NIMBLE WISDOM GLOBAL

Merger month in malls | 30 November 2017

SESFIKILE CAPITAL
Listed Property Investments

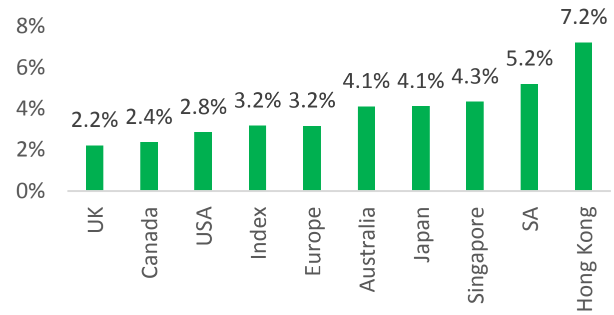
MARKET OVERVIEW

This month global REITs (EPRA/NAREIT Developed Rental Index) rose 3.19% taking year to date returns to a respectable 7.9% - broadly in line with our full year expectations of 7%. For the first time in many months, REITs outperformed Equites with the S&P500 rising 3.07% while global Equites (MSCI World Index) rose 2.17%. US 10-year bond yields began the month at 2.38%, fell 6bps to a monthly low of 2.32% before rising 9bps to close the month at 2.41%.

In the US, tax reform took centre stage with a permanent reduction in corporate tax from 35% to 20% being passed by the Senate, albeit being effective in 2019. The House of Representatives is the next key hurdle and if achieved it will be signed by Donald Trump. On Friday 8 December the US added 228 000 jobs, thus keeping the unemployment rate at 4.1%, with labour participation staying flat at 62.7% and wage growth decelerating from 2.7% to 2.5% y/y.

By region this is the only month in 2017 where all regions closed in the green with Hong Kong leading at 7.2%, followed by SA (due to a 3.6% strengthening in the Rand) at a return of 5.2%. Singapore continued to rally by closing 4.3% higher followed by Japan and Australia that closed 4.1% in the green. Europe which delivered in line with the benchmark was a laggard for the first time in two quarters followed by the USA (2.8%), Canada (2.4%) and the UK at 2.2%.

Chart 1: Monthly returns per region



Source: Bloomberg, as at 30 November 2017

Key Points in this report

- Rising 3.19% in November, Global REITs have delivered total returns of 7.9% for the 11 months of the year. This month US & Global Equites underperformed REITs by closing 3.07% and 2.17% higher in USD respectively. US 10-year bond yields were roughly flat over the month, rising only 3 basis points to 2.41%.
- The US was dominated by Tax reform this month with the Senate voting for a 15% reduction in the corporate tax rate to 20%. The House of Representatives has yet to vote on the motion before the bill is passed and signed by president Trump. US employment was flat at 4.1% as 228 000 jobs were added in November.
- Global REITs currently trade at a 4.2% forward yield vs. global bonds at 1.95% (weighted average) implying a 221bps yield spread. The long-term spread is 150bps. With one month to go in 2017, global REITs have delivered 7.9% in the first 11 months – within our expected range of 7% for the year.

President Donald Trump's Tax reform took center stage in November. The Senate's version of the tax reform passed on 2 December includes a permanent reduction in corporate income tax from 35% to 20%, however this will only become effective until 2019. The next step is for the House and the Senate to come to agreement on a version of the tax reform that they are both happy with to form the final bill that will be signed off by President Trump. The US Fed is widely expected to hike interest rates by 25bps this month.

The US added 228 000 jobs this November, slightly worse than expectations thus keeping the unemployment rate to 4.1% with labour participation remaining flat at 62.7%. Importantly wage growth disappointed slightly to 2.5% annualised (from 2.7%) for November.

