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

The Fund returned 6.1% for the quarter, resulting a return of 60.4% over the last year. The Fund benefited from its overweight positioning in Equites, EPP and MAS. We also have non-benchmark positions in Fairvest, which performed strongly after a good set of results, and Arrowhead A, which reacted positively after the successful conclusion of merger talks with Fairvest. Our relative positioning in Resilient, Sirius, Attacq, Investec Property and Growthpoint detracted value during Q3-21. During the period, the largest increase in exposure occurred in Equites, Redefine and Growthpoint. We once again initiated a position in Hammerson. The largest reductions in exposure occurred in Vukile, Irongate and Attacq. We also sold out of our positions in Stor-Age and Accelerate Property Fund.

Although the listed property sector experienced some stutters during the quarter, strong support, especially during August, propelled the sector forward to once again deliver a good quarter. The past quarter delivered a total return of 6%, resulting in a year-to-date return of 28%. This has now been the fourth consecutive quarter of positive returns. As a result, the sector has returned 58% over a rolling 12-month period. However, it is still down 18% since the start of 2020 from a total return perspective, illustrating the severity of the initial selloff in Q1-20. From a relative performance viewpoint, the sector continues to gradually gain ground against both the JSE All Share Index (ALSI) and All Bond Index (ALBI) over the medium- and long-term and, due to the recovery from the post-Covid-19 lows, has outperformed both indices handsomely over a 12-month period. The All Property Index's (ALPI's) one-year forward dividend yield is 8.5%.

At the start of the quarter, many property landlords had to contend with the social unrest experienced in certain parts of the country. Although very unfortunate, it seems that it is likely to have a limited spill-over effect for the listed property sector despite what was reported in the media. It is estimated that the reinstatement costs of the properties impacted will be likely 1% - 2% of the SA portfolio values of the sector. Most impacted properties were already trading by the end of September, with a limited number of stores still closed. Very few national retailers indicated the permanent closure of stores. Those properties severely damaged by fire will mostly open between March and September 2022, but they are only a handful. A few warehouse properties bore the brunt of the unrest, with a total rebuild likely necessary, which will also be completed by latest September 2022. All the landlords have claimed the damages and loss of income from SASRIA and have started receiving payments, but not all, which remains a small risk to highlight despite assurances that SASRIA will be able to make all payments.

Those companies with May and June reporting periods reported results mostly in line with expectations, with some surprising on the upside. Operationally, the trading environment remains challenging despite the reprieve for landlords from much lower Covid-19 related rental discounts, which are now mostly related to hospitality, entertainment and food and beverage tenants. The reported weighted-average distributable earnings per share came in 12.4% lower (excluding the traditional larger UK dual-listed companies). Dividend per share growth came in at -14.4% (excluding any company where there is no base dividend in the comparative period). The calculation is done in rand, so all euro or pound reported earnings have been converted at the exchange rate determined by the company. The average dividend pay-out ratio was 81.7%.

It is clear from this past quarter's results releases that most of the operational trends experienced in the last 12 – 24 months are being cemented. Landlords are using lower rentals to alleviate potential tenant pressure and to ensure that buildings are occupied. Across all three sectors, we are seeing double-digit negative reversions. Unfortunately for the office sector, this reprieve for tenants is not enough, and vacancies continue to slide, approaching on average the high teen levels. Retail tenant sales growth versus FY2019 is showing some resilience, coming in at low to mid-single growth, spearheaded by convenience retail, especially in the non-metropolitan areas. With limited market rental tension, longer industrial lease expiries continue to experience negative rental reversions despite low vacancies and tenant demand. There is continued pressure on escalation rates, which on average have now reduced by 1% over the last five years to 6.8% across all three sectors.

On the cost side, landlords do not anticipate a reprieve soon with regards to administered pricing, although it does seem that improved cost control is starting to reap some benefits. In preparation for the next interest rate hike cycle, interest cost management has turned more active. Companies are utilising the still lower base interest rates to either exit legacy hedges for more beneficial hedges at lower rates or increase the overall swap profile where they may have increased their floating interest rate exposure as interest rates decreased.

The key for the sector is that loan-to-value (LTV) ratios are either flat or decreasing. Balance sheet risks have now mostly subsided, with many companies heading on a clearer path to deleveraging. Dividend pay-out ratios should settle on average between 80% - 90% for the sector and, together with dividend reinvestment plans, will likely be used in future as the key tool to manage balance sheets at the margin. There will continue to be evidence of more active balance sheet management through some larger disposals, but we believe the bulk of this has been done, and from now on, one should expect just tail-end disposals.

With Covid-19 discounts moving out of the system, landlords can now focus on its impact on the potential permanent rebasing of rents or occupancies. Companies have a new base to work from to achieve distributable earnings growth, which, after an initial base effect improvement, should, unfortunately, continue to be under pressure, with below inflation growth expectations beyond the initial post-Covid-19 recovery. Concerns remain for the office market and how the excess space in the market will be absorbed. No new demand for space is coming through, with mostly space consolidation creating movement in the market. Although landlords are referring to alternative use being important in removing space from the market to ensure the return of rental tension, residential conversions in markets like Sandton and Bryanston are still looking challenging due to the starting values of properties. On the industrial side, more landlords are starting to reference the risk of longer leases expiring with large negative reversions and building cost inflation not yet creating market rental tension in the newly developed space coming onto the market. While retail sales growth should partially support the recovery in retail rents, the office and industrial market dynamics will still take time to play themselves out in the sector. We, therefore, believe that the sector is not completely out of the woods as, despite recovering from Covid-19 related concerns, it now once again needs to focus on moving beyond the precarious position it was already in prior to Covid-19, namely a combination of weak tenant demand, high tenant incentives, vacancy pressure and the burden of operating cost growth outpacing rental growth.

Portfolio manager
Anton de Goede and Mauro Longano
as at 30 September 2021