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Property Insights

John Loos:
Property Strategist

FNB Commercial Property Finance

Tel: 087-312 1351

Email:
john.loos@fnb.co.za

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The FNB Property Broker Survey – Perceived Commercial Property Market Activity, along with Broker Satisfaction, slides weaker.

Key Points

- The 3rd Quarter 2019 FNB Commercial Property Broker Survey sees all 3 major commercial property sectors, i.e. Office, Industrial and Retail, showing declines in perceived market activity levels.
- In the 3rd quarter of 2019, the percentage of respondents experiencing conditions as satisfactory declined at a more rapid rate than the prior quarter, from 64% in the 2nd quarter to 49%.
- 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 (or least pessimistic perhaps) about the Industrial and Warehouse Property Market. However, Industrial Property's 3rd quarter activity rating did decline noticeably, recording 5.25, down from 6.03 in the prior quarter's survey. By comparison, the Retail Property Activity Rating was noticeably lower at 4.51 in the 3rd quarter, down from the prior quarter's 5.25, while the Office Property Market also declined from 5.05 in the 2nd quarter to a lowly 4.62 in the 3rd quarter survey.
- Our "Indices for Perceived Change in Market Activity over the Past 6 Months" were all negative (i.e. perceived activity declines on an aggregated basis) in the 3rd quarter survey. The market with the highest index reading was Office, although this was nevertheless still a weak reading of -3.03. The Industrial and Warehouse Sector Index reading was a negative of -10, implying that the percentage of respondents perceiving a decrease in activity in this sector exceeded those perceiving an increase by 10 percentage points. The Retail Market returned the weakest reading of the 3, a negative -17.77.
- The Property Market Activity Near Term Expectations Indices, reflecting broker near term expectations, saw the respondents as a group being least optimistic about the Retail Property Market, which recorded a zero, whereas the Industrial Property Market recorded a +10 and the Office Property Market +10.61. The most noticeable deterioration from the prior quarter, however, is in the Industrial Property Expectations Index, whose prior quarter reading was a solid +46.

The 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.

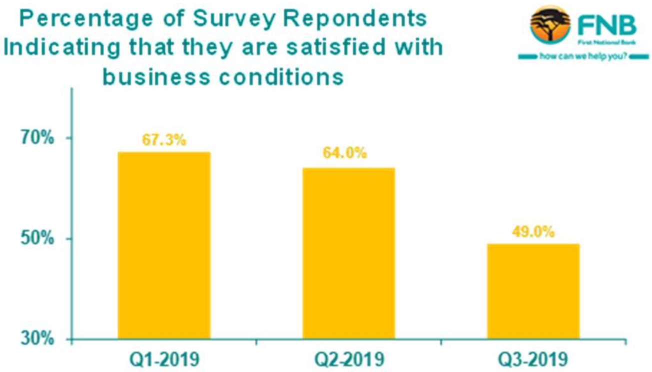
Given FNB Commercial Property Finance's strong focus on the "Owner-Serviced" market, a pre-requisite in selecting broker respondents is that they deal in owner-serviced properties, but a portion will also have dealings in the developer or investor markets as well as in the listed sector.

In this report we focus on the part of the survey where we ask respondents to rate their perception of the buying/selling market (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.

Broker satisfaction with business conditions deteriorates markedly in the 3rd quarter

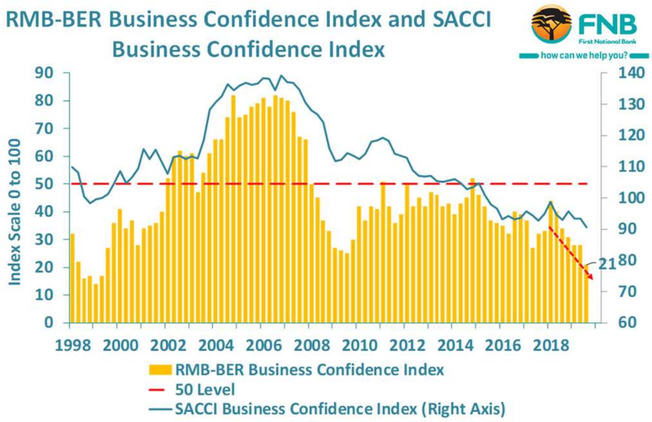
But before we survey activity level perceptions, we ask all respondents to say whether they find business conditions "satisfactory" or not in the form of a simple "yes or no" answer. In the 3rd quarter of 2019, the percentage of respondents experiencing conditions as satisfactory declined at a more rapid rate than the prior quarter, from 64% in the 2nd quarter to 49%.



This now means that for the 1st time in the 3-quarter old survey a slender majority of respondents (51%) are dis-satisfied with business conditions.

While 49% of those still satisfied remains significant, the weakening trend in confidence amongst brokers follows a similar direction to overall national business confidence, as portrayed by both the RMB-BER Business Confidence Index as well as the SACCI Business Confidence Index.

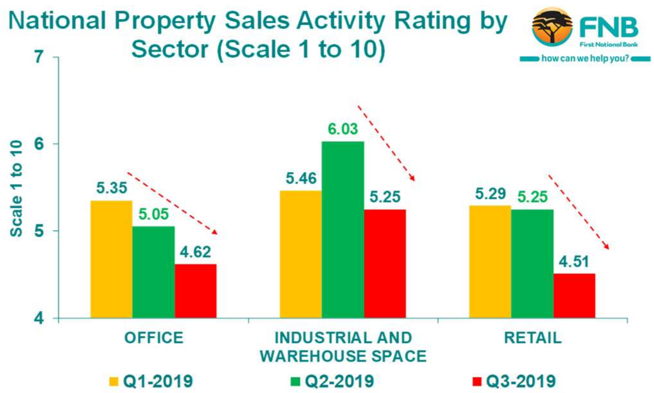
The former index reached a lowly 21 level on a scale of 0 to 100, the lowest since 1998, while the latter index has reached lows similar to those last seen in the multi-year economic contraction of the early-1990s.



Activity Rating by Major Property Class – All 3 sectors weaken in Q3

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 (or least pessimistic perhaps) about the Industrial and Warehouse Property Market. However, this market's 3rd quarter activity rating did decline noticeably, recording 5.25, down from 6.03 in the prior quarter's survey.

By comparison, the Retail Property Activity Rating was noticeably lower at 4.51 in the 3rd quarter, down from the prior quarter's 5.25, while the Office Property Market also declined from 5.05 in the 2nd quarter to a lowly 4.62 in the 3rd quarter survey.



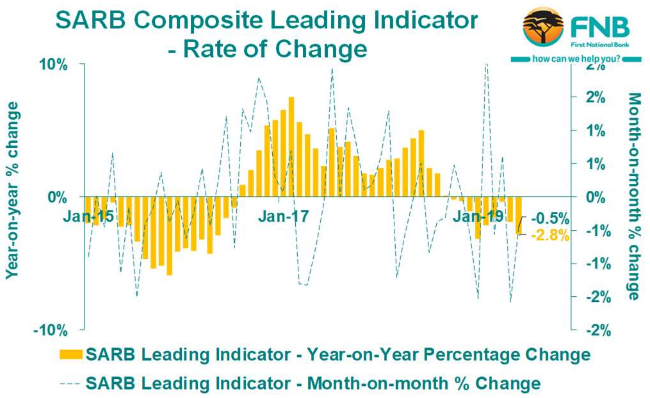
Weakening in all 3 property sectors is no surprise given economic fundamentals

Weak activity levels, and the quarter-to-quarter weakening in the activity levels of all 3 major property sