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Commercial Property Finance

Property Insights

FNB Commercial Property Broker Survey – 2nd Quarter Market Activity Survey points to relative Industrial Market strength, but Office Market weakness with ongoing planning by certain companies to scale back on office space

John Loos:
Property Strategist

FNB Commercial Property Finance

Tel: 087-312 1351

Email: john.loos@fnb.co.za

Key Points

- The 2nd Quarter of 2021 FNB Commercial Property Broker Survey saw all 3 major commercial property sectors, i.e. Industrial and Retail, showing further increases in perceived market activity levels, with the Office Property Market's Activity Rating the weakest, and Industrial remaining the strongest.
- The percentage of broker respondents perceiving business conditions to be satisfactory rose slightly further in the 2nd quarter survey to 27%, up from 26% in the previous quarter. This remains a very weak level.
- When asking brokers for their ratings of market activity levels on a scale of 1 to 10, we see that the group of respondents is most upbeat about the Industrial and Warehouse Property Market. The Industrial Property Market's 2nd quarter 2021 Activity Rating rose further from 5.44 in the prior quarter to 5.47. The Retail Property Activity Rating also increased, from 4.18 to 4.38 over the same 2 quarters. The Office Property Market Activity Rating remained the weakest of the 3, but also rose from 3.39 to 3.63.
- The Near Term Expectations Indices of property market activity, reflecting broker near term expectations, saw the respondents being least optimistic about Office Property, which recorded a negative value of -2, while the Industrial Property Market recorded a positive +17. The Retail Sector response was in between the former 2 sectors, with a mildly positive +4.
- In all 3 markets, the brokers still saw the recessionary economic impact from COVID-19 lockdowns as being a major influence (drag) on their near term market activity expectations. However, in the Office Sector, the lockdown-related Work From Home (WFH) success is also widely believed to be influencing a portion of firms to plan the downscaling of their space requirements, while this sector is also heavily impacted by recent job reduction . The impact of online retail in the Retail Property Sector is still seen as far less significant than the WFH impact on the Office Market.

The Methodology

The FNB Commercial Property Broker Survey 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.

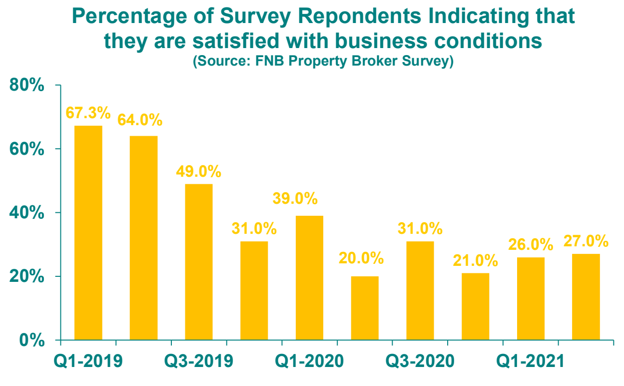
Given FNB Commercial Property Finance's strong focus on the "Owner-Serviced" market, a pre-requisite in selecting broker respondents is that they at least deal in owner-serviced properties, but a portion will also have dealings in the developer or investor markets as well as in the listed sector.

In this report we focus on the part of the survey where we ask respondents to rate their perception of the buying/selling market's (i.e. not rental market) activity levels on a scale of 1 to 10, 10 being the strongest activity level rating.

The term "activity" is as experienced by a property broker, and can include everything from indications of interest in buying or selling, e.g inquiries or viewings related to potential buying or listing, through to actual transaction levels. However, it typically correlates positively to economic cycles and property demand.

