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Property Insights

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Property Broker Survey –Market Balance Q3 2021

Brokers continue to see all 3 major commercial property buying/selling markets as oversupplied, the Office Market being the most oversupplied, and Industrial the least.

We continue with the 3rd quarter 2021 results of our FNB Commercial Property Broker Survey, which surveys a sample of commercial property brokers in and around the 6 major metros of South Africa, namely, City of Joburg and Ekurhuleni (Greater Johannesburg), Tshwane, Ethekwini, City of Cape Town and Nelson Mandela Bay.

Given FNB Commercial Property Finance's strong focus on the "Owner-Occupied" Property Segment, a pre-requisite in selecting broker respondents is that they deal in owner-serviced properties, but a portion will also have dealings in the developer or investor markets as well as in the listed sector.

In this report, we deal with questions relating to the perceived balance/imbalance between demand and supply of properties being transacted in the main markets. Market "strength" refers to a relatively strong demand level relative to supply, and vice versa for market "weakness". These questions include estimates of average times of properties on the market prior to sale, as well as perceptions of whether demand exceeds supply or vice versa.

Key themes that emerge from the results are:

- The Industrial Property Market is still perceived to be the strongest of the 3 major commercial property sectors, i.e. Industrial, Retail and Office.
- However, an oversupply of property on the market relative to demand in all 3 property classes has continued in the 3rd quarter survey.
- In the area of Industrial Property, it appears to be that the 3 coastal metros, i.e. Cape Town, Nelson Mandela Bay and Ethekwini, are where the relative market strength lies, with Gauteng metro regions being the area of relative weakness, Johannesburg being especially weak.
- In Retail and Office Property it has become unclear as to whether the coastal metros or Gauteng are the major regions of relative strength of weakness.
- Given a bias towards "oversupply" in all 3 major commercial property markets, we remain of the expectation that 2021 will see a continuation of a decline in average values on commercial property, following significant average value decline in 2020.
- The Office Property Sector is seen as the weakest of the 3 major property classes, with a significant proportion of survey respondents perceiving many companies to be re-assessing their office space requirements in light of the successful lockdown-related remote working period.

Average Time on the Market still perceived as increasing in 2 out of 3 segments, Industrial Property being the exception.

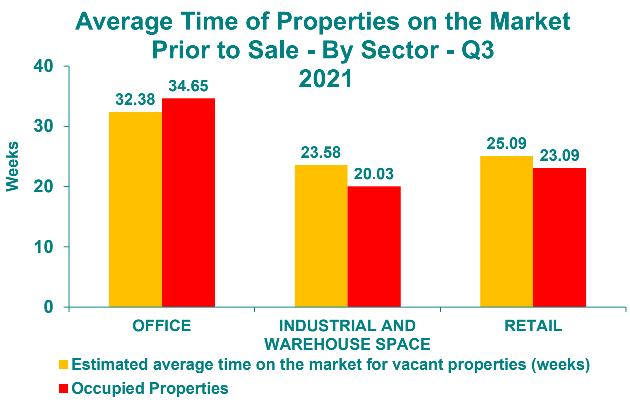
From our residential market survey, we found the movement over time in the estimated average time of properties on the market prior to sale to be a useful indicator of changes in the balance between supply and demand, an increase in average time of properties on the market prior to sale signaling a deteriorating demand relative to supply and vice versa.

We have attempted to apply this same questioning to our commercial property broker survey, splitting the survey by the 3 main property classes, namely Office, Industrial and Retail, and splitting it further by "Vacant Properties" vs "Occupied Properties"

The relative picture between the 3 major property sectors is still one where brokers perceive the Industrial Property Market to be the strongest of the 3 classes, with an average time on the market for occupied industrial properties of 20.03 weeks being quicker than the 23.09 weeks in the case of retail and 34.65 weeks for office space.

Vacant industrial properties, too, averaged the shortest average time on the market of the 3 segments to the tune of 23.58 weeks, compared to 25.09 weeks in the case of retail space and 32.38 weeks in the case of office properties, in the 3rd quarter 2021 survey.

