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Commercial Property Finance

Property Insights

FNB Commercial Property Broker Survey – 1st Quarter Market Activity Survey points to further recovery progress, but still not back to pre-lockdown levels

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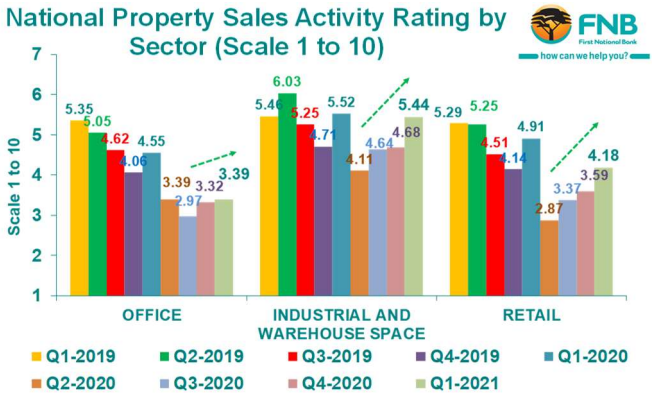
Key Points

- The 1st 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 mildly in the 1st quarter survey to 26%, up from 21% in the previous quarter, but this remains a very weak level and largely reflective of weak business confidence across the broader economy.
- 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 1st quarter 2021 Activity Rating rose noticeably from 4.68 in the prior quarter to 5.44. The Retail Property Activity Rating also increased, from 3.59 to 4.18 over the same 2 quarters. The Office Property Market Activity Rating remained the weakest of the 3, but also rose slightly from 3.32 to 3.39.
- 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 -7, while the Industrial Property Market recorded a positive +26. The Retail Sector response was in between the former 2 sectors, with a mildly positive +10.
- In all 3 property 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 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 seen as far less significant than the WFH impact on the Office Market.

Executive Summary

The 1st Quarter 2021 FNB Commercial Property Broker Survey component that surveys broker perceptions of buying/selling market activity by major commercial property class, continued to show rising activity ratings in all 3 classes, i.e. the Industrial, Retail and Office Property Classes.

The Industrial Property Market recorded the highest activity rating to the tune of 5.44 on a scale of 1 to 10, the Retail Property Market 4.18, while the beleaguered Office Property Market was the weakest with a lowly 3.39 rating.



In all 3 markets' cases, the activity ratings in the 1st quarter represented a further strengthening on the previous quarter's readings, but in all 3 cases the levels have not yet recovered to the pre-lockdown levels recorded in the 1st quarter of 2020 survey.

The fact that the activity ratings are rising but not yet back to "fully recovered", ie pre-lockdown levels, appears more-or-less reflective of recent economic data. Real GDP (Gross Domestic Product) growth remained negative in the final quarter of 2020 at -4.13% year-on-year, which is significantly better than the -17.78% 2nd quarter 2020 drop, but at the same time also not "fully" recovered.

Interest rates are very low, having declined by 300 basis points last year, but unlike the interest rate-sensitive residential property, the Commercial Property Market typically tracks the economy's movements more closely, and this appears to again be the case.

There are some extra factors over and above the economic cycle which may explain the differences in strength between the 3 major commercial property sectors. The brokers perceive all 3 sectors to have been heavily impacted by lockdown and the resultant deep recession. However, they implicitly explain their greater optimism in Industrial Property as due in part to its greater affordability compared to the other 2 property sectors. In addition, they believe that an additional source of demand for Industrial emanates from a greater move to online retail, necessitating increased warehousing and logistics space.

They don't however, perceive retail property to be as challenged by technological progress and online retail as what they perceive office space to be from the lockdown-induced surge in working from home (WFH) and the great success thereof.

Over 40% of brokers surveyed see office-bound companies revising their office space needs and in many cases downscaling. The planned downscaling is not only due to greater levels of WFH, however. Office space demand is also heavily influenced by employment trends in the Finance. Real Estate and Business Services (FREBS) Sector, and this sector's employment dropped by a massive -7% year-on-year in the 2nd and 3rd quarters of 2020, and this alone is likely to translate into a significant drop in office space required by the sector.

Looking ahead at the near term, the brokers are most upbeat about Industrial Property, and this is the property category whose market activity they, on average, expect to increase the most in the next 6 months. A more mild positive increase is expected for the Retail Property Market and a decline in Office Market Activity.

Moderate expectations for the Commercial Property Sector overall seem appropriate. High frequency economic data in recent months points to the pace of economic recovery slowing. Month-on-month growth in the OECD's version of the Leading Business Cycle Indicator for South Africa slowed consistently from a June 2020 high of 2.9% to a virtually insignificant +0.06% in January 2021, suggesting slowing economic growth acceleration to come.

And indeed, we saw the large Manufacturing Sector's year-on-year growth negative in January 2021 (-3.4%) once more, after its 1st positive growth rate since early-2019, in December 2020. Real goods retail sales remained in negative territory in January (-3.5%), as did electricity production (-2.4%).

These weak economic numbers are reflected in weak national business confidence. The RMB-BER Business Confidence Index recorded only 35 on a scale of 0 to 100 in the 1st quarter, down from 40 in the prior quarter, while property broker business confidence is also a lowly 26 on a scale of 0 to 100.