Further very slight improvement, but Broker Business Confidence remains very weak

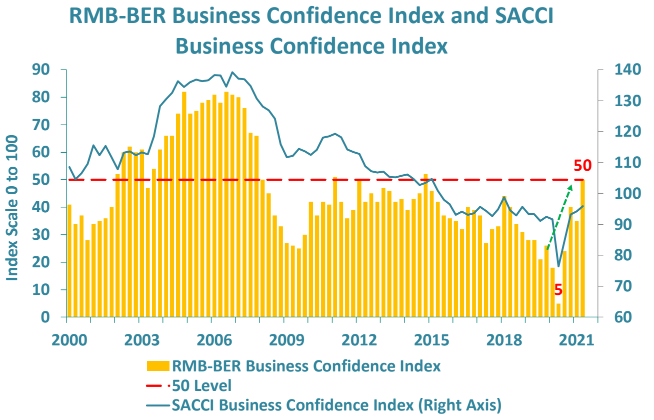
Before we survey activity level perceptions, we ask all respondents to say whether they find business conditions "satisfactory" or not in the form of a simple "yes or no" answer. In the 2nd quarter of 2021, the percentage of respondents experiencing conditions as satisfactory rose mildly from 26% in the prior quarter to 27%. This is improved, but implies that a major 73% of respondents were still dissatisfied with business conditions as at the time of the May 2021 survey.



This survey response gives a perspective of business confidence in the Commercial Property Sector which now appears weaker than broader economy-wide business confidence.

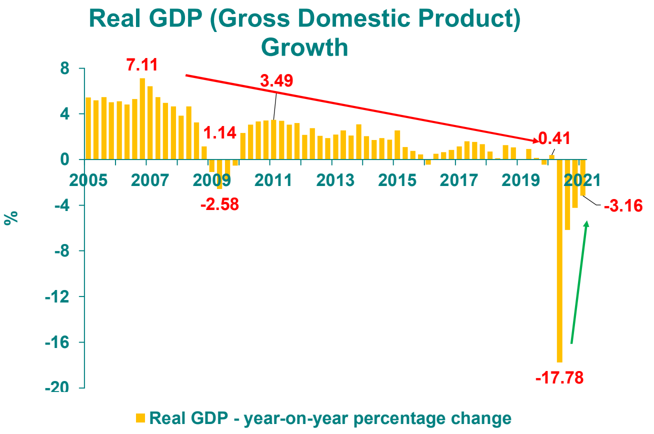
Economy-wide business confidence, as portrayed by the RMB-BER Business Confidence Index, has seen a more noticeable rebound to 50 (scale of 0 to 100) in the 2nd quarter of 2021, after bottoming at a lowly 5 during the 2nd quarter of 2020 as hard lockdowns hit.

This reading itself is mediocre at best, but does suggest that the Commercial Property Sector may be in weaker shape than the overall economy.



While the Commercial Property Market does tend to track the overall economy to a very significant degree, we would expect its recovery to lag that of the overall economy. When businesses have taken such a major financial knock as that of 2020's deep recession, finances and confidence are low, and leasing additional space or investing in additional commercial property would probably, for many, be on the backburner for some time until confidence is significantly better.

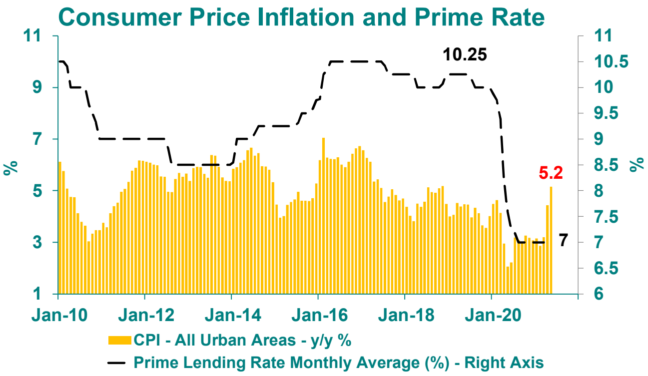
And examining economic data, times are still tough for business in general, with real year-on-year percentage change in GDP (Gross Domestic Product) still down -3.2% as at the 1st quarter of 2021.



In addition, there is a growing belief that the next move in interest rates will be up, not this year but next, and that may be encouraging some caution by investors looking ahead.

CPI (Consumer Price Index) inflation as at May 2021 had surged to 5.2%, thus into the upper third of the SARB's 3-6% inflation target range.

Food and petrol price inflation surges were notable in driving this surge in living costs.