An interesting feature in this most recent survey is that vacant office properties are perceived to be selling slightly faster than occupied office properties for the 1st time since the survey was started back early in 2019. Does this imply that vacant office properties for repurposing purposes are becoming relatively more popular in that troubled market? It is probably a bit too early to tell.



In the FNB Commercial Property Broker Survey, it is more difficult to estimate average time on the market than is the case in the FNB Residential Property Estate Agent Survey, given a far smaller sample size when it comes to number of transactions, so from quarter to quarter the different groups of respondents do perceive average time quite differently, and the data moves can be more volatile.

However, in an easier-to-answer follow up question as to whether the past 6 months has seen average time of properties on the market increase, decrease or remain unchanged, brokers appear better able to assess the direction in average time as opposed to the actual average time itself. And, on average, the respondents remain biased toward "lengthening average time on the market" in 2 out of the 3 major commercial property sectors, Industrial Property being the only one with a bias towards declining average time on the market.

- Perceptions regarding the direction in "average time on market" over the past 6 months

The follow up question to the average time on the market estimate, is asking respondents whether they believe that the average time on the market has increased, decreased or stayed the same since 6 months prior (i.e. since the 1st quarter of 2021).

Out of the responses we create an index by allocating a +1 score to an "increased" response, a zero to an "unchanged" response and a negative -1 to a "declined" response.

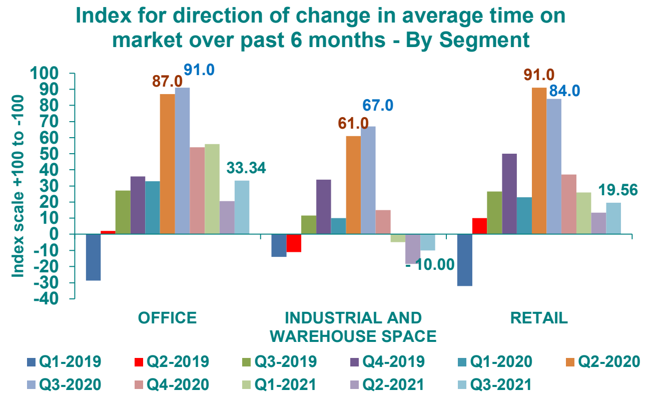
The scale of the "Index for direction of change in time on the market over the past 6 months" is thus from +100 to -100. A score of +100 would imply that 100% of respondents perceived an increase in time on the market over the past 6 months (market weakening) and -100 would imply 100% of respondents perceiving a decline, while a zero level would mean that those providing an "increased" response equals those responding with "decline".

2 out of the 3 property classes, i.e. Office and Retail, returned a positive number, implying that the aggregate of responses in these sectors points towards an increase (market balance weakening) in average time of properties on the market compared to 6 months prior.

In addition, this "increased" bias in these 2 property classes has been seen consistently in quarterly surveys since early-to-mid-2019.

The Office Index showed the most strongly positive (weakest) reading of +33.34 in the 3rd quarter, which was mildly up from the +20.63 of the previous quarter. The Retail Index showed a similar reading of +19.56 in the 3rd quarter of 2021, also slightly higher than the prior quarter's +13.47.

The only market to buck the trend appears to have been Industrial Property, which showed a negative reading of -10. Indicating a bias towards declining average time on the market for the 3rd consecutive quarter, thus pointing to an improving demand-supply balance in this market.



Therefore, while actual estimates of average time of properties on the market is difficult, and as such the trend in prior survey responses to this question aren't always clear due to some volatility, the simpler follow-up question regarding direction in average time on market over the prior 6 months has shown less volatility and a clearer trend over most of the history of the survey towards an "increasing time" bias in the Office and Retail Sectors since early-2019. Industrial Property is the only market turning to a declining trend since early-2021, some time after the end of hard lockdown.