Recent economic numbers, therefore, suggest little further recovery progress early in 2021. Achieving further strengthening in Commercial Property Market activity levels could thus be tough going, especially in the Office Market with its recent major employment decline along with the big WFH structural change.

With regard to relative performances of property sectors, the brokers now appear to see the Office Property Market as becoming the underperformer of the 3 markets, with the Retail Property Market recovering more noticeably after a very poor 2020.

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.

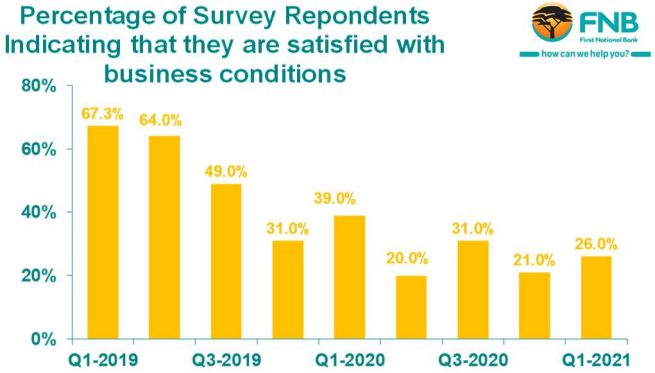
Given FNB Commercial Property Finance's strong focus on the "Owner-Serviced" market, a pre-requisite in selecting broker respondents is that they at least deal in owner-serviced properties, but a portion will also have dealings in the developer or investor markets as well as in the listed sector.

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.

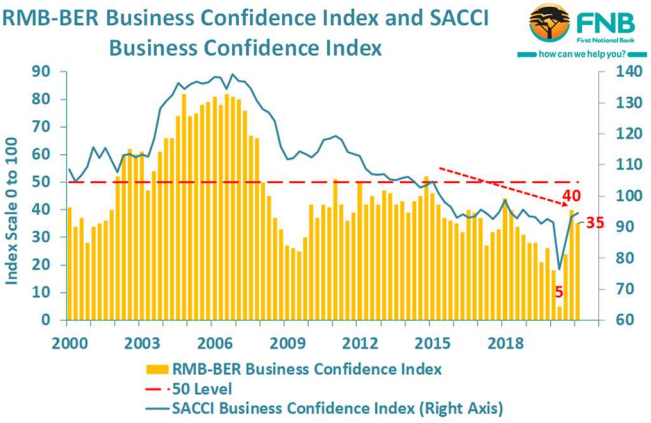
Some slight improvement, but Broker Business Confidence remains in the doldrums

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 1st quarter of 2021, the percentage of respondents experiencing conditions as satisfactory rose mildly from 21% in the prior quarter to 26%. This is improved, but implying that a major 74% of respondents were still dissatisfied with business conditions as at the time of the February 2021 survey.



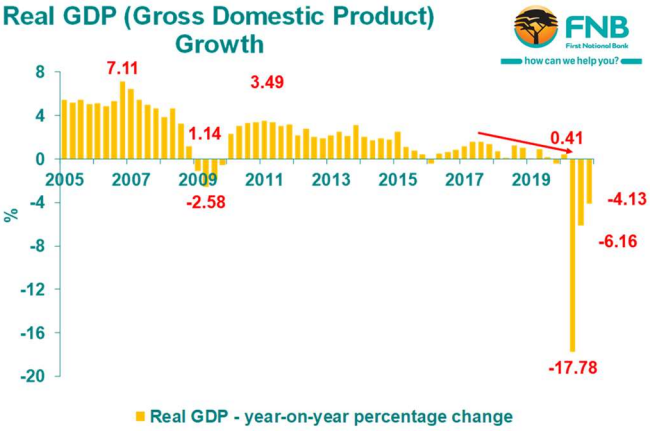
This survey response gives a perspective of business confidence in the Commercial Property Sector which now appears weaker than broader economy-wide business confidence.

Economy-wide business confidence, as portrayed by the RMB-BER Business Confidence Index, saw a renewed decline to 35 in the 1st quarter of 2021, after 2 prior quarters of increase to reach 40 in the final quarter of 2020 (scale 0 to 100). This reading itself remains weak and reflective of poor confidence levels in a still-recessionary economy.



The weak, albeit improved since the 2nd quarter 2020 lockdown level, business confidence level is not too surprising, given that economy-wide production level as measured by GDP (Gross Domestic Product) remained -4.13% down year-on-year in the final quarter of 2020, in other words not yet back up to pre-lockdown levels. In any other recession this would be seen as a very weak economy growth number, only made to look reasonable perhaps by the -17.78% year-on-year drop recorded for the hard lockdown 2nd quarter of 2020.

Recent GDP growth rates thus remain some of the weakest in recorded history. And while the residential side of the property market is highly responsive to cuts in interest rates, such as those rate cuts earlier last year, the Commercial Property Market is more influenced by economic conditions and performance. Hence the slow recovery post-lockdown.