Activity Rating by Major Property Class – Office Property perceived as the weakest

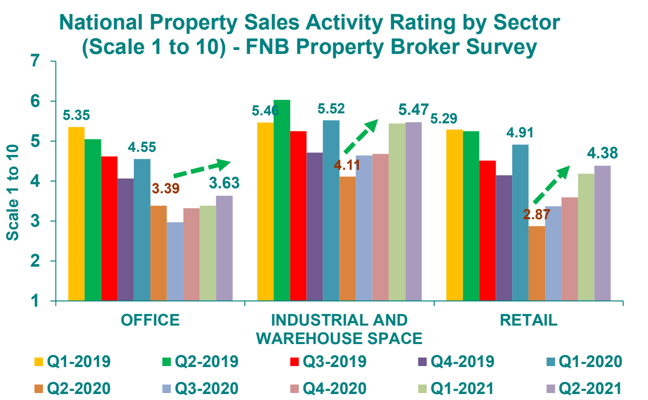
When examining the 3 major commercial property classes, the weak confidence levels are likely driven most by the Office Market, to a lesser extent by the Retail Property Market, and least by the Industrial Market which is relatively vibrant it would appear.

When asking brokers for their ratings of market activity levels on a scale of 1 to 10, we still see that the group of respondents is most upbeat about the Industrial and Warehouse Property Market. This market's 2nd quarter of 2021 Activity Rating rose very slightly, from 5.44 in the previous quarter to 5.47.

This was the 4th consecutive quarter of increase in this activity rating, and its level is now near to the 5.52 pre-lockdown rating recorded in the 1st quarter 2020 survey.

By comparison, the Retail Property Activity Rating was noticeably lower at 4.38 in the 2nd quarter. However, it too recorded its 4th consecutive quarter of increase, from 4.18 in the previous quarter.

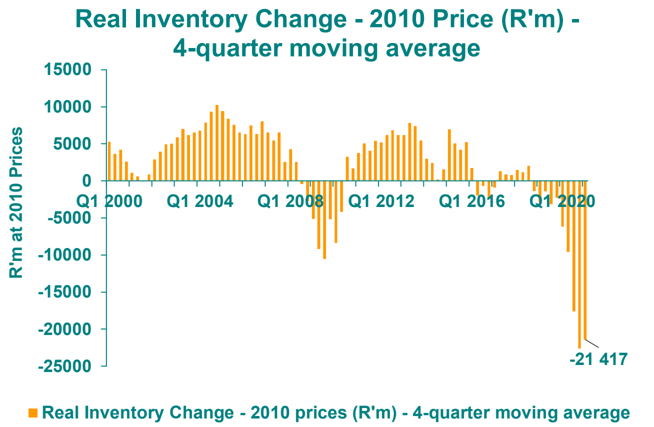
The Office Property Market Activity Rating remained the weakest of the 3 property classes. It did rise mildly for the 3rd successive quarter, from 3.39 in the 1st quarter of 2021 to 3.63 in the 2nd quarter.



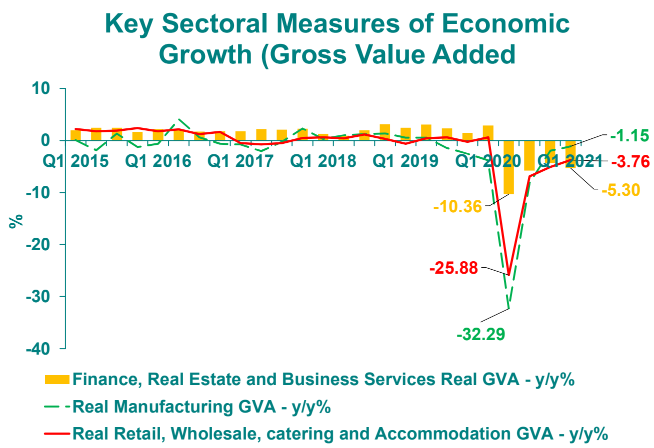
None of the 3 major commercial property classes have seen their activity ratings return to pre-lockdown levels recorded in the 1st quarter of 2020 yet, although Industrial Property's most recent rating is coming close.

This relative situation remains in line with an economy whose level of output, as measured by Real GDP, is also not back up to pre-lockdown levels.

