METOPE

Market Commentary

31 March 2024

Market Commentary for the quarter ending 31 March 2024

In the first quarter of 2024, the South African listed property sector continued to show resilience amidst a backdrop of shifting global economic and political dynamics. Internationally, markets continued to navigate uncertainties, with the United States experiencing what appears to be a "soft landing" scenario, marked by resilient growth despite earlier concerns over rising interest rates. This has lead the market to push out expectations of the Fed's first rate cuts to later in the year. In contrast, Europe and the UK are facing a more pronounced easing of inflation alongside sluggish growth, which might prompt their respective central banks to consider rate cuts sooner rather than later, while attention remains focused on China's efforts to sustain its 5% growth target amidst ongoing challenges in its property sector.

Locally, inflation continues to moderate, with March CPI coming in at 5.3%, and core inflation falling to 4.9%, heading closer to the SARB's target of 4.5%. However, risks are to the upside due to tensions in the Middle East and the resultant volatility in oil prices as well as currency risks around uncertainty surrounding election outcomes. The SARB maintained its cautious approach, keeping interest rates steady since May 2023, and will likely take cues from global central banks and look for further evidence of a sustained reduction in the inflation outlook.

In this environment, the local property sector demonstrated strength, albeit with more tempered gains compared to the robust rally seen in the final months of 2023. Despite this moderation, the sector maintained its upward trajectory, buoyed by solid fundamentals and some increased investor confidence. Both the ALPI and the SAPY saw gains of 3.8% for the quarter, lead by Nepi Rockcastle, Attacq and Fortress.

A number of funds reported results to Dec 2023. Key takeaways from these recent results include the improvement in property fundamentals in South Africa, with rental reversions showing shallower or slightly positive trends, notably in the retail and industrial sectors, despite ongoing struggles in offices, potential signal that we at the bottom of the cycle. This offers some optimism for sustained rental growth in the future, albeit at a slow pace. However, higher interest rates remain challenging in the short to medium term, though potential rate cuts could offer upside. It's also encouraging to see investor interest in the sector, with over R1bn raised during the quarter by Vukile & Spear.

Once again, CEE counters performed exceptionally well, even though one of them did not pay out a dividend. Fundamentals in the region remain strong. Sirius' recent update also indicates that the counter is performing very well despite the challenging environment in Germany.

Fortress successfully unbundled its capital structure from dual to single-class stock, a longstanding issue for the company that had hindered distributions in the past. This action led to a stock rerating, as it resumed paying dividends and with a streamlined structure. As part of the restructure, Fortress distributed Nepi Rockcastle shares to Fortress B holders and converted A shares to B shares. The result is a cleaner structure with only one share class, and a smaller holding in Nepi Rockcastle (16%, down from 24%). This saw a rerating in the share price, with the new FFB shares returning 13.5% for the quarter. In its interim results to 31 Dec 2023 (pre-restructuring), the company reported strong operational performance, with life-for-like net operating income positive across all sectors (retail +2.4%, logistics +9.2%, industrial +10.8%, CEE logistics +14.3%) except for offices, which experienced a significant decline of -20.1%. Retail is showing signs of recovery, with trading densities up by 6.9% over the past 12 months and low vacancy rates at 1.6%. Distributable earnings was 19% higher than the comparable period, while the group's net asset value was 22.4% higher. Following the restructuring, the company was able to pay out 100% of earnings to shareholders, declaring a dividend of 81.44cps. Management is guiding for a final distribution of 60.44-65.57cps, putting the company on a dividend yield of c9%.

Another top performer for the quarter was Nepi Rockcastle, the largest listed retail landlord in Central Eastern Europe and property company on the JSE, which released a strong set of results for the year ended 31 Dec 2023. The company surpassed its distributable earnings per share (DEPS) for the first time since Covid, reporting DEPS growth of 9.3% for the year. This was a result of strong like-for-like net operating income (NOI) growth of +13%, supported by active asset management initiatives, rental uplifts of c.+8% above indexation and a reduction in vacancy rates. In addition, three acquisitions concluded in 2022 contributed to bottom line growth. Trading performance of the portfolio was strong, with increased footfall and basket size adding positively to tenant sales. The balance sheet remains strong, with gearing at 32%, one of the lowest in the sector, and an all-in weighted average cost of debt of 2.5% and 100% of interest rate risk hedged. The company has guided for growth in DEPS of 4% for FY2024.

Attacq reported a robust set of interim results to 31 Dec 2023, including an upward revision of full-year guidance and clarity on their MAS stake. The company announced the sale of its entire stake in MAS, yielding total proceeds of R773m. Management cited the non-yielding nature of the holding and lack of control over decisions as the primary reasons for the sale. Proceeds from the sale are expected to be deposited in an interest bearing facility for the next 12 months until deployment towards the significant development pipeline. Operationally, an excellent interim period, with trading densities increasing by 9.0%, valuations rising by 2.8%, like-for-like net operating income up by 6.4%, positive retail reversions of 5.8% and occupancy improving to 93%. Furthermore, credit metrics showed improvement, with LTV notably lower at 25.3% (driven by proceeds from the GEPF / AWIC transaction), and the proceeds from the MAS sale expected to further strengthen the balance sheet. The company aims to expand exposure in logistics given its strong performance in recent years. Management remains confident in driving growth, bolstered by the MAS stake sale and operational cash flow generation, positioning the company well to meet forecasts and advance its development pipeline. Attacq returned 15.7% for investors over the quarter.

Looking ahead, we can expect continued volatility in the Rand and share prices for the next few quarters due to uncertainties in both domestic and global markets, including the trajectory of interest rates, which are now expected to remain "higher-for-longer", rising geopolitical tensions in the Middle East, and the ongoing economic recovery efforts. While it is encouraging to see fundamentals in the property sector improving, we don't expect to see a material recovery in risk sentiment for South Africa and the asset class until after elections are concluded, with international investors likely adopting a 'ait and see' approach.

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