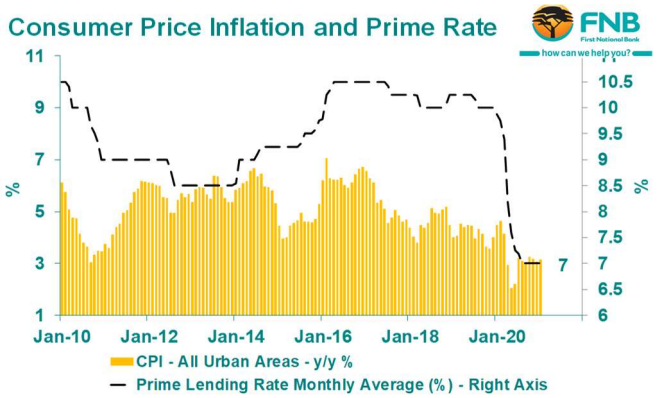


Nevertheless, interest rate trends do have some influence on the Commercial Property Sector in terms of cushioning the blow during times of economic weakness, and had interest rates not been cut by 3 percentage points in the 1st half of 2020, Commercial Property Market conditions and business confidence among brokers would likely have been far worse.

CPI (Consumer Price Index) inflation as at January 2021 continued to hug the SARB's lower inflation target boundary of 3%, recording 3.2% year-on-year, thus continuing to justify low inflation rates where Prime rate remains at 7% for the time being.

Inflation pressures may just be starting to increase mildly, as global economic growth improves on the back of vaccine rollouts and a normalization of economic activity. Already, we have seen a major increase in global oil prices since lockdown lows earlier last year, with year-on-year petrol price inflation locally recently turning positive, and many other commodity prices typically follow as the global economy strengthens.

However, any increase in price pressure is not seen as troublesome in the near term, and interest rates remain low and stable at 7% Prime Rate, where they have been since July 2020.



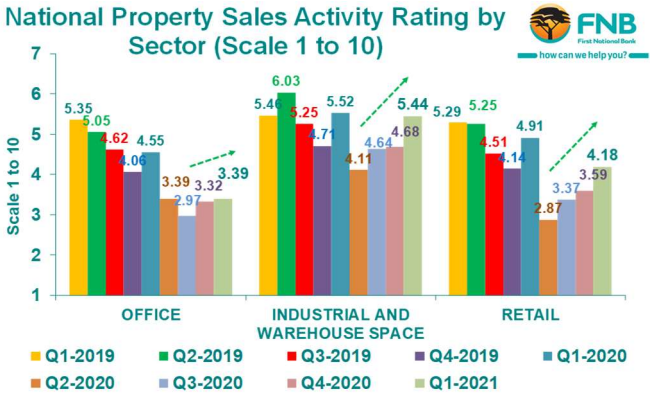
Activity Rating by Major Property Class – Office Property perceived as the weakest

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 1st quarter of 2021 Activity Rating rose further, from 4.68 in the previous quarter to 5.44.

This was the 3rd 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 4.18 in the 1st quarter. However, it too recorded its 3rd consecutive quarter of increase, from 3.59 in the previous quarter.

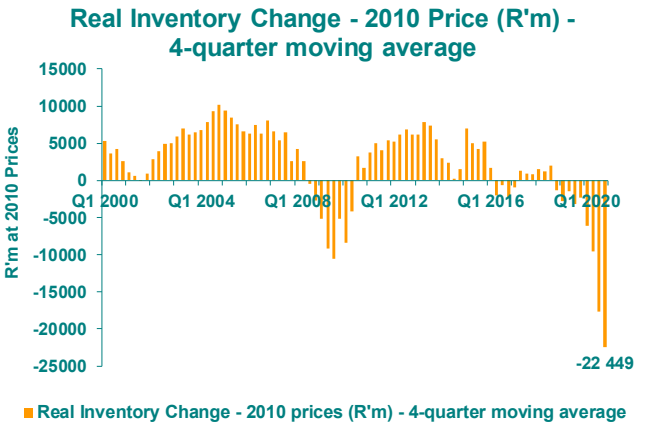
The Office Property Market Activity Rating was the weakest of the 3 property classes. It did rise mildly for the 2nd successive quarter, but it was a less pronounced rise from 3.32 in the 4th quarter of 2020 to 3.39 in the 1st quarter of 2021.



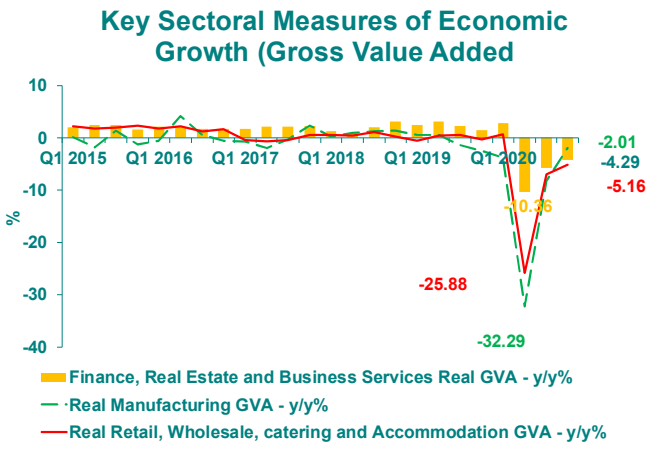
None of the 3 major commercial property classes have seen their activity ratings return to pre-lockdown levels recorded in the 1st quarter of 2020 yet, although Industrial Property's most recent rating is coming close.

This makes sense when all of the areas of the economy that drive demand for space in, and thus influence performance of, these property classes had not yet "fully" recovered to pre-lockdown levels as at late-2020, just prior to when the 1st quarter survey was undertaken.