The Warehousing part of Industrial Property sees its performance and demand driven to a significant extent by inventory requirements. With 2019 and 2020 seeing a sharp and sustained drop in real economy-wide inventory levels, the economic fundamentals underpinning demand for warehouse space are not strong. However, it is more the medium to long term inventory level requirements that are key to warehousing demand, and we would assume some recovery in inventory levels in 2021/22 as GDP "normalizes".



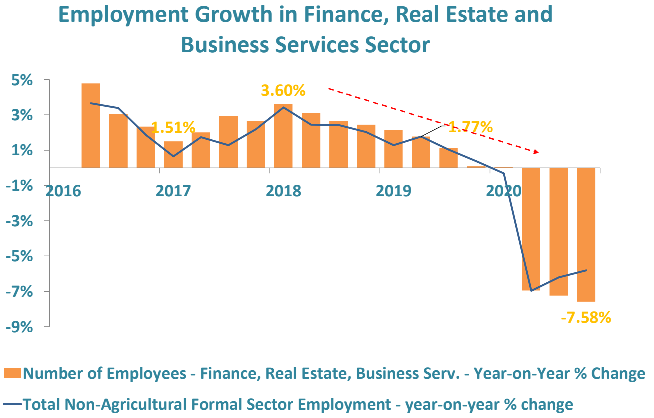
In the 1st quarter of 2021, Manufacturing Gross Value Added (GVA) year-on-year growth was still negative at -1.15%, and this sector's GVA is a key influence on demand for Industrial Property Space and tenant performance. Real Retail and Wholesale Trade, Catering and Accommodation GVA growth was a more significant negative -3.76%, and this in turn is a key influence on the Retail and Hospitality Property Sectors.



The GVA of the Finance, Real Estate and Business Services (FREBS) Sector was also in negative growth territory to the tune of -5.3% in the 1st quarter of 2021, with this sector being a key influence on office property performance.

However, while the GVA of the latter sector influences tenant performance in the Office Sector, it is more the employment trends in the FREBS Sector that influence the demand for office space.

And by the final quarter of 2020, the FREBS Sector's employment numbers dropped sharply by -7.58% year-on-year.



In short, all of the key economic variables that we see as strong influences on demand for the 3 commercial property sectors' space remained weak and below pre-lockdown levels in the early stages of 2021.

Therefore, the brokers' perceptions of activity levels in all 3 property markets not yet having recovered to pre-lockdown levels appears very much in line with key relevant economic indicators.

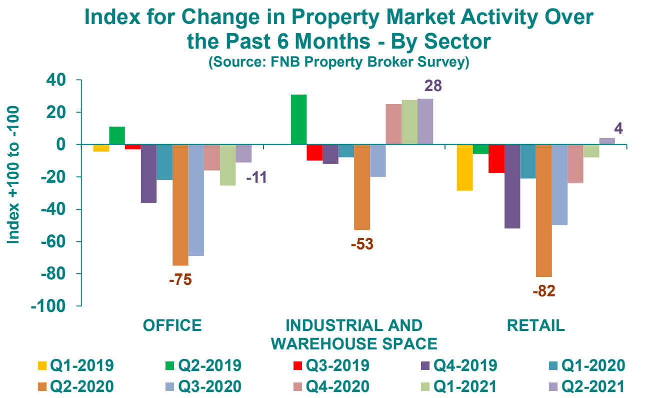
Industrial Market Activity is perceived to have strengthened the most in recent quarters.

Each quarterly survey selects a different sample of brokers from the Property Industry. Therefore, although we ask for quarterly activity ratings, we ask a follow up question as to whether the current quarter's respondents perceive a strengthened activity level over the 6 months leading up to the survey date.

The trend in the answer to this question may not necessarily be the same as the trend in prior quarters' activity ratings, given that the sample of respondents differs each quarter.

The follow up question asks whether the respondents have perceived a decline, increase or no change in activity levels compared with 6 months prior. From these results we compile an index, allocating a score of +1 to each percentage points' worth of "increased" responses, zero to that of "unchanged" responses and -1 for that of "decreased" responses. The index is thus on a scale of +100 to -100.

In the 2nd quarter 2021 survey, the market with the highest index reading, by a significant margin, was the Industrial and Warehouse Property Market. This sector's reading had improved slightly from the prior quarter's positive +27, to +28.



