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

Against our expectations, the property sector surprisingly maintained the momentum of the last quarter of 2020 into the first quarter of 2021, delivering a quarterly return of 8.1% for Q1-21. With the initial Covid-19 sector sell-off occurring in March 2020, this subsequent recovery led the 12-month return to a strong 34.2%. However, the sector is still down 30.3% since the start of 2020, illustrating the severity of the initial sell-down.

Like Q4-20, this past quarter was dominated by the so-called recovery trade into sectors that should benefit more from an economic recovery. Within property, this was skewed towards retail landlords, but also the larger, more liquid names and those stocks with UK exposure, where the vaccination roll-out has thus far been more successful than most other larger economies. While sector specialist unit trusts experienced outflows at the start of the quarter, reversing the strong flows into the sector towards the end of 2020, it seems that selective positive capital flow momentum returned as the quarter progressed. The sector gained ground against both the ALSI and ALBI, not only on a rolling 12-month basis (even turning positive vs the ALBI), but also mostly over three and five years. The ALPI's one-year forward dividend yield is 9.6%.

With a return of 6.2% during Q1-20, the Fund underperformed the benchmark, losing some ground on most time periods. The key reason for this underperformance is the limited exposure to UK-focused companies, which rerated strongly as a result of the recovery trade. The Fund's relative positioning in A shares, especially Dipula A and Fortress A, also detracted from performance as an increase in sector risk appetite continued to benefit stocks more sensitive to the underlying economy. Our positioning in MAS, Attacq, Fairvest and Growthpoint added value during Q1-20. During the period, the largest increase in exposure occurred in Growthpoint and Irongate (previously named Investec Australia Property Fund). The largest reduction in exposure occurred in Redefine and Hyprop, while the Fund's positions in SA Corporate, Capital & Counties and Tsogo Sun Hotels were reduced to zero.

The quarter saw the first new listing of a property stock on the JSE since 2018, with the inward listing of already Frankfurt-listed German landlord Deutsche Konsum. No capital was raised in South Africa (SA) as part of the listing. The company focuses on the convenience retail segment of the German market with smaller assets either anchored by a grocer, DIY operator or non-food discounter. On the potential of broader corporate activity in the sector, both Tower and Rebosis are now trading under cautionary. Tower is likely entertaining an external offer to be taken private, while Rebosis is likely to get an external capital injection to improve its balance sheet. With regards to further expansion offshore, both Tradehold and Fortress announced transactions where exposure to direct European property has been gained. In turn, Attacq continued to decrease its exposure to MAS to strengthen its balance sheet and Resilient reduced NEPI Rockcastle exposure, partly to support its holding in Lighthouse and thus indirectly Hammerson.

With the November and December financial period reporting now concluded, the weighted-average distributable earnings per share growth came in at -30.7%, dividend per share growth at -52.2% and the average dividend pay-out ratio at 65.8%. Albeit Covid-19 rental discounts are much less than initially granted at the height of the first lockdown in SA, the comparable period is still pre-Covid.

- There are some noticeable trends coming out of this reporting season: Flat to negative like-for-like NRI growth (depending if the reporting period includes the hard lockdown at the start of Covid-19) with continued pressure on revenue and costs.
- Vacancies mostly only marginally higher on a portfolio level, with retail vacancies bucking this trend and mostly lower, seeing most pressure in office vacancies and an increase in industrial/logistics vacancies.
- Covid-19 discounts have continued, but to a lesser extent than at the start of Covid-19 lockdowns, for mostly hospitality, gym and restaurant-linked tenants.
- Reversions are where landlords are taking the biggest hit to keep vacancies intact – it has moved clearly into negative double-digit territory with the pain not necessarily over.
- Landlords are actively managing the Edgars space, where replacement leases were not concluded, or room was left in leases to take space back where tenant mix can be improved if the Edgars space is reduced by mostly bringing in additional grocer, pharmacy or value fashion tenants.
- Escalation rates continue to be under pressure, with most landlords reporting a lower portfolio escalation rate than that of the corresponding reporting period; portfolio averages on retail dominated portfolios are moving to below 7% and will likely continue to move lower as existing leases are renewed.
- Portfolio values seem to have settled after the write-downs experienced last year; it is likely that marginal, low single-digit write-downs will be experienced in 2021.
- The various measures taken by companies to bolster balance sheets, ranging from an equity raise to withholding dividends with deeply discounted scrip dividends in between, have brought some stability in balance sheets, with the general trend being either flat or a decrease in gearing levels.
- With local interest rates being at historic lows, companies are gradually reducing their dependencies on offshore funding by either existing cross-currency swaps or bringing back debt onto the local balance sheet to reduce foreign exchange risk.

The focus on the sector has shifted away from balance sheet concerns to the potential of an earnings recovery. Muddling through stretched balance sheets, with mostly cash conservation methods, looks like the norm for the sector for at least the next 12 months. With regards to the potential of an earnings recovery, there is a risk that the positive economic recovery trade currently boosting the sector globally may play out differently in SA. There were earnings constraining factors already at play for local landlords in the few years preceding Covid-19, which will make a return to normality from an earnings perspective, with 2019 as the base year, a much longer road than just the next year or two. Covid-19 has resulted, together with continued cost pressure and the prevalence of negative reversions, in a permanent rebasing of earnings and especially dividends (with the introduction of pay-out ratios). Therefore, despite the current momentum in the sector, we believe that we should see some settling in share prices as the full, permanent impact of Covid-19 on sector dynamics are assessed.

Portfolio manager
Anton de Goede
as at 31 March 2021