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, although 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 as GDP "normalizes".



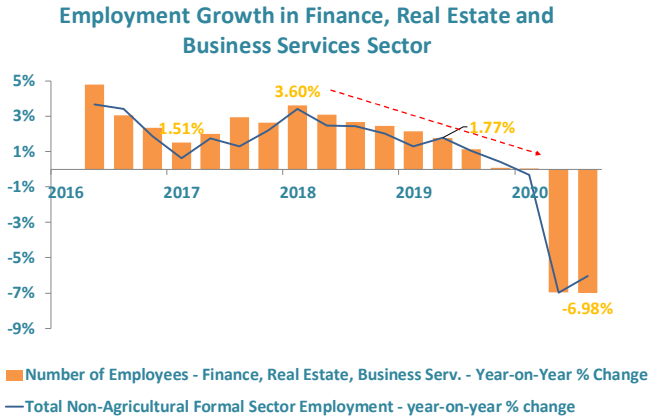
In the final quarter of 2020, Manufacturing Gross Value Added (GVA) year-on-year growth was still negative at -2.01%, and this sector's GVA is a key influence on demand for Industrial Property Space and tenant performance. Real Retail and Wholesale Trade, Catering and Accommodation GVA growth was a negative -5.16%, 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 -4.29% in the final quarter of 2020, 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 in recent quarters, i.e. the 2nd and 3rd quarters of 2020, the FREBS Sector's employment numbers dropped sharply by near to -7% year-on-year.



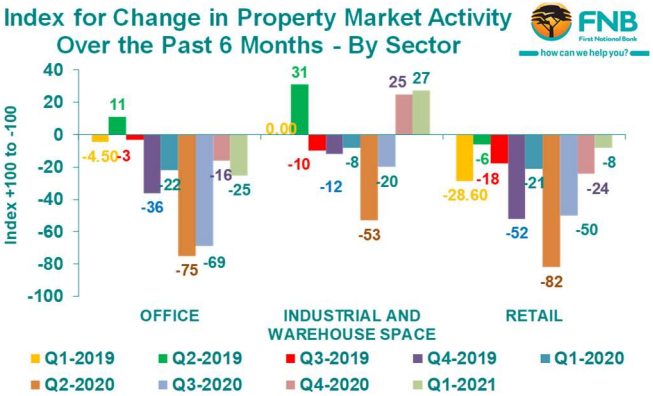
In short, all of the key economic variables that we see as strong influences on demand for the 3 commercial property sectors' space have remained weak in recent times, the aftermath of a very deep 2020 recession. For brokers not to perceive activity levels in the major 3 commercial property sectors as yet having returned to pre-lockdown levels, therefore should not be surprising.

Industrial Market Activity was the only sector perceived as having strengthened over the prior 6 months by Q4 2021 respondents

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 1st quarter 2021 survey, the market with the highest index reading, and the only positive one, was the Industrial and Warehouse Property Market. This sector's reading had improved slightly from the prior quarter's positive +25, to +27.

This implies that the respondents perceiving a strengthening in activity in this sector over the prior 6 months exceeds those that perceived weakening by +27 percentage points.

The Office Property Market reading was a far weaker negative of -25, implying that the percentage of respondents perceiving a decrease in activity in this sector exceeded those perceiving an increase by 25 percentage points.

The Retail Market returned a reading slightly "less weak" than that of Office, but still significantly weaker than Industrial, at -8.

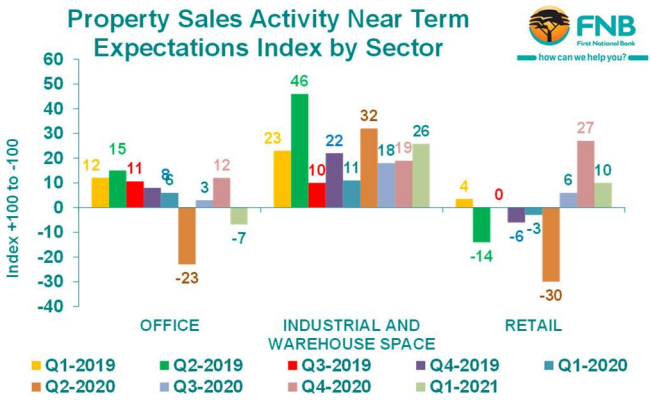
In terms of buyer-seller market activity, the group of survey respondents therefore continues to see the Industrial Property Market as the strongest of the 3 major segments, as well as the one with the strongest improvement over the prior 6 months.

Outlook – Respondents most optimistic about the Industrial Market over next 6 months

We compile an index using the same methodology, 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, which recorded a positive reading to the tune of +26, while they are least optimistic about the Office Property Market, which recorded a negative -7. The Retail Market recorded a mild negative of +10.



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 impacts of "COVID-19" remained by far the most dominant factor cited as an influence on broker thinking and on their expectations.