This implies that the respondents perceiving a strengthening in activity in this sector over the prior 6 months exceeds those that perceived weakening by +28 percentage points.

The Office Property Market reading was a far weaker negative of -11, implying that the percentage of respondents perceiving a decrease in activity in this sector exceeded those perceiving an increase by 11 percentage points.

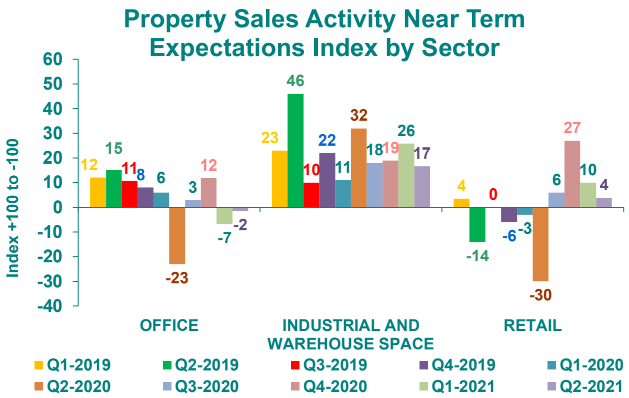
The Retail Market returned a reading slightly "less weak" than that of Office, but still significantly weaker than Industrial, at a small positive of +4.

In terms of buyer-seller market activity, the group of survey respondents therefore continues to see the Industrial Property Market as the strongest of the 3 major segments, as well as the one with the strongest improvement over the prior 6 months.

Outlook – Near-term expectations of market activity strengthening have become less pronounced in the most recent survey

We compile an index using the same methodology as the one viewing activity change over the past 6 months, but this time asking brokers for their expectations of the direction of market activity in the 6 months ahead ("increase", "stay the same" or "decrease").

The respondents as a group are most optimistic about Industrial Property Market Activity in the near term, this sector's index recording a positive reading to the tune of +17. However, this represents a weaker aggregate expectation compared to the +26 reading of the previous quarter. They remain least optimistic about the Office Property Market, which recorded a negative -2. The Retail Market recorded a mild positive of +4, which also represents a weaker aggregate expectation than the +10 reading of the prior quarter.



Key drivers of Brokers' Expectations –COVID-19 economic impact still seen as the biggest influence over the 3 sectors.

In an open-ended follow up question to the one regarding expectations of near-term activity direction, we ask brokers to provide reasons as to why they expect the direction that they do.

In all 3 property classes' survey responses, the various "COVID-19-related" impacts remained by far the most dominant factor cited as an influence on broker thinking and on their expectations.

- The Office Market –The impact of COVID-19 on Office Property includes revision of office space requirements both as a result of increased "work from home" as well as the negative economic impact.

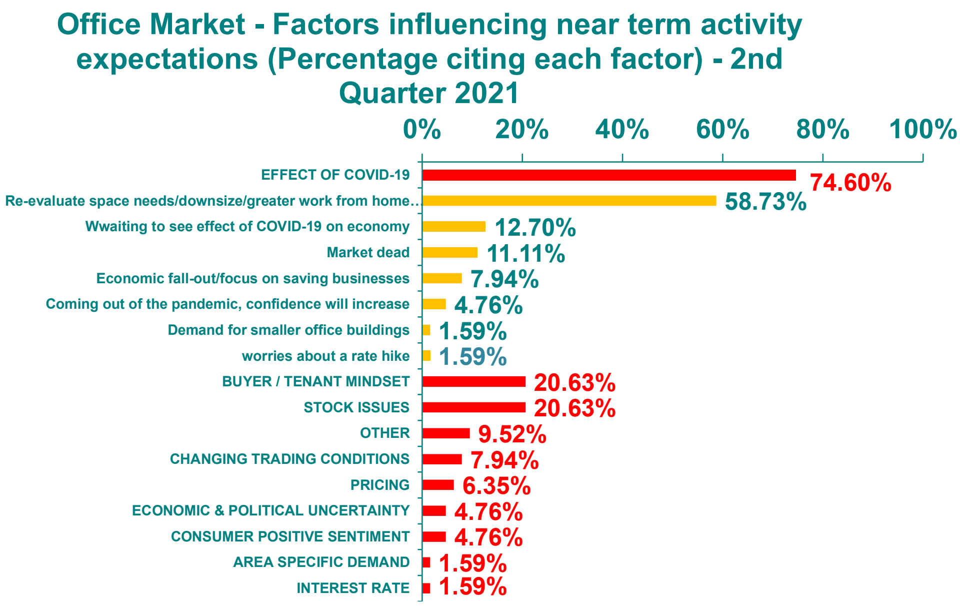
In the 2nd quarter 2021 survey, the Office Property component showed 74.6% of respondents citing factors related to the "Effect of COVID-19" as a key factor driving their activity expectations.