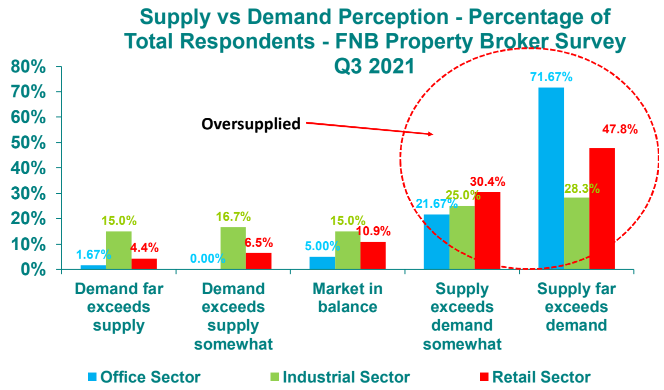
The "increasing time on market" bias has become less pronounced in the Office and Retail Sectors since spikes in the 2 winter quarters of 2020. This has much to do with the end of hard lockdowns that happened around that time. It was difficult to do property trades in the midst of hard lockdowns, while the economy was in an extremely deep recession.

But the fact that the brokers still have a bias towards lengthening average time on market continues to reflect the recessionary economic times in which South Africa finds itself, with Real GDP (Gross Domestic Product) still not back to 2019 pre-COVID levels.

Demand vs Supply Strength Perceptions

An additional supply-vs-demand question is asked, where the respondents are asked whether they perceive "demand far exceeds supply" (option 1), "demand exceeds supply somewhat" (option 2), the market is in balance" (option 3), "supply exceeds demand somewhat" (option 4) or "supply far exceeds demand" (Option 5).

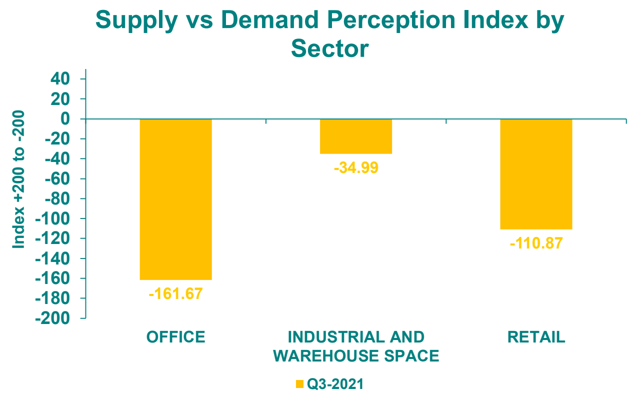
All 3 property sectors have the majority of respondents pointing to "supply exceeding demand", either "somewhat" or "far". The Industrial Market possesses the lowest percentage of respondents, i.e. 53.3% perceiving supply to exceed demand, whereas 78.2% perceive supply to exceed demand in Retail Property and 93.3% in the case of the Office Property Market.



Once again we create an index from the responses, option 1 receiving a score of +2, option 2 a +1 score, option 3 a zero score, option 4 a -1 score and option 5 a -2 score.

The index is thus on a scale of +200 to -200, where +200 would imply 100% of respondents choosing option 1, and -200 meaning a 100% option 5 response.

All 3 sector indices were negative in the 3rd quarter survey, with the Industrial Property Market least so on a -34.99 reading, followed by Retail at -110.87 and Office recording the weakest -161.67.

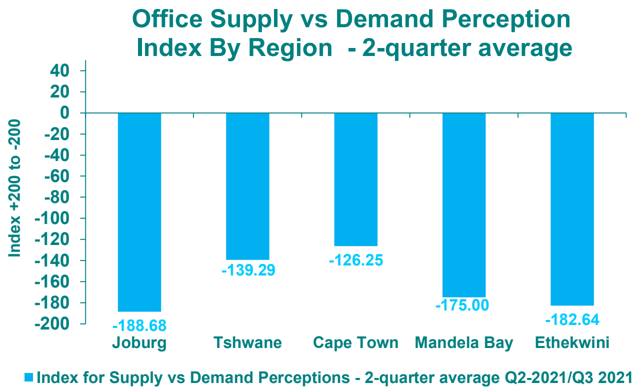


In short, respondents strongly perceive all 3 markets to be oversupplied, but with the Industrial Market believed to be the least oversupplied, followed by Retail and then Office.