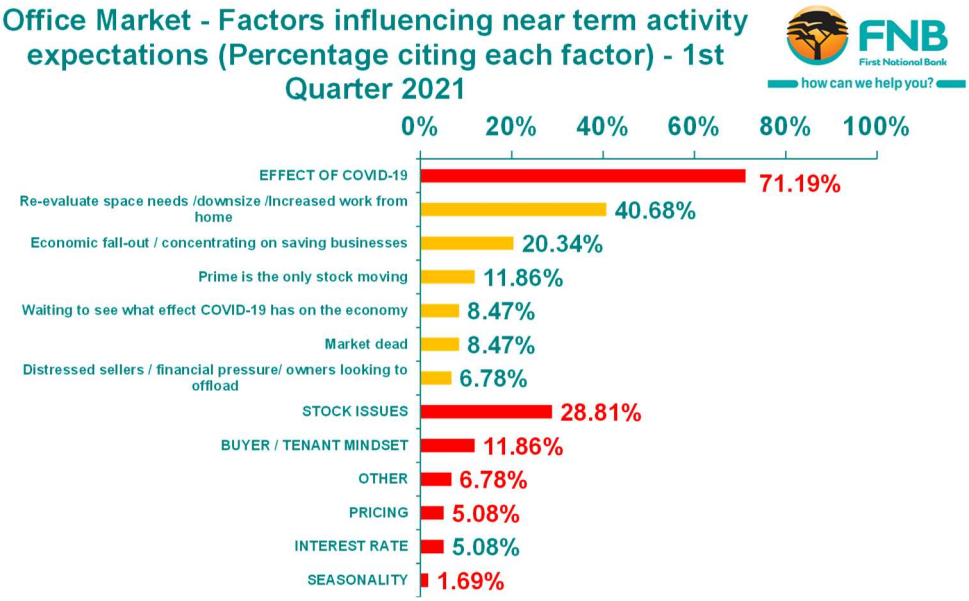
- The Office Market –The impact of COVID-19 on Office Property includes revision of office space requirements both as a result of increased "work from home" as well as the negative economic impact.

In the 1st quarter survey, the Office Property component showed 71.19% of respondents citing "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 40.68% 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 20.34% of brokers mentioning "Economic Fallout/Businesses focused on saving themselves", and this too can typically lead to a dampening of office space demand.

A further noticeable factor cited was that of "Stock Issues", which was mentioned by 28.8%. The majority of these point to oversupply on the market, with largely only prime properties perceived to be trading.



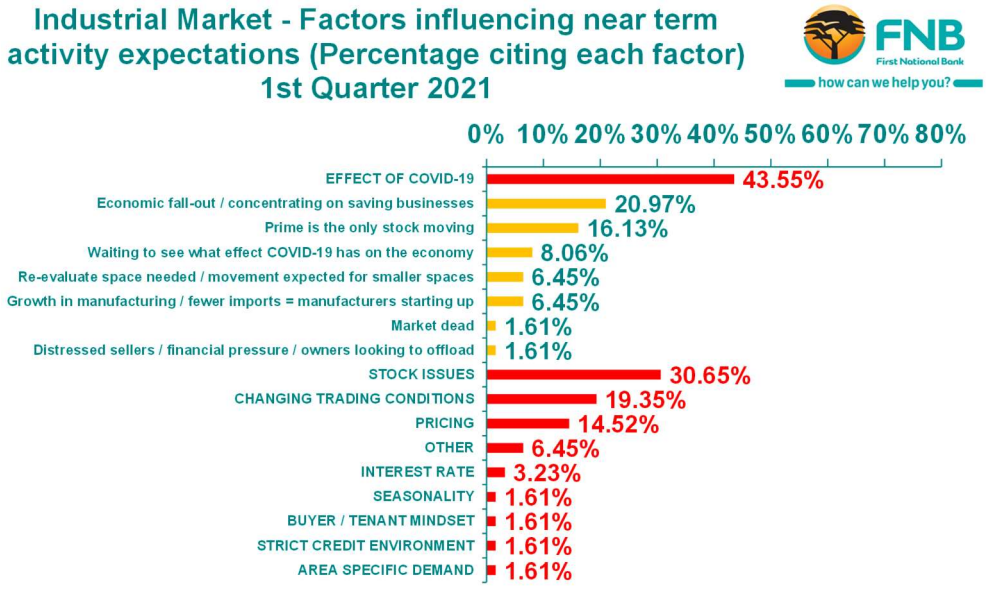
- The Industrial and Warehouse Market

In the Industrial and Warehouse Property Market survey component, the "Effect of COVID-19" was also the major factor, with 43.55% 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, 20.97% cited the economic fallout from COVID-19, while 16.13% alluded to market weakness from this COVID period where only prime properties were generally trading. 8.63% point to something of a wait-and-see approach by market

players to see what the ultimate impact of COVID-19 was/will be.

However, some noticeable positives come through in this survey response too. Industrial Property is the most affordable property category of the 3 major property classes, and 14.52% cite pricing as an influence on their near term expectations, with a strong bias in favour of sellers being reasonable in their pricing.

And under the major category of factor called "Changing Market Conditions", cited by 19.35% of respondents, 14.52% of respondents see smaller businesses entering the Industrial Market, with 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. 4,84% of respondent point to a portion of buyers looking for greater storage space for stock, with the increase in online retail being mentioned as a driver.