Looking at the sub-components of this key factor is perhaps more insightful though. A very significant 58.73% of brokers perceive companies to be re-evaluating their office space needs, and in many instances downscaling on office space, thus a key factor influencing their near term expectations of market activity in this segment.

The "Work From Home (WFH)" surge during and following lockdown features prominently in these space requirements revisions. However, it is more than just about WFH, with 12.7% of brokers mentioning investors "waiting to see what the Covid-19 impact is on the economy", 11.11% saying "the market is dead", and 7.94% pointing to "Economic Fallout/Businesses focused on saving themselves", and these factors too can typically lead to a dampening of office space demand.

A further noticeable factor category cited was that of "Buyer Mindset", which includes rather leasing than owning a risky asset, going for more affordable lower grade properties, and a "wait and see" approach by some. In short, a cautious buyer mindset.

20.63% also point to "Stock Issues", with the bias significantly towards an oversupply of stock on the market.

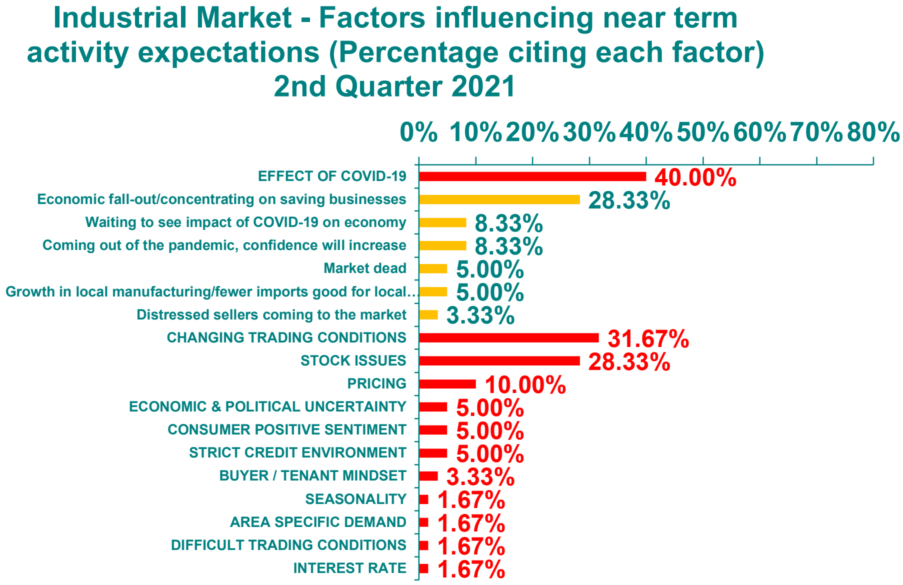


- The Industrial and Warehouse Market

In the Industrial and Warehouse Property Market survey component, the "Effect of COVID-19" was also the major factor category, with 40% of survey respondents pointing to the economic fallout from COVID-19 lockdowns as being a key issue in influencing their near term market activity expectations. Within this general category of response, 28.33% cited the economic fallout from COVID-19, while 8.33% referred to an investor "wait and see the impact of COVID-19" attitude and 5% said the market was "dead". However, 8.33% expecting "confidence to increase as we come out of COVID-19, while 5% believed that less imports were positive for local Manufacturing, so there was some positive expectation around.

