NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS
Property Fund
Quarter Four, 2020

Nedgroup Investments Property Fund

Performance to 31 December 2020	Fund[1]	Benchmark[2]	Index[3]
3 months	18.0%	22.1%	22.2%
12 months	-29.6%	-32.7%	-34.5%

Market overview

No year has deserved the description "annus horribilis" more than 2020 and for investors in South Africa's listed property sector, it was a disastrous year. The sector, represented by the FTSE/JSE SA Listed Property (SAPY) index, delivered a total return of -34.5%. Prices fell the most on record, while the annual income return was below 6% for the first time in the sector's history. During the height of the lockdown in South Africa, a number of tenants refused to pay rent or were granted rent discounts if their business operations were impacted by the lockdown. This resulted in a marked decline in rent collection rates and placed enormous cash flow pressure on the landlords. At the same time, property prices were lowered by valuers concerned about the impact the pandemic would have on future occupancy rates and market rentals. Loan-to-value ratios increased and, in some cases, breached bank covenants. Many South African REITs were forced to lower their dividend payout ratios to retain cash for capital expenditure and to pay down debt. As a result of the lower distributable earnings because of lower rent collections and the lowering of dividend payout ratios, on average, SA REIT dividends declined by approximately 40% in 2020.

Listed property's performance would have been materially worse in 2020 had it not been for a strong recovery in prices during the fourth quarter. Historically low interest rates, an improvement in rent collections following an easing in lockdown restrictions and deep discounts to net asset value all contributed to a change in investor sentiment towards the sector at the end of October. At the same, large institutional selling that had characterised the sector for much of 2020 seemed to ease at the start of the fourth quarter and in fact, a few large institutions turned net buyers of SA listed property, taking advantage of the large discounts to net asset value on offer and the potential for high dividend growth in 2021. The major issues weighing on the sector, like employees working from home and increased online shopping, have not diminished and are likely to remain in place for at least the next two to three years. However, these risks appear to have been completely discounted by the market if one considers that the average discount to net asset value is still in excess of 30%, despite the fourth quarter's significant increase in share prices.

Portfolio commentary

South Africa's listed property sector is dominated by companies exposed to offices and large malls. Unlike most other publicly traded real estate markets across the world, there is little choice for an index-hugging investor to avoid substantial exposure to the two sectors most at risk in the short-term. Away from the SAPY index, with its 75%+ exposure to offices and malls, there are opportunities to invest in companies with exposure to relevant property types in a post-COVID-19 world. Companies like Fairvest and Safari, which own smaller shopping centres in rural areas and townships and which are not constituents of the SAPY index, are examples of the types of businesses to which the Fund has significant exposure. During 2020, Safari was the top performing SA REIT, delivering a POSITIVE return of 19.3%, while Fairvest's return of 4.0% in 2020 made it the third-best performing SA REIT. Industry heavyweights, like Growthpoint (-35.9%) and Redefine (-56.0%) fared significantly worse than the likes of Fairvest and Safari.

The fund's Equites (-4.9% in 2020) and Stor-Age (-0.5%) positions were added to during the fourth quarter, given the positive and improving fundamentals for both companies. The current portfolio composition continues to emphasise investment in relevant property types, which include rural and township shopping centres,

[1] Net return for the Nedgroup Investments Property Fund, A class. Source: Morningstar (monthly data series).
[2] Benchmark is (ASISA) Real Estate General category average.
[3] FTSE/JSE South African Listed Property Index

warehouses and/or self-storage and a geographic preference for the Western Cape over other provinces in the country.

This has necessitated an overweight position in smaller and medium-sized SA REITs and the avoidance of some of the larger, more liquid REITs listed in South Africa. It has also led to a much larger domestic focus than the SAPY index, although both Equites and Stor-Age increased their exposure to the UK property market during 2020. The fund's large position in pan-African property company, Grit, was reduced during the quarter, with the proceeds of those sales used to acquire the increased Equites and Stor-Age positions.