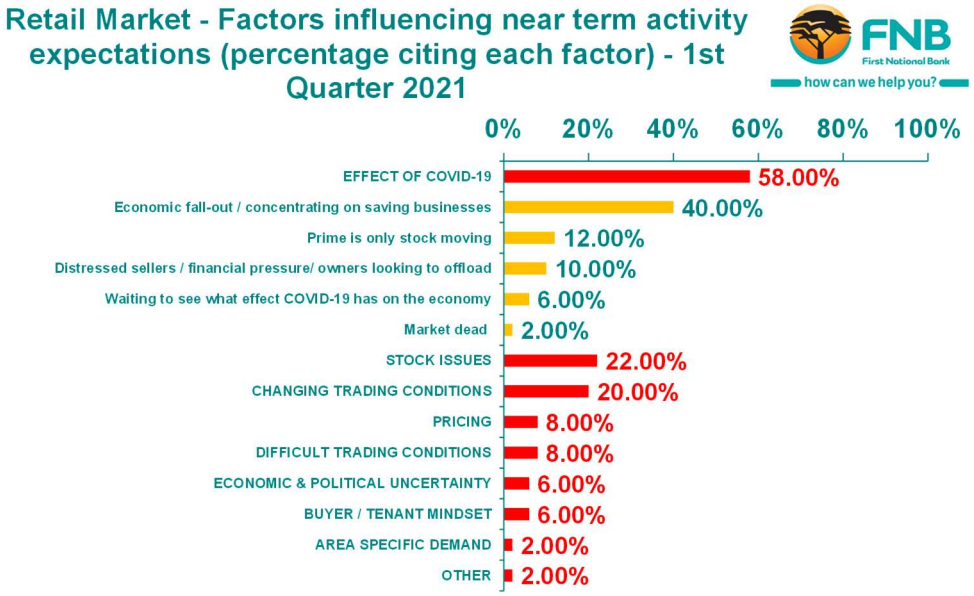
- The Retail Property Market

The brokers appear to see the emergence of online retail as only a minor current issue, with 8% of respondents citing online retail leading to declining footfall under the "Difficult Trading Conditions" category..

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.

58% of respondents see the Impact of COVID-19 as key, and within that major response category 40% of brokers see the economic fallout of COVID-19 as a key factor influencing their expectations.

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.



Conclusions – Better Times, but economic data suggests further recovery may be tougher to achieve

The 1st quarter 2021 FNB Property Broker Survey was undertaken during February, well after the "hard" COVID-19 lockdowns of the 2nd quarter of 2020, but with an economy still battling to reach "full recovery", i.e. a level of GDP equal to that of pre-COVID-19 lockdown.

While economic activity had rebounded significantly during the 3rd and 4th quarters of 2020, following the end of the 2nd quarter "hard lockdown", GDP level was still below that of the final quarter of 2019, as were the GVA levels all of the sectors know to be strong influences of demand for space in the 3 major commercial property sectors (Retail, Industrial and Office).

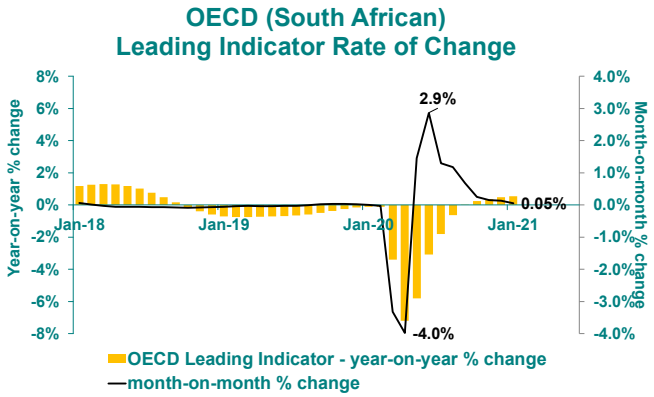
Therefore, in a still-weak economy, it is not surprising to see the 1st quarter 2021 broker business confidence survey component continue to show the overwhelming majority of respondents being dis-satisfied with business conditions., albeit slightly improved on the prior quarter level.

In all 3 major commercial property classes, there was a further increase in the Market Activity Rating, but reaching levels still below those ratings recorded shortly prior to last year's 2nd quarter lockdowns. This, too, appears in line with a "recovered but not fully recovered" economic situation.

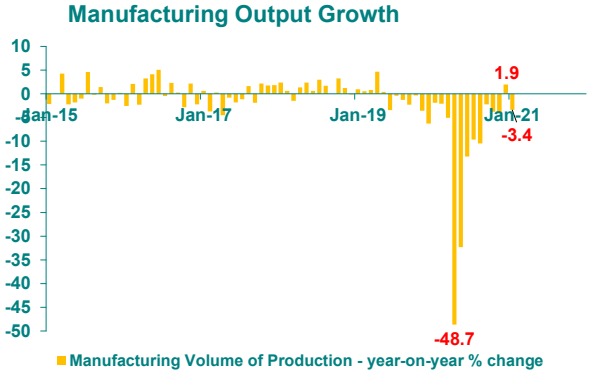
- High frequency economic data suggests that further recovery in the Commercial Property Market may be slow going

Examining certain high frequency economic indicators, it would appear too that modest near term market activity expectations are not overly unrealistic, as the last steps towards "full recovery" in the economy appear likely to be slow. A portion of economy-wide production capacity has been eliminated during last year's deep recession, and both business and consumer confidence still low.

