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

Performance and fund positioning

Despite the local listed property sector taking a breather, with the FTSE/JSE All Property Index (ALPI) returning -0.4% for the quarter, the undercurrent of the strong return momentum that started at the end of October 2023 remains. Although not as high as at the end of Q3-24, the ALPI still delivered a 12-month return of 30%. The sector maintained the recent stronger correlation with bond yields, and yields marginally moved higher in line with offshore bond and property yields. Uncertainty about the offshore interest rate cycle on the back of more stubborn inflation has returned, with South Africa outperforming most offshore markets into the year-end.

Unit trust-linked capital flows into sector-specific funds continued to be negative on a quarterly basis, with the last positive quarter being Q1-22. However, overall support for the sector has been gradually coming from larger institutional capital as part of broader asset allocation decisions rather than retail flows. It does, however, seem that a recovery in flow momentum is possible, but this momentum change is still erratic as some allocation away from property seems to have taken place into the quarter end following the asset class's strong run. From a relative performance viewpoint, despite the sector losing ground against the FTSE/JSE All Share Index (ALSI) and FTSE/JSE All Bond Index (ALBI) over 12 months, it still outperformed handsomely and continues to do so over three years as well. The asset class's longer-term relative underperformance compared to equities and bonds – which goes back 10 years and more – will take longer to reverse. The ALPI's one-year forward dividend yield is 7.8%, and that of the Fund is 7.7%.

Delivering a flat return for Q4-24, the Fund outperformed the ALPI benchmark, resulting in an improved performance relative to the benchmark over most time periods, and gradually closing the underperformance gap over 12 months. Positions that added to the relative performance for the quarter include the overweight positions in MAS, Fairvest B, Stor-age, Attacq, Burstone and Equites as well as underweight positions in larger, more liquid names like Redefine and Growthpoint. Value destruction over the quarter did come from our relative positioning in names like Vukile, Emira, Hammerson and Shaftesbury Capital. UK-linked companies, in particular, suffered this past quarter due to a poorly received UK Budget, with it putting a higher tax burden on corporates and the market reception of the Budget putting pressure on the UK bond market and overall borrowing costs. Over the 12-month period, the detraction in relative returns was mostly due to being underweight some larger, more liquid SA-centric companies that benefited from the positive sentiment towards the country post the formation of the Government of National Unity (GNU) and being overweight more offshore focused companies. During the quarter, the largest increase in exposure occurred in Vukile, NEPI Rockcastle, Fortress and Lighthouse. The largest decrease in exposure occurred in MAS, Shaftesbury Capital, and Sirius. The largest single transaction for the quarter was switching our entire holding in Dipula into Fairvest B after the latter made an offer for Coronation's holding, on behalf of our clients, in Dipula.

The results season of companies with either an August or September reporting period concluded in December. No real surprises were delivered, with companies reporting earnings, at the margin, similar to expectations. Distributable earnings per share growth for this reporting season came in at -2.0%, while dividend per share growth came in at -1.0%, with an average pay-out ratio of 81.8%. For once, offshore focused companies were the laggards, especially Sirius compared to a year earlier. When excluding offshore names from these numbers, the SA-centric names delivered marginally better distributable earnings per share growth of -0.9%, while dividend per share growth came in at -1.2% with an average pay-out ratio of 84.0%. This performance is, however, a solid improvement from numbers delivered one year prior when SA-centric distributable earnings per share growth came in at -5.6%. Operationally, the strong momentum in rental and vacancy improvements has started to become more muted.

Key sector news beyond the reporting season during this past quarter related mostly to new listings. Two established UK REITs – Assura and Supermarket Income REIT – inwardly listed on the local bourse during the quarter. No additional capital was raised through these listings, but we believe it may come down the line for balance sheet purposes due to either high gearing or expansionary portfolio actions. We believe these listings came about due to the success of Sirius, the German and UK landlord, that has been successful since its inward listing in 2015 to access the local institutional capital for portfolio growth opportunities.

The SA Property Owners Association (SAPOA) released its Q4-24 office vacancy survey. After nine consecutive quarters of a decrease in office vacancies in South Africa, the sector experienced an increase, albeit marginal, of 10bps in Q4-24, taking it to 13.7%, still down from recent highs of 16.7% as at Q2-22. All grades experienced vacancy moves higher, with A-grade office space reversing the trend of Q3-24 in being the sector experiencing the biggest move higher (vs experiencing the largest move lower in Q3-24) of 30bps to 12.1% (still better than the 12.6% of two quarters ago). On a city level, the increase in vacancies was driven by Cape Town, again a reversal of recent trends, and, to a lesser extent, Johannesburg. Despite increasing by 80bps to 6.5%, Cape Town continues to have the lowest vacancy of the major cities, and still much better than the 7.5% vacancy of 12 months ago (and 10% the year before that). Development as a percentage of gross lettable area (GLA) has decreased from 0.7% to 0.6%, which is close to the historical lows experienced during Covid, of which 82% is pre-leased.

The SA Council of Shopping Centres (SACSC) published retail trading data related to Q3-24. Recent trends have been for retail trading density growth across most shopping centre formats in South Africa to congregate around a narrow band. However, some differentiation is once again starting to come through, with smaller centres holding up better than super regional and regional centres. GLA weighted year-on-year (y/y) growth decreased from 4.8% in Q2-24 to 4.0% in Q3-24, dragged lower by these two larger formats. The only format maintaining its growth momentum between quarters was Community Centres (GLA of 12 000m² – 25 000m²), recording the highest y/y trading density growth of 5.9%.

Outlook

Although the positive investor sentiment following the formation of the GNU and lack of loadshedding remains, the reality of a continued weak economy and persistently higher interest rates than what was initially expected in this cycle is becoming a more prolonged operating backdrop for the sector. Although not as promising as initially thought, it does, however, create a basis for the return of more sustainable positive distributable earnings growth, driven not only by lower interest rates but also by operating efficiencies. Our expectations are for low- to mid-single-digit sector average distributable earnings growth for 2025. Despite continued cost pressure, the benefit of utility cost management is now starting to bear fruit in not only securing electricity (and water) during times of wanting, but also rather gradually starting to manage it as an integrated revenue stream.

The MSCI released its bi-annual SA property index for H1-24 during Q4-24, which provided a good yardstick for direct property returns for the first six months of the year. Total return momentum for SA property is improving with the 5.3% delivered for H1-24 (10.5% annualised) an improvement both y/y and period-on-period. It was the best six-monthly return since the outbreak of Covid. Property values are however still below the levels of 2018, with industrial property, which is once again the strongest sector, the closest to breaking even to pre-Covid levels. Through its data collection the MSCI has seen an increase in capital spend in portfolios, which echoes the strong signal in improved operating conditions and balance sheets coming through in sector results.

Companies continue to take a more expansionary stance into a lower interest rate environment, may it be through direct asset acquisitions as in the case of NEPI Rockcastle, Lighthouse and Vukile, but also indirect acquisitions as in the case of Fairvest (now a 26% shareholder in Dipula). The strong run of the sector over the last 18 months has resulted in equity as a funding source being a much more achievable reality as exhibited by both NEPI Rockcastle and Fairvest this past quarter.

While the sector continues to exhibit an encouraging improvement in its underlying operational dynamics, it may be that its recovery in rating relative to other asset classes have reached some saturation point, as already seen with the sector's marginal negative yield relative move to bonds during Q4-24. All else being equal, distributable earnings expectations and either achieving or missing these should drive the sector's return prospects in the short to medium term.

Portfolio managers
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as at 31 December 2024