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

Performance and fund positioning

Local listed property maintained the strong return momentum of the latter part of the prior quarter into Q3-24 as the positive sentiment regarding the election outcome and formation of a government of national unity spurred on the local capital markets on all fronts. The more recent strong correlation between bond and listed property yields remained intact with listed property yields following local bond yields lower. The sector was also buoyed by a positive results season, with companies reporting results either in-line or better than expectations, leading to a positive rerating relative to other asset classes. The result was a quarterly return for the FTSE/JSE All Property Index (ALPI) of 19% and a return of 51% over 12 months. Over 12 months, the sector has now fully reaped the benefit from a shift in sentiment – from investors who started to discount a much softer landing in the interest rate cycle of major global markets in Q4-23, to the positive surprise of a 50bps interest rate cut in the US in September of this year.

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. 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, the sector gained ground against the FTSE/JSE All Share Index (ALSI) and FTSE/JSE All Bond Index (ALBI) over most time periods and has cemented its post-Covid outperformance. The sector is however still lagging both indices over longer time periods. The ALPI's one-year forward dividend yield is 7.5% and that of the Fund is 7.2%.

Delivering a return of 18.5% for Q3-24, the Fund did not fully keep pace with the market, thereby underperforming its ALPI benchmark. This resulted in a small deterioration of the Fund's relative performance to the benchmark over 12 months, which is negative. Relative positions that detracted from the performance for the quarter include the overweight positions in more offshore-centric counters like Sirius, Shaftesbury Capital and MAS as well as underweight positions in larger, more liquid SA-centric names that benefited from the strong local rally, like Redefine, Vukile and Fortress. This was mostly counteracted by our relative positioning in names like Attacq, Hyprop, Resilient and Lighthouse. Over the 12-month period, where the underperformance is larger, 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 SA, and being overweight either more offshore focussed companies and smaller, less liquid local specialist landlords. During the period, the largest increase in exposure occurred in Fairvest B, Stor-Age and Vukile. The largest decrease in exposure occurred in Hyprop, Growthpoint and Resilient.

The results season of companies with a June reporting period concluded in September. This results season did bring a few surprises with some companies outperforming their previously provided distributable earnings growth guidance. Distributable earnings per share growth for this reporting season came in at 1.9%, while dividend per share growth came in at 0.2%, with an average pay-out ratio of 85.0%. If offshore names are excluded from these numbers, the SA-centric names delivered distributable earnings per share growth of -2.0%, while dividend per share growth came in at -1.8% with an average pay-out ratio of 88.4%. The average reported growth was dragged lower by a poor, but expected, showing from names like Growthpoint and Hyprop. As previously mentioned, the base effect of increasing interest rates in a reporting period is gradually working itself out of the earnings cycle. This is noticeable in this reporting season in companies that reported full year numbers, with the H2-24 y-o-y distributable earnings growth being in most cases much stronger than that of H1-24 y-o-y growth.

Key sector news beyond the reporting season during this past quarter related mostly to corporate action linked to asset sales or acquisitions. Burstone announced the sell down of its exposure to its Pan European logistics JV to Blackstone, keeping 20%, which will have a very positive impact on the derisking of its balance sheet. Growthpoint and Vukile agreed to sell their respective stakes in European listed counters Capital & Regional and Lar Espana as part of broader corporate action. NEPI Rockcastle is on the acquisition path with a large acquisition in Poland with potentially more to come, while both Vukile and Lighthouse continue to scour Iberia to increase their exposure to either Spanish or Portuguese shopping centres.

The SA Council of Shopping Centres (SACSC) published retail trading data related to Q2-24. Retail trading density growth across most shopping centre formats in SA congregated around 4%-6% y-o-y, which is a departure from the previous theme of either dominant or convenience shopping centres outperforming. Regarding footfall growth, there has been a decline in footfall for H1-24 versus H1-23 for the "mass" consumer segment, especially in community centres. This compares to an increase in footfall for H1-24 versus H1-23 for the "affluent" consumer segment across all centre formats.

The SA Property Owners Association (SAPOA) released its Q3-24 office vacancy survey. This most recent quarter was the ninth quarter showing a decrease in office vacancies in SA, now at 13.6%, down from 16.7% as at Q2-22. All grades experienced moves lower, with A grade office space the strong mover in Q3-24 being 80bps lower to 11.8%. Cape Town has the lowest vacancy of the major cities at 5.7%, down from 8.3% as at 12 months earlier. The overall absolute vacant space in SA is 151 828m² lower over the quarter, with total office gross lettable area (GLA) being 281 861m² lower. This could potentially point to some repurposing of space into other alternative uses, with reference to C grade space being taken out of the survey for residential conversions in nodes like Parktown, Houghton, Fourways and the Johannesburg CBD. New office development as a percentage of GLA is at 0.7%, which is close to the historical lows experienced during Covid, of which 85% is pre-let – the highest pre-let level in 34 years.

Outlook

Over the last few reporting seasons, we have seen companies report continued lower vacancies, a positive momentum shift in rental growth and improved operating cost management. We expect this to continue at the margin, with a gradual decrease in average debt funding costs as interest rates decrease the next driver of distributable earnings growth. All these tailwinds have led to management teams moving more offensive in terms of portfolio size growth, with Sirius, Vukile, Lighthouse and Spear REIT all raising capital to fuel their growth ambitions.

The key driver of sector returns over the last few months has been the strong showing of the broader capital markets in SA based off the positive political sentiment, which can turn quickly, but seems unlikely at this stage. From current levels, all else remaining equal, it is essential that the recovery in operational performance is continued if the rerating of the sector relative to other asset classes is to be maintained.

The rerating has been substantial compared to historical levels since 2000 and therefore requires strong distributable earnings growth to be warranted. We expect a recovery in sector average distributable earnings growth of mid to high single-digit compound annual growth rates for the next three years. Although a good improvement from recent growth levels, it may be that investor sentiment has overreached the impact of lower interest rates on the sector and share price volatility could return as investor sentiment change if distributable earnings growth is not as strong as what is being priced in at present.

Portfolio managers
Anton de Goede and Mauro Longano
as at 30 September 2024