The OECD Leading Business Cycle Indicator for South Africa, often a useful indicator of near term economic growth direction, points to that slowing pace of recovery unfolding. After a strong post-hard lockdown rebound to a month-on-month growth rate high of 2.9% in June 2020, this index's growth rate has tapered all the way to +0.05% by January 2021.

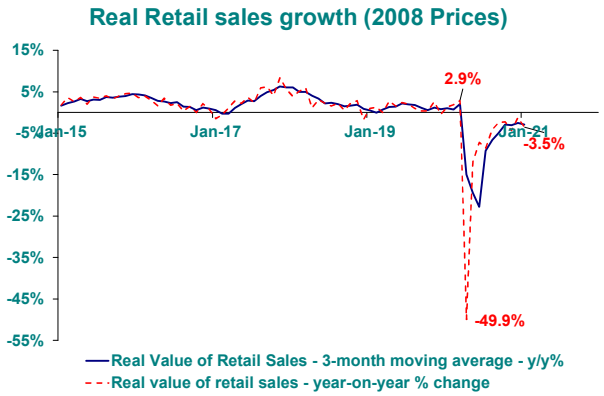


Examining monthly Manufacturing Volume of Production data, which is strongly linked to industrial property, we saw a renewed year-on-year decline in January 2021 to the tune of -3.4%, after 1 month of mild positive growth of +1.9% in December 2020 (that was the 1st and last month of positive year-on-year growth since April 2019.

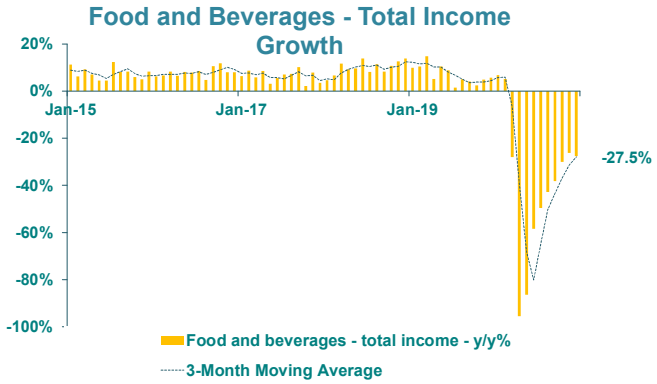


And viewing the more up to date New Sales Orders Sub-Index of the Absa Purchasing Managers Index (PMI), we saw this dip back into below-50 "contractionary territory" for 3 months to January 2021, following a prior post-lockdown surge, before recording a February mild expansionary reading of 54. Recent months' readings of the New Sales Orders Index have thus painted a somewhat erratic picture.

Retail-related high frequency data appears to have been following a very similar trend, rebounding strongly directly after hard lockdown, as one would expect, before beginning to battle to achieve that last part of the recovery to "fully recovered" level,. Real Retail Sales still languish in negative growth territory to the tune of -3.5% as at January 2021.



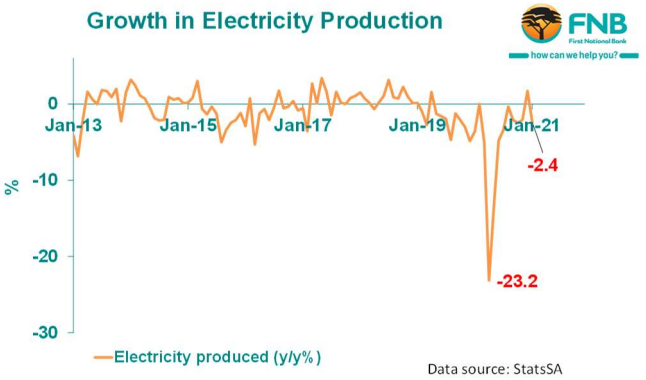
Severe weakness, however, as at December 2020 remained the Restaurant, Catering and Take-Aways Retail Sector, whose sales was still down -27.5% year-on-year. This sector was hampered by social distancing restrictions as well as a severe dent to consumer purchasing power during the deep 2020 recession, which typically leads to weak spending on non-essentials such as eating out or take-aways.



- Back to Old Structural Economic Problems

In recent weeks, South Africa has been reminded of the old structural economic problems which have long since become drags on growth. The Budget Speech re-emphasised the mounting Government debt crisis, while more recently Eskom load shedding has started once more despite a weak economy and resultant weak electricity demand pressures..

Electricity available for distribution was -2.4% down year-on-year in January 2021.



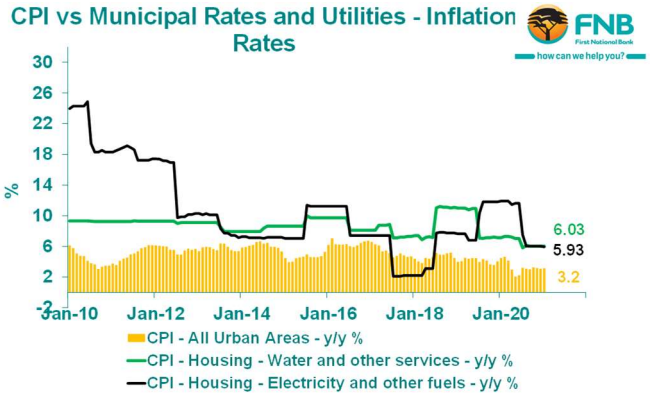
A longer run perspective shows us that as at January 2021, total electricity production was down -8.2% on exactly a decade ago in January 2011, the year in which where the post-Global Financial Crisis growth recovery peaked. January 2021's production was also -14.9% down on the highest winter month of 2011, i.e. July of that year.