Provincial Comparisons – Demand vs Supply Strength Perceptions

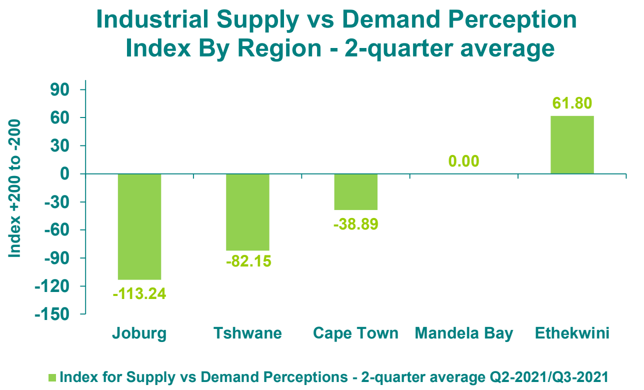
Due to smaller sample size at individual metro level, we are concerned with volatility in the surveys, and therefore opt to use a 2-quarter average of survey responses for the Demand-Supply Perceptions Indices for individual regions.

Examining the perceived market balance by major metro region, the Office Space survey points to Greater Johannesburg having the weakest demand vs supply balance, with its index being the most negative -188.68. This reading is only marginally weaker than the other 4 metro regions, which are all showing highly oversupplied readings, between -126.25 (Cape Town) and -182.64 (Mandela Bay).



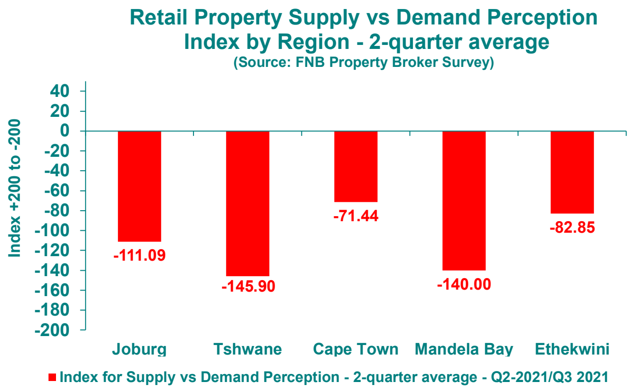
In the Industrial Property Market survey, the 3 coastal metros come out relatively stronger than the Gauteng Metros, with Ethekwini having a positive reading of +61.8, followed by Nelson Mandela Bay with zero, and Cape Town with –38.89.

At the weakest end of the Industrial Property Market is Greater Johannesburg, with a negative index reading of -113.24, followed by Tshwane with -82.15.



In the area of Retail Property, the survey points to significant oversupply across all 5 metro regions.

Tshwane is the weakest market, with a negative reading of -145.9, followed by Nelson Mandela Bay with-140. The "least weak" of the 5 were the 2 major coastal metros, Cape Town with a -71.44 reading and Ethekwini with -82.85.



Conclusion

Perceptions relating to demand relative to supply remain weak, regardless of whether one views the bias towards increasing time on the market, or the perceptions of demand vs supply.

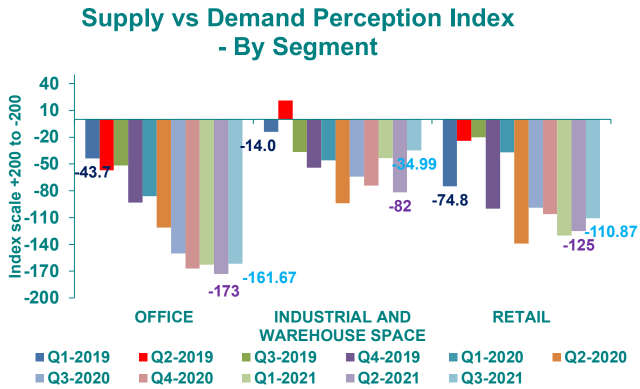
In the follow up question as to perceptions of demand relative to supply, the broker group perception is tilted strongly towards oversupply. This is most severely the case in the Office Property Market.

