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

After an initial volatile start to the second quarter of 2020 (Q2-20), the listed property sector (ALPI), maintained the positive momentum of the last two weeks of May into June, delivering the best quarterly return since the third quarter of 2008, which followed the interest rate hiking cycle of 2007/2008. The sector delivered a total return of 18.7% for the quarter, resulting in it returning 37.7% since the lows experienced in March.

The ALPI's year-to-date (YTD) total return is still, however, -38.3%, with the challenges related to Covid-19 still lingering in the background. The partial recovery came about as some certainty regarding rent collection, deferrals and discounts gradually returned as companies released trading or pre-close updates towards the end of the quarter. Providing some additional comfort is that landlords representing the South African Real Estate Investment Trust (SA REIT) Association, South African Property Owners Association (SAPOA) and the South African Council of Shopping Centres (SACSC) have joined forces to form the SA Property Industry Group, which is able to negotiate with stakeholders, may it be tenants, banks or regulators, with one voice. This is key in ensuring that solutions are found to ensure the sustainability of the commercial property sector for the longer term beyond the existing Covid-19-related challenges. Despite the sector's strong showing during the quarter, its 12-month rolling underperformance versus the Africa All Share Index (ALSI) widened further to -37%, with a marginal inroad into the underperformance versus the All Bond Index (ALBI) to -43%. Post the first quarter, we have cut our dividend expectations for the sector even further, assuming for some companies no dividend payment in the 2020 financial year. Thereby, the current forward yield of the ALPI is 7.6%, down from 14% prior to the first round of dividend adjustments, with the forward yield gap at -179 basis points (bps).

With a return of 15.6% during Q2-20, the fund underperformed the benchmark. 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 Fairvest, Emira and Octodec added value during Q2-20, while value detraction came from the relative positioning in Investec Australia Property, Dipula A and Lighthouse. During the period, the Fund increased exposure to Investec Property, Growthpoint and Equites, while reducing exposure to Liberty Two Degrees, Stor-Age and SA Corporate, to mention some of the repositioning.

Considering all the companies that have now reported for their February and March reporting periods (a few utilising the JSE extension for reporting time periods), distributable earnings in reporting currencies were down 6.1% year-on-year (y/y). Excluding the offshore-focused companies, distributable earnings were 8.0% lower. Dividend growth was much lower, with many companies, especially those reporting interim results, not declaring a dividend. Most of the results had no or minimal impact from Covid-19 and thus the low single-digit distributable earnings growth, excluding Redefine (Redefine was 31.9% lower due to not recognising any income from listed holdings EPP or RDI for the first half of 2020, as the companies did not declare any dividends) is not a reflection of the rent collection for the past three months. Over this period, rent collection seems to have averaged at between 70% and 80% per month with a combination of rent deferral and discounts making up the balance.

Most rental discounts or deferrals are being provided to smaller independent retailers and food and beverage operators. Within the current Covid-19 trading period, retail rent collection has improved from initial collections of circa 50% in April to mid-70% at present, while both office and industrial have deteriorated from levels above 80% to levels closer to 70%. On the office and industrial side, tenants dependent on severely impacted sectors such as travel, tourism and hospitality, have started to feel the bite of negatively impacted cash flow. Thus far, on average, rental discounts for the quarter should result in a 2% to 3% loss of annual rental income for more diversified portfolios and between 5% and 6% for more retail heavy landlords. This is excluding the impact of a failed Edcon, although most landlords believe that both Edgars and Jet will be sold (partially or wholly) with the profitable stores continuing to trade. For the space given up, landlords mostly feel that rental is at an already discounted level and should provide some upside when leased. Many landlords will use the additional space to add grocers in centres in which another food anchor can be justified.

Some companies have already indicated distributable earnings to be more than 15% lower for the June reporting period, even reporting annual results, thus reporting for periods ending May and June coming up the next few months will be a better reflection of the impact of Covid-19.

Balance sheet risk, with most of this associated with potential property value write-downs, remains very topical for the sector. Investors have become much more focused on see-through gearing levels, cross-currency swap risk and refinancing risk. Announcements such as that of Redefine's disposal of its Australian student accommodation developments and RDI holding, as well as that from Vukile of its stake in Atlantic Leaf (both stocks with concerns over elevated see-through gearing levels) are therefore very important for the sector to regain some broader investor support.

Uncertainty still exists as to what extent REIT rules and tax dispensation will be relaxed to accommodate those REITs with cash flow pressure due to rental discounts and deferrals, allowing them to pay out less than the required 75% of distributable earnings to ensure balance sheet management. Accompanying management commentaries with recent results releases caution on general operating conditions post the transition period beyond Covid-19 lockdown trading. No company is prepared to commit to any guidance of medium- to longer-term relevance. Uncertainty remains over dividend payments, as many companies continue to rather postpone any dividend declaration to the full year if reporting interim results, with most rather managing short-term liquidity. As previously mentioned, we will support companies with legitimate liquidity concerns in their decisions to withhold dividends if this will put the company in a meaningfully improved balance sheet position. With this as background, stock selection remains difficult, as it is all about how one is pricing risk at present. Risk is associated with balance sheet pressure, property values and loss of income. We recognise that meaningful risks continue to exist, but see continued selective value from the sector, despite the strong quarterly move in some share prices, with some companies already successful in derisking balance sheets.

Portfolio manager
Anton de Goede
as at 30 June 2020