The fund distributed a total of 4.5c per unit in 2020. This is a decline of more than 50% and is lower than initial estimates of a 35% decline first published in the second quarter, during the height of the lockdown. The outcome was lower than forecast after several REITs delayed the announcement and payment of dividends until 2021. Companies with September year-ends have until the end of March 2021 to pay their dividends after the JSE agreed to a two month extension for dividend payments to assist with cash flow management in the short-term. Companies like Dipula and Octodec have taken advantage of this extension and paid no dividends in 2020 (both companies skipped the payment of their interim dividends and delayed the payment of their final dividend, if any, until the end of the first quarter of 2021).

Top 5 winners and losers for Q4 2020:

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Arrowhead B	4.0%	3.0%	**Spear**	6.3%	-0.5%
Fairvest	14.2%	2.7%	**Equites**	5.6%	-0.4%
Safari	12.2%	2.7%	**Redefine**	0.6%	-0.2%
Octodec	4.3%	2.0%	**Rebosis**	1.3%	-0.2%
Indluplace	10.1%	1.6%	**Grit**	8.1%	-1.4%
TOTAL		**12.0%**	**TOTAL**		**-2.7%**

Current positioning and outlook

As described earlier, the portfolio continues to emphasise exposure to relevant property types. Large malls and offices are likely to face significant headwinds for at least the next two to three years and exposure to these two property types is small. The office exposure in the portfolio is predominantly to government-occupied properties in Pretoria and Johannesburg that are unlikely to experience the same work from home headwinds as P-grade and A-grade offices in nodes like Sandton and Rosebank. The fund has maintained a relatively large exposure to residential through Indluplace and Octodec, where rent collection rates have remained quite high and occupancies are likely to start improving once universities reopen and economic growth accelerates. The prices of both companies have been rising steadily following hefty price declines during the second quarter but continue to offer significant long-term value for investors.

While the distributions paid by the fund more-than-halved in 2020, distribution growth is currently forecast to exceed 50% in 2021. Forecast risk remains high, given the uncertainties posed by COVID-19 and the variability of dividend payout ratios among the REITs owned in the fund. Most REIT management teams have opted not to provide the market with guidance for their upcoming results, neither have they firmed up their dividend policies. Notwithstanding these uncertainties, the outlook for 2021 is one of improved rent collections (versus 2020) and continued cost reductions which should lead to growth in distributable earnings off the low base established last year. This should lead to further improvements in investor sentiment towards listed property and lift prices further in the short term.

Disclaimer

WHO WE ARE

Nedgroup Collective Investments (RF) Proprietary Limited is an authorised Collective Investment Scheme and the representative of Nedgroup Investments Funds PLC in terms of the Collective Investment Schemes Control Act. It is a member of the Association of Savings & Investment South Africa (ASISA)..

OUR TRUSTEE

The Standard Bank of South Africa Limited is the registered trustee.
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HOW ARE OUR FUNDS PRICED

Funds are valued daily at 15:00. Instructions must reach us before 14:00 (12:00 for Nedgroup Money Market Fund) to ensure same day value. Prices are published daily on our website and in selected major newspapers.

FEES

A schedule of fees and charges is available on request from Nedgroup Investments. One can also obtain additional information on Nedgroup Investments products on our website.

DISCLAIMER

Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. Past performance is not necessarily a guide to future performance. Nedgroup Investments does not guarantee the performance of your investment and even if forecasts about the expected future performance are included you will carry the investment and market risk, which includes the possibility of losing capital. Our funds are traded at ruling prices and can engage in borrowing and scrip lending.

Some funds may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks, which could include foreign exchange risks, market conditions and macro-economic and political conditions.

A fund of funds may only invest in other funds, and a feeder fund may only invest in another single fund, both will have funds that levy their own charges, which could result in a higher fee structure.

The Nedgroup Investments Money Market Fund offering aims to maintain a constant price of 100 cents per unit. A money market fund is not a bank deposit. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument held. In most cases the return will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of a capital loss. Excessive withdrawals from the fund may place the fund under liquidity pressures and that in such circumstances a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed. The yield is calculated using an annualised seven day rolling average as at the relevant dates provided for in the fund fact sheet. Nedgroup Investments has the right to close its funds to new investors in order to manage it more efficiently.

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