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

Performance and fund positioning

Local listed property initially started 2024 with a continuation of its strong return momentum experienced into the end of 2023, bucking the trend of global counterparts retracing some of the gains realised since end-October 2023. However, in the second half of the quarter, the momentum fizzled out as weaker bond yields and, once again, a change in sentiment in the rate at which interest rates will be cut resulted in a lacklustre back end of the quarter. The result was a return of 3.5% for Q1-24 and 20.3% over 12 months.

Capital flows into the sector continue to be negative, although the turn in flow momentum continues to gather steam. January even experienced a month of net positive capital flow in the specialist property unit trust segment, the third such month in two years. 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 now outperformed these indices over all relevant periods shorter than three years. The ALPI's one-year forward dividend yield is 8.9%, and that of the Fund is 8.7%.

Delivering a return of 2.5% for Q1-24, the Fund did not fully keep pace with the market, thereby underperforming its ALPI benchmark. This resulted in a deterioration of the Fund's relative performance to the benchmark over 12 months, which was positive for most of 2023. Relative positions that detracted from performance include Equites, Burstone, Hyprop, MAS, and Growthpoint. On the opposite end of the spectrum, the Fund did benefit from its relative positioning in Attacq, Fortress, NEPI Rockcastle, Shaftesbury Capital, and Dipula. During the period, the largest increase in exposure occurred in Growthpoint and Resilient, similar to Q4-23, as well as Hammerson. The largest decrease in exposure occurred in Dipula, Fortress, and NEPI Rockcastle.

The most noticeable corporate announcement of the quarter was (once again) the long-awaited vote on what many expected to be the last attempt to collapse the dual share structure of Fortress. Despite a lot of apparent jostling beforehand, the scheme of arrangement was approved with a large majority in both share classes. The result is a single share class, with the old Fortress B shareholders receiving NEPI Rockcastle shares in exchange for the structure to collapse.

Results season for companies with a December reporting period concluded in March. Distributable earnings and dividend per share growth for the reporting companies experienced a pullback compared to their previous six months' reporting period that concluded in September 2023. While strong underlying earnings momentum out of NEPI Rockcastle and MAS (and even more so from the UK-centric stocks from a low base) supported distributable earnings per share growth for the broader sector, the SA-centric stocks delivered distributable earnings and dividend per share growth of -2.6% and -4.5% respectively, even with Fortress delivering distributable earnings growth of 19.0%. The stocks delivered a wide range of earnings growth, ranging from the highs of Fortress to -13.4% for Hyprop. Most of the results were well guided to by management teams, therefore, the results as such, had a fairly limited impact on share prices. The exception here was Hyprop, where the decision not to declare an interim dividend due to uncertainty out of Nigeria and concerns regarding Pick n Pay as anchor tenant resulted in share price weakness.

With all companies now having reported FY2023 results, one can compare the FY2022 and FY2023 distributable earnings and dividend per share growth delivered between the two financial years. Although there has been a wide disparity of growth delivered amongst the various companies within each year, the average distributable earnings and dividend per share growth produced by the more SA-centric stocks for the two years were not far off each other, with FY2023 coming in at 2.1% distributable earnings per share and 2.1% dividend per share growth with a 87% pay-out ratio compared to FY2022's 3.1% distributable earnings per share and 1.6% dividend per share growth with an 88% pay-out ratio.

Outlook

The last few months, either through reported results, pre-close updates or management interaction, have cemented a few key observations on the sector's current state. These observations were echoed by the companies participating in the SA REIT Conference, which was held during Q1-24, with management teams moving towards a more open stance for increased active portfolio asset management, partly buoyed by what many see as the trough in the valuation cycle and fewer operational hazards compared to that experienced since Covid-19. Management teams continue to take a more front-footed stance, with Spear REIT and Vukile being recent examples, raising equity to decrease debt and create balance sheet capacity. This confidence implies some operational successes as well, which are becoming more prevalent with less negative reversions, lower vacancies and better cost management, mostly linked to electricity via increased solar installation.

On a subsector level, the gradual recovery in the retail sector has been well flagged, with vacancies within the listed space at or close to historical lows while rental reversions are turning positive in many cases – the first time since 2019. The industrial subsector continues to experience positive fundamentals. Vacancies remain low and there is a renewed interest in lower-quality older industrial stock. At face value, the office sector, although slowly recovering from post-Covid-19 lows, looks to be the sector that continues to be under the most pressure. The headline numbers, however, belie the fact that in many nodes, especially in most of Cape Town and pockets in Durban, Johannesburg and Pretoria, tenant demand is outstripping supply due to historically low levels of speculative development. Demand is partly underpinned by international BPO operators for setting up call centres, while existing tenants are realising that work-from-home flexibility for employees does not necessarily imply lower space requirements. Although reversions are generally negative, vacancies continue to decline (driven by P-grade space) and market rentals have stabilised with pockets of growth emerging where supply is lacking.

It is likely that the continued recovery in operational metrics for the sector is broadly already reflected in current share price levels. The next leg of positive share price movement will probably come from interest rate decreases, and with an increasing number of companies not extending their hedged debt profiles when hedges expire, any cut in interest rates will have an immediate benefit. The sector therefore remains sensitive to any news on this front, both local and offshore, as investor sentiment is fickle with regards to the size and velocity of the cutting cycle, with sentiment easily changing daily.

Portfolio managers
Anton de Goede and Mauro Longano
as at 31 March 2024