METOPE

Market Commentary

31 December 2022

Market Commentary for the quarter ending 31 December 2022

Markets ended what was a very tumultuous year on a strong note, with global equities gaining as inflation appears to have peaked and markets begin pricing in a slow in the pace of monetary tightening. Concerns over a deep global recession have, in recent weeks, been subsiding, as labour markets remain strong and inflation drivers weakening. Global growth is expected to slow in 2023, however markets are already looking forward to the recovery, with slowing growth already reflected in prices of equities. Central banks are expected to slow the pace of rate hikes as inflation continues to moderate.

China's reopening after strict Covid lockdowns, while posing a threat to inflation, has added to market optimism, particularly for commodity exporters such as South Africa. Risk-on sentiment saw the dollar weakening against other currencies after a strong run in the first three quarters of the year.

South African inflation average 6.9% for the year, after peaking at 7.8% in July. Core inflation was a more modest 4.9%. In response to persistent inflation, the SARB hiked rates by a further 75bps in November, bringing the total increases in 2022 to 300bps.

South African listed property gained 19% for the quarter, ahead of equities and bonds which gained 5% and 5.7% respectively. This can be attributed to improved sentiment as well as a number of funds reporting better than expected results. Among the top performers for the quarter were South African-focused Growthpoint, Redefine and SA Corporate, which all delivered over 20% total return for the quarter. Central Eastern Europe's Nepi Rockcastle delivered a strong 27% for the quarter as concerns over trading conditions in the region eased despite the ongoing tensions in neighbouring Ukraine.

The last of the reporting for the year showed that while conditions remain tough on the ground, there are signs that we've reached the trough and we are seeing some improvements in the outlook. Reversions and vacancies appear to have bottomed out, and valuations are starting to reflect the improvement in the income outlook.

Vukile reported results for their half year to September 2022, highlighting a strong operational performance in both the South African and Spanish portfolio. Like-for-like Net Operating Income (NOI) growth of 4% in South Africa and 7.5% in Spain was partially offset by rising finance costs as the group unwound its cross-currency interest rate swaps and borrowing costs rose in line with interest rates, resulting in distributable income per share growth of 1.2%. The South African portfolio saw vacancies reduced by 30bps and positive rental reversions of 1.6%, while the Spanish portfolio saw positive reversions of 4.6%. Portfolio valuations improved by 3% and 1% in the SA and Spanish portfolios respectively.

Redefine reported its FY22 results in November, with EPP being consolidated for just under 6 months of the period. Distributable income per share increased 1.5% for the year, with earnings from EPP and lower borrowing costs, as well as over-recoveries from tenants supporting growth. Vacancies reduced across the portfolio, most notably in the office sector which saw vacancies reduce from 16.4% to 14.4%. An increase in NAV of 4.5% was supported by improved property valuations in South Africa and Poland and lower debt as a result of dividends retained. The group declared a dividend 43cps for the year, representing a payout ratio of 80%. The group continues to work to reduce is gearing, ending the year with an LTV of 40.2%, down from 42.4% in the prior year.

Octodec delivered an improved set of results for the year which saw gearing reduce to 39.7% from 43.2%. The group declared a dividend of 130cps for the year, up 160% from the previous year's 30cps dividend. Octodec's vacancies remain high, one of the highest in the sector at 19.5%, down from 22.5% the previous year. The group's residential and industrial vacancies saw significant improvement; however vacancies in their office portfolio remain stubbornly high. Octodec trades on a forward yield of c13.5% at the end of December, and a discount to NAV of 58%, one of the highest discounts in the sector.

As we enter 2023, while the outlook for inflation has improved, consumers will continue to face pressure due to higher costs of living and interest rates. Loadshedding continues to place significant pressure on small businesses. We expect the slow pace of recovery for the sector to continue, with small improvements to rentals on the back of higher inflation and a bottoming out of reversions as leases expire. Gearing levels across the sector are conservative going into this period of increased interest rates, with gear at around 38% and interest rates hedged on over 80% of debt. We expect non-discretionary retail to continue to outperform as consumer cut back on discretionary spend in the face of higher living costs. Offices, although still struggling with high vacancies, are seeing an improvement in occupancy levels, in particular in the Western Cape as people return to offices. Logistics and storage will likely experience some pressure on prices, however demand and rental growth remains strong.

Listed property should benefit from a high yield going into 2023 as investors seek cash returns in an uncertain environment. Stable cashflows underpinned by improving fundamentals, good quality portfolios, inflation hedging leases and robust balance sheets position SA listed property should enable the sector to remain resilient in what could be another year of volatility and uncertainty. We expect a yield of 8.5%, and stable or moderate growth in capital values. The sector is still trading at a high discount to NAV of 35% relative to its long term average of a 4% premium. Only once inflation and interest rates stabilise do we expect any meaningful narrowing of the discount to NAV / yield differential.

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