NIMBLE WISDOM GLOBAL

First hike in a decade | 31 October 2017

SESFIKILE CAPITAL
Listed Property Investments

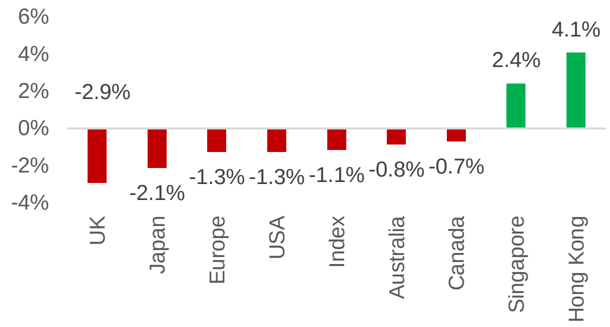
MARKET OVERVIEW

This month Global REITs (FTSE/EPRA developed renters index) closed 0.94% in the red, again underperforming Equities as the S&P500 closed 2.33% higher while the European Stoxx 600 index closed 59bps in the green. US 10-year bond yields closed only 5bps higher at 2.38% despite rising to 2.46% intra-month.

On 2 November 2017 the Bank of England (BoE) raised interest rates by 25bps to 0.5% for the first time in decade. Although this was partly priced in a few months prior, Mark Carney's extremely dovish comments seemed to push UK Gilts lower as the rate of hikes is likely to be seldom and 'shallow' which weakened the British Pound slightly against major currencies. In the US, President Trump announced ex-lawyer and Carlyle Group managing partner Jerome ('Jay') Powell as the next Federal Reserve Bank (Fed) chair starting in February 2018. Bond yields appeared to shrug the news off as he was viewed as a 'safe and predictable pair of hands'.

Hong Kong real estate pushed on this month closing 4.1% in the green followed by Singapore that closed 2.4% higher as the only two countries to end positive. Although posting negative returns, Canada and Australia outperformed the index at -0.7% and -0.8% respectively. Laggards this month include USA and Europe at -1.3%, Japan (-2.1%) and the UK (-2.9%)

Chart 1: Monthly returns per region



Source: Bloomberg, as at 31 October 2017

Key Points in this report

- Taking 10-month returns to 4.6% in USD, global REITs fell 0.94% in October, underperforming global equities that closed in the green. US 10-year bond yields rose by a paltry 5bps to 2.38%
- Trump named Jerome Powell, and ex Carlyle Group managing partner the next chair of the Fed, starting in the first quarter of 2018. The current Fed is expected to hike rates one more time next month. In the UK, the BoE hiked rates by 0.25% to 0.5% on 2 November 2017 for the first time in a decade. However, Mark Carney maintained that the hiking process will be long and shallow, which sent the British Pound weaker.
- Global REITs currently trade at a 4.4% forward yield vs. global bonds at 1.91% (weighted average) implying a 245bps yield spread. This gives investors an approximately 95bp cushion relative to the long-term spread of 150bps. We see value in the sector at these levels.

The US economy unexpectedly continued on a strong growth path in the third quarter, growing at 3.0% q/q in spite of fears of a slowdown because of hurricanes Harvey and Irma. As expected, there was a slowdown in consumer spending which recorded growth of 2.4% compared to 3.3% in Q2, however the 6.0% growth in domestic investment and a smaller trade deficit helped to boost the economy. The US added 261 000 jobs in October which was about 53 000 jobs less than expected but, due to lower labour participation, the unemployment rate unexpectedly dropped to 4.1% from 4.2%. Importantly, average hourly earnings grew at 2.4% y/y, lower than the market anticipated growth rate of 2.7%.

The Fed held its penultimate FOMC meeting at the end of October and as expected kept rates unchanged. However, the strong momentum of the US economy coupled with the rebound in employment in October reaffirms our view that the Fed will increase interest rates at the next FOMC meeting scheduled to take place on 12-13 December. Jay Powell was nominated to replace Janet Yellen as the new Fed Chair once her term expires on 3 February 2018. Jay has been a board Governor since 2012 and supported gradual increases in the federal funds rate, the normalization of the Fed's balance sheet, and current floor system of administered rates with elevated reserve balances. Therefore, in many ways, Powell is a new face to the public but many of the current policies are likely to continue.

In line with the hawkish guidance statement in September, the UK Monetary Policy Committee (MPC) voted 7-2 for the first UK interest rate hike since 2007. In his guidance, Mark Carney stated that inflation was likely to breach the 2% target in the short term but due to lower demand, it would fall back below the target in the medium term. The Monetary Policy Committee stuck to the two long-standing pieces of guidance about the pace of policy tightening, i.e., that it would be at a gradual pace and to a limited extent, and that it was a data-dependent decision and policy was not on a pre-set course.