And under the major category of factors called "Changing Market Conditions", cited by 31.67% of respondents, 13.33% of respondents see smaller businesses entering the Industrial Market, and investors/buyers still finding good value here. In tough economic times, the relative affordability of the Industrial Market would surely have appeal for a group of businesses. 13.33% believed that increased online retail was driving demand for additional warehousing space, while there was also talk of some companies converting warehouse space to office space or customizing it for other purposes.

28.33%of brokers pointed to "stock issues", with about 20% implying stock shortages.



- The Retail Property Market

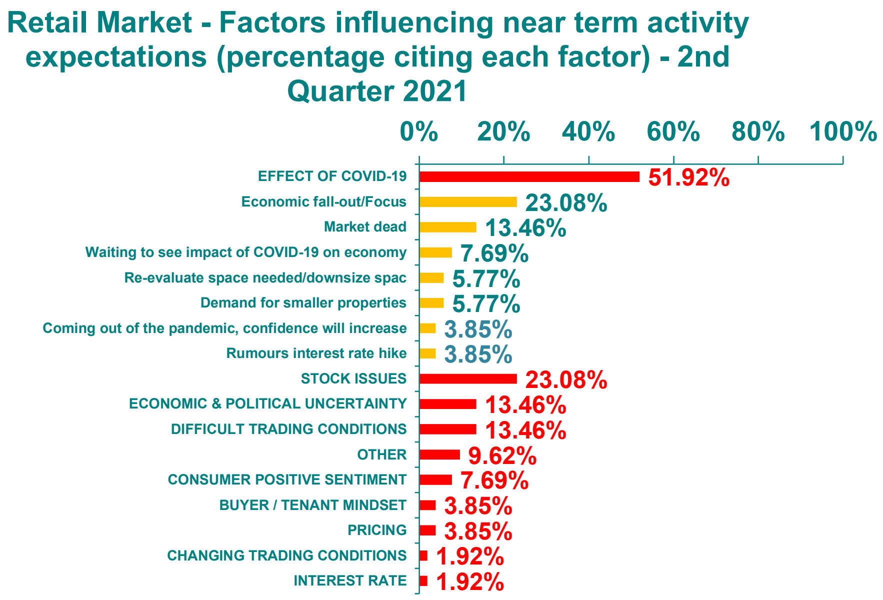
The broker respondents still see the COVID-19 impact, and the recessionary impact of the lockdowns, as by far the main issue that the Retail Property Sector faces.

51.92% of respondents see the Impact of COVID-19 as key, and within that major response category 23.08% of brokers see the economic fallout of COVID-19 as a key factor influencing their expectations. 13.46% see the market as "dead", and 7.69% perceive a widespread "wait and see" approach as slowing activity.

In addition, in another category of factors, i.e. "Economic and Political Uncertainty", 13.46% of respondents cite either a weak economy or sharply rising municipal rates and utilities tariffs as a key issue.

Therefore, the broker group still sees general economic performance and its impact on consumer purchasing power as the key issue for retailers and their landlords.

However, the challenge of online retail to retail shopping centres reflects in the survey again as a "minor partner", with 11.56% of repondents citing online retail as contributing to declining footfall, under the major category of "Difficult Trading Conditions".



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Conclusions – Better Times, but broker near term activity expectations have moderated

The 2nd quarter 2021 FNB Property Broker Survey showed perceptions of further market activity strengthening in all 3 major commercial property classes.

It continues to point to Industrial Property being the strongest of the 3 markets from an activity point of view, Retail Property in the middle, and Office Property the market with the weakest activity.

However, while the perception is one of strengthening in all 3 sectors in the recent past, expectations of strengthening in activity in the near future (next 6 months) have moderated. The aggregated expectation of respondents of further strengthening remains most pronounced in the Industrial Sector, but here as well as in the Retail Property Sector the strengthening expectation has weakened, while in the Office survey the aggregated bias is still slightly in favour of declining near term activity.

In all 3 property classes, the brokers still see very significant negatives in terms of the economic and market impact emanating from the COVID-19 pandemic disruptions and the resultant 2020 recession. In the Office Market, the brokers continue to perceive a major structural change in the form of greater work from home levels compared to pre-pandemic levels, continuing, and a significant level of planning to downscale on office space requirements by companies. This is key to the brokers surveyed remaining the least optimistic on the Office Market's strength and activity levels.

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