GLOBAL REIT NEWS:

Company	Comment
Hammerson looks to buy Intu	On 6 December pan European mall and outlet owner Hammerson announced an offer to acquire UK (and Spain) mall owner Intu in an all share offer at 0.475 HMSO per INTU. The deal valued Intu at a 28% premium to the pre-announcement price and 18% discount to NAV. Although the shopping mall / retail REIT sector has been out of vogue in the last 12 months, the deal makes Hammerson a dominant UK mall owner with 17 of the top 25 malls in the UK, plus key outlet malls across Europe. Hammerson stated that they could cut £40m worth of costs in the first year then achieve £25m per annum in cost synergies, which would be accretive to the 57% of Hammerson shareholders that also hold Intu, and boost HMSO's recurring EPS by an estimated 5% per annum.
Brookfield offers to buy GGP Inc.	On the 12 November 2017, the Toronto based Brookfield Property Partners bid $14.8bn or $23/share for the 66% of the class A mall REIT GGP that it doesn't own. The $23 offer price is equivalent to a 20% premium to the share price just before the offer (~$19/share). The offer equates to a yield of approximately 6.3% which we believe is too low and significantly undervalues GGP's class A assets. Furthermore, days following the GGP offer, Third Point LLC, a New York-based hedge fund reported that it had acquired 5% of the class A mall REIT Macerich and US real estate press (REIT Zone) reported that another New York-based hedge fund Jana Partners LLC has been accumulating shares in another Class A mall REIT Taubman Centers. The flurry of potential M&A and rumors is evidence that the market is significantly undervaluing the high-quality class A mall REIT sector and valuations are not in line with current fundamentals and operating performance of the sector.

In central Europe, the Polish government announced proposals to stop Sunday trade in an effort to appease certain factions in its voter base. The ban will be on a phased basis over three years starting in 2018 with one Sunday a month closing in 2018, rising to two Sundays a month in 2019 then 'every Sunday' in 2020. Restaurants, Cinemas and other entertainment related business will be permitted to operate however. This will likely negatively impact Polish retailers and in turn, listed property companies Atrium, Immofinanz, Echo Polska Properties and Nepi-Rockcastle.

LOOKING FORWARD

In line with global equity markets, listed property has shown significant volatility in 2017, in effect driven in the main by politics and 'headlines' as opposed to property fundamentals. In the main a lot of our earnings and fundamentals expectations have been met with 2017 earnings slowing down by approximately 100bps from 2016 from a growth perspective. Supply growth was a key theme across both US multifamily, self-storage and industrial sectors. In the multifamily sector labour shortages appear to have pushed supply out with many buildings not being completed on time. The self-storage sector remains murky with little visibility on the timing and extent of supply. The industrial sector has seen supply rise, but still well below demand, and, with US logistics vacancies being at around 5%, rental growth has continued to push ahead.

Despite Brexit fears, UK commercial property has held up and fared better than expected. Central London specialists Derwent London and Great Portland Estates upgraded their rental growth expectations from -3% to +2% with cap rates rising only modestly. In Europe we expect an acceleration in property fundamentals particularly in Germany (office and residential), Ireland and Spain. The retail sector seems to be picking up from a consumer perspective with retailer sales recovering and mall operators outperforming Retail price inflation (RPI indexation) by 2-3% per annum.

Largely driven by elevated retailer bankruptcies in the US, malls and strip centre REIT share prices have underperformed significantly this year. Despite this A class Mall REIT earnings have been defensive with SSNOI's rising 3-4%, occupancies staying flat at around 95%, and releasing spreads remaining in the double digits at 11-15%. The sector is certainly more defensive, withstanding e-commerce than what the headlines suggest. Perhaps recent mergers in the UK and US prove that they are undervalued.

After delivering total returns of 7.9% for the first 11 months of the year, global REITs trade at a 4.2% dividend yield and 8% discount to NAV. The forward dividend yield is at a 221bps discount to global bonds versus a long term spread of 150bps. With around 5-6% earnings growth expected per annum over the next 24 months we expect total returns in the region of 7% in USD over the medium term.




Evan Jankelowitz
BCom (Hons), CFA

Mohamed Kalla
BCom, CFA

Kundayi Munzara
BSc (Hons), CFA

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

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