So in an economy not yet back at "full" pre-lockdown production, already the electricity constraints are acute. Electricity is a key issue for commercial property in 2 ways. Firstly, erratic supply is an economic growth drag and thus a commercial property performance drag. Secondly, the next double-digit electricity tariff increase is in the pipeline

And of course it isn't only Eskom tariff hikes that are troublesome for all property operating costs. Municipal rates and other tariffs consistently rise above general inflation too. This is witnessed in the CPI (Consumer Price Index), which although is applicable to residential property gives one an idea of the extent of this ongoing problem.

As at January 2021, the CPI for "Water and Other Services", which includes municipal rates and non-electricity utility tariffs, rose by 6.13% year-on-year, having inflated above the 3.2% CPI inflation rate, and having generally out-inflated the overall CPI inflation rate for most of the past decade.

The CPI for Electricity, at 5.93% year-on-year, out-inflates the overall CPI by a similar magnitude.



- Has the Retail Property Broker Survey surprised on the upside?

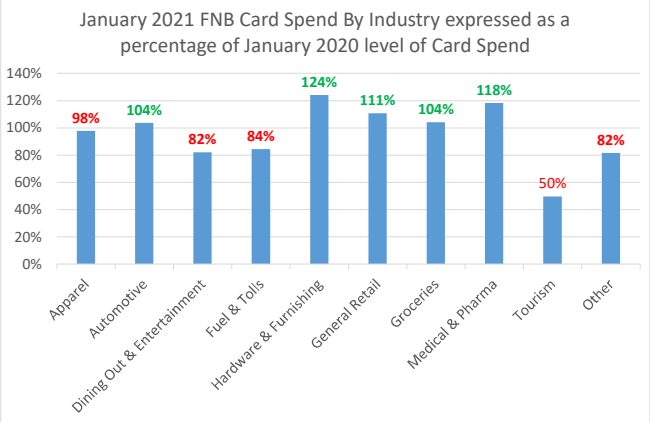
At a stage of 2020, the Retail Property Activity Rating was the lowest of the 3 major commercial property sectors. Its steady rise to well above that of Office Property may have surprised some.

Should we be surprised? We don't think so. At 4.18, this sector's activity rating is not overly strong just year, still lagging significantly behind that of Industrial Property.

And from bearing the full brunt of hard lockdown back in April/May 2020, off a low base the trading environment for retailers has improved significantly, albeit not back to pre-lockdown levels.

In addition, much of the weakness in consumer spending was more outside of the retail shopping centres, while certain "in centre" consumer spending

categories actually performed fairly well. We refer firstly to FNB Credit Card Spend on Tourism activities, which is mostly outside of retail centres, and as at January 2021 was only 50% of the January 2020 level. With weak economic activity and high levels of remote working, fuel credit card spend in January 2021 was only 84% of January 2020.

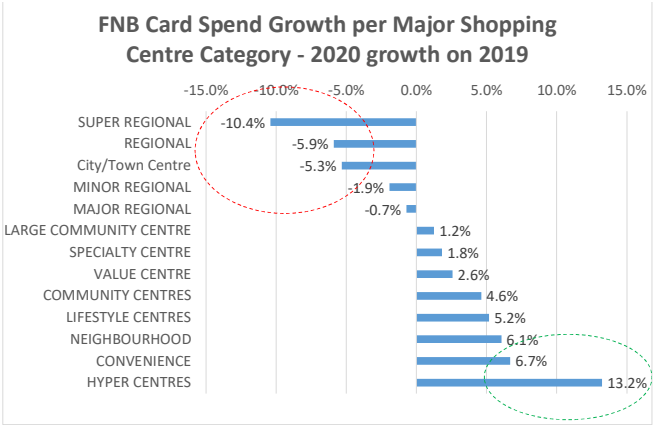


By comparison, some of the major more "in centre" spending items saw stronger performance, Grocery spend at 104% of January 2020, General Retail at 111%, Medical and Pharmaceuticals at 118%, Hardware and Furniture at 118%, and even the weakish Clothing and Apparel category fairly respectable at 98% of January a year prior. It was really the "Eating Out and Entertainment" card spend category which was still very weak at 82% of January 2020.

Finally, our property broker survey is probably biased more towards the smaller sized shopping centre categories, due to the fact that brokers taking part are required to have an "owner serviced" property market element to their sales at least for a part of their time. This implies that many are focused more on smaller sized properties and landlords. This may mean that their Retail Property responses are biased towards the smaller sized centre market which appears to be outperforming the larger Super Regional and Regional Centre categories for instance.

FNB card spend data by centre category points to a major difference between centre categories in spend growth in the year 2020, from a significant decline of -10.4% in the case of Super Regional Centres at the one end of the spectrum to +6.7% growth at the smallest sized Convenience Centre end of the spectrum. However, highly grocery focused Hyper Centres outperformed all categories with +13.2%.

Hyper Centres aside, the relatively stronger small sized centre categories may well be far more reflected in property broker perceptions of late.



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