The recent surveys, however, have shown signs of mild reduction in oversupplies on the market according to broker perceptions.

After a sharp deterioration in broker oversupply perceptions in the Office Market up to the end of 2020, the Office Supply-Demand Perception Index readings are slightly improved, from a historic weakest -167 reading in the final quarter of 2020 to a marginally less weak -161.67 by the 3rd quarter of 2021.

Since the Retail Market's worst "oversupplied" reading of -139 as at the 2nd quarter of 2020, it has made slightly more progress towards balance than the Office Market, recording a negative -110.87 as at the 3rd quarter of 2021.

The Industrial Market, however, has made the most progress towards restoring balance, seeing its "oversupplied" reading diminish from a worst -139 as at the 2nd quarter of 2020 to -34.99 by the 3rd quarter of 2021.



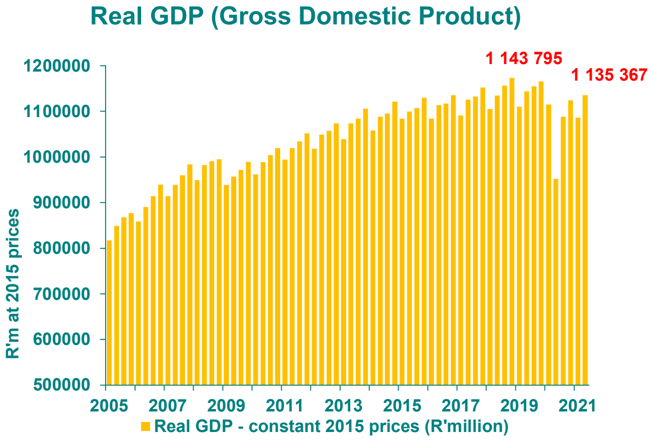
But the fact that all 3 markets still have a significant "oversupplied market bias appears reflective of the deep economic recession which South Africa's economy has gone through, and that it has still not "fully" recovered to pre-COVID-19 GDP levels. Such economic weakness is sure to contain demand for commercial property.

The oversupply is also in part the result of an economy stagnating over many years prior to the 2020 lockdowns.

Real GDP did grow at a massive year-on-year rate +19.27% in the 2nd quarter of 2021. However, this sharp growth was largely due to a very low base created in the 2nd quarter of 2020 due to hard lockdowns in much of the economy, resulting in a sharp drop in GDP in that quarter.

We thus prefer to view actual GDP level, and compare it with the corresponding quarter of 2019, a more normal year. Here, we see that 2nd quarter 2021 GDP was still -0.7% down on 2nd quarter 2019 GDP.

In addition, 2019 was not a wonderfully high base, with GDP growth having stagnated for some years prior, and we had already seen our broker survey perceived oversupplies rising through 2019 as that year progressed.



The oversupplied markets accompanied by ongoing GDP weakness lead us to expect decline in average property values to continue in 2021, most notably in Office, less so in Retail, and least in Industrial Property.

The sectoral picture that emerges from the survey component pertaining to market balance/strength is one of Industrial Property being the strongest market of the 3 major commercial property classes, i.e. Industrial, Office and Retail, but with all 3 markets still showing significant oversupplies of property relative to demand.

Within the Industrial Property Market, it would appear that the 3 coastal metros' Industrial Property Markets have been outperforming the 2 Gauteng Metros significantly, Ethekwini Metro actually perceived to have an undersupply of industrial property relative to demand.

- Office still the weakest market in 2021

Finally, what has been noticeable in many of the survey question responses is that the Office Property Market is by far the weakest of the 3 markets according to broker perception.

The Office Market not only has the normal economic challenge of job cuts in office-bound services sectors, translating into less space requirements by companies. It is also challenged by the highly successful forced remote working "experiment", caused by 2020 lockdowns, and broker surveys consistently point to many companies re-assessing their office space needs, and many planning to lessen their amount of office space leased or owned. This downscaling process may well still be gathering momentum. It is thus looking likely that Office Property will be the underperformer of the 3 main commercial property classes in 2021 as a whole and even beyond.

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