US REIT results:

REIT results:

Company	Results comment
Equity Residential	US Multifamily REIT EQR reported Q3 normalized FFO of $0.80 compared to $0.78 in 2016, equivalent to growth of 2.6% and beat market expectations by $0.01. SS NOI growth was 2.4% driven by SS revenue growth of 2.2% and SS expense growth of 1.7%. SS revenue was driven by 2.1% rent growth and a 20bps increase in occupancy to 96.2%. The West Coast continues to show the strongest SS NOI growth with LA (8.1%), Orange County (5.2%), San Diego (5.0%) and Seattle (3.4%) all outperforming. New York continues to lag with -1.7% SS NOI growth for the quarter. The company reported a net debt to EBITDA ratio of 5.67x and a weighted average cost of debt of 4.27%. Management raised FY17 normalized FFO guidance to $3.10-$3.14 from $3.08-$3.14.

Company	Results comment
Invitation Homes	US Single family REIT INVH reported Q3 17 core FFO of $0.24, $0.01 below the market estimate. SS NOI was up 8.1% driven by 4.7% SS revenue growth and a 30bps drop in SS expenses. The decrease in SS expenses was driven by 15.4% lower personnel expense, 9.1% lower turnover expense, 7.4% lower insurance expense, and 7.4% lower leasing & marketing expense. SS core NOI margin increased 230bps to 62.7% in Q3 2017 from 60.4% in Q3 2016. SS blended net effective rental rate growth was 4.3% driven by new lease growth of 3.4% and renewal growth of 5.0%. Net debt / annualized Adjusted EBITDA remained at ~10.2x. Management narrowed FY 2017 core FFO guidance from $0.96-1.04 to $0.98-1.02 (midpoint remained the same at $1.00).
Kilroy Corp	West coast US office KRC reported Q3 2017 FFO of $0.88 beating the market estimate by $0.03. SS Cash NOI increased 0.8% (2.4% on a GAAP basis) driven by a 0.1% increase in SS revenues and a 1.8% drop in SS expenses. Average occupancy was down 2.4% y/y to 94.3% due to known move-outs. Cash rents on second generation space increased 0.8% much lower than previous quarters (Q217: 12.6%, Q117:15.2%, Q416: 11.6%, Q316: 11.8%). In October, KRC announced that Dropbox had signed a lease for 100% of The Exchange. The company reported a net debt to adjusted EBITDA ratio of 4.8x and a weighted average interest rate of 4.4% (97.6% fixed). KRC increased its FY17 FFO guidance by $0.02 at the midpoint to between $3.40-$3.44 from $3.35-$3.45.
Kimco Realty	US strip centre REIT KIM reported adjusted FFO/share of $0.38 flat relative to 2016 and $0.01 above market expectations. SS NOI grew 3.1% driven by SS revenue growth of 1.3% and a 3.5% drop in SS expenses. Blended leasing spreads increased 16.0% driven by new leases and renewals up 52.0% and 8.1%, respectively. SS occupancy was 92.7%, 30bps better than the previous quarter but 40bps lower y/y. The redevelopment pipeline comprised 42 projects (up from 35 in Q2) with an estimated cost of $555m. Management slightly reduced the guidance range for adjusted FFO from $1.50-$1.54 to $1.51-$1.52.
Prologis	Global logistics REIT PLD reported core FFO of $0.67 which was $0.01 above estimates. The company achieved 6.1% cash SS NOI growth driven by the US which grew at 8%. Cash rents spreads were up 10.6% and net effective rents grew at 22.7% driven by US at 31.9% - the 7th consecutive quarter of growth above 20%. SS Occupancy was down 10bps y/y as management prioritized rental growth over occupancy. PLD has $2.8bn worth of development (45% US, 25% EU, 30% Asia) in its pipeline which is 50% pre-leased at 6.3% yield. Management tightened the FY17 Core FFO guidance from $2.78-$2.82 to $2.79-$2.81.
Public Storage	US storage REIT PSA reported core FFO per share of $2.61, a 3.2% increase y/y and in-line with market expectations – top line FFO was down 6.4% y/y. SS NOI grew by 2.6% driven by 2.4% growth in SS revenues (3.3% in Q2) and 1.6% growth in SS expenses (Ad/Selling expenses were down by 10.3% compared to an increase of 42% in Q2). Occupancy finished the quarter at 93.2% which was a 110 bps lower than 2016. The weighted average occupancy over the quarter was 94.5%, an 80bp decline y/y. Rental growth was 3.4%, lower than the 4.4% and 4.9% growth achieved in Q2 and Q1, respectively. PSA do not provide guidance as a matter of policy.

Company	Results comment
Simon Property Group	Class A mall REIT SPG reported FFO of $2.89 compared to $2.70, an increase of 7% y/y and beat market estimates by $0.02. SS NOI grew 2.5% with average base rental increasing 3.3% y/y to $52.42 per sqf. Occupancy was up 10bps sequentially and down 100bps y/y to 95.3%. Blended leasing spreads for trailing twelve months was $7.21, an increase of 11.2% (Q3 was 12.9%). SPGs share of the costs of all new development and redevelopment projects under construction was approximately $1.3bn with an expected stabilized rate of return of 7%. Management increased the low end of guidance from $11.14-11.22 to $11.17-11.22. Furthermore, the board increased the quarterly dividend by 2.8% to $1.85/share.

LOOKING FORWARD

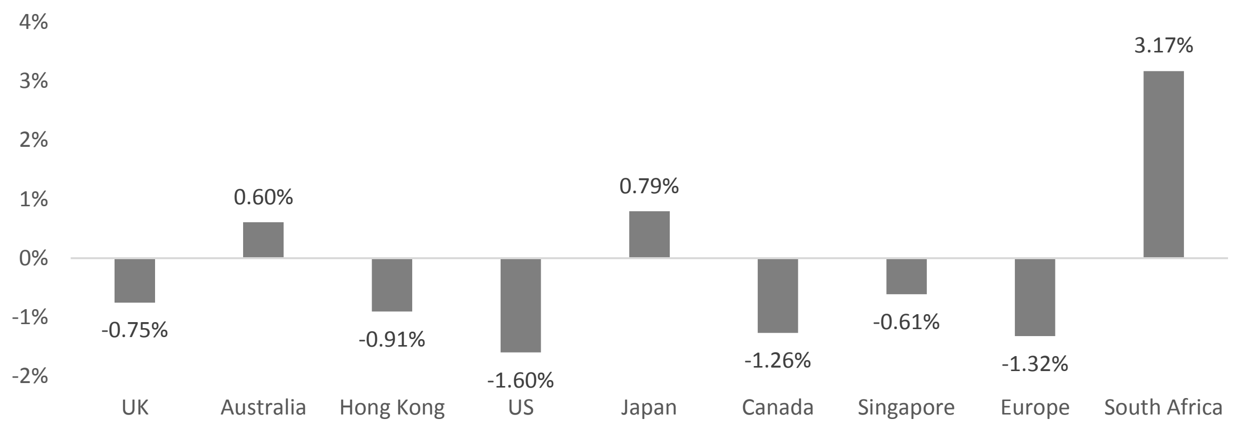
US REITs reported Q3 earnings and the results scorecard points to a slight slowdown in earnings momentum with less companies beating forecasts or raising guidance. That being said 5-7% FFO growth still seems a reasonable growth expectation over the next 2-3 years. Global REITs trade at a 4.4% forward yield in USD, a 245bps spread to 10-year government bonds and 8% discount to NAV. We see value at these levels and would be comfortable forecasting 7-9% USD total returns over 12 months.

PERFORMANCE COMMENT – SESFIKILE BCI GLOBAL PROPERTY FUND

In the month ended 31 October 2017 the Sesfikile BCI Global Property Fund (ZAR) delivered a +4.18% total return versus the Benchmark (FTSE/EPRA NAREIT Developed Rental Index, NET TR, ZAR) that delivered +3.16% - an outperformance of 102 basis points over the period.

This month's outperformance was driven by the fund's overweight positions in Nepi Rockcastle (+0.10% relative alpha), Host Hotels and Resorts (+0.10%) and Cubesmart (+0.09%) over the month. Another contributor was European Mall operator Unibail-Rodamco which added 0.08% of alpha. Detractors to performance include our geographic underweight position in Canada (-0.06% relative alpha) and overweight positions in US domiciled REITs Simon Property Fund (-0.22%) and Kimco Realty (-0.14%).

Chart 3: Sesfikile Global Property Fund Regional tilts relative to benchmark



Source: Bloomberg, as at 31 October 2017

As at 31 October 2017 the fund had 1.82% in cash.

Evan Jankelowitz
BCom (Hons), CFA

Mohamed Kalla
BCom, CFA

Kundayi Munzara
BSc (Hons), CFA

Anil Ramjee
Mcomm. (EconSci), MSc. (Property)

SESFIKILE CAPITAL
Listed Property Investments

DISCLAIMER