations as executive directors of the company, both of which were accepted by the Board. Meanwhile, Arrowhead CFO Imraan Suleman resigned following allegations of the unauthorised use of company resources.

The Financial Services Conduct Authority (FSCA) provided an update on the ongoing investigations into Nepi Rockcastle. The regulatory body has concluded the investigation into related party share trading between October 2017 and February 2018. It found no substance to the allegations that directors, related parties and other parties believed to be related to either Resilient, Fortress, Lighthouse Capital and NEPI Rockcastle were supporting the NEPI Rockcastle share price. In other activity, Hyprop and Attacq announced the disposal of Achimota Mall in Ghana to Growthpoint Investec African Properties (Growthpoint and Investec's joint venture). This is their first step in recycling capital out of their 'Rest of Africa' investments, an intention that has been well flagged in the past.

The South African Property Owners' Association (SAPOA) released its quarterly office vacancy survey for Q1-19, which shows that office vacancies were down 10bps to 11.0% from a quarter earlier. Of the four office grades, B-grade space was the only one to show an improvement, with vacancies falling 70bps to 13.1%; P-, A- and C-grade spaces recorded vacancy increases of 190bps, 10bps and 20bps, respectively, from the prior quarter, to end the quarter at vacancy rates of 8.0%, 9.2% and 14.9%, respectively. Of the five metropolitan areas, four (Durban, Port Elizabeth, Johannesburg and Cape Town) saw an improvement in occupancies, while Pretoria recorded deterioration. Growth in asking rents over the last 12 months slowed to 0.9% vs. 4.4% in the previous quarter. Office space under development amounts to 2.2% of existing stock (44.5% of this is pre-let). As has been the case for some time now, a high degree of concentration remains, with 56% of all office developments concentrated in three nodes in Gauteng, these being Sandton, Waterfall and Rosebank.

The economic backdrop remains challenged, as evidenced by the Q1-19 GDP growth print of -3.2% (quarter-on-quarter annualised), reflecting constrained domestic demand from both a household consumption and a fixed investment point of view. The feed-through to property fundamentals was confirmed by the recent reporting season, which reflected the various headwinds to organic rental growth within the sector. Continuing a trend seen over the last year or so, negotiating power remains in tenants' favour, with the result that landlords are managing for occupancies rather than rental growth; outside of a recovery in broader economic activity, it will likely be difficult for property fundamentals to rebound from their current levels. Against this backdrop, opportunities within the domestic listed property universe remain limited as dividend growth could still see further pressure going forward, even though initial yields appear attractive.

Portfolio manager
Anton de Goede and Kanyane Matlou
as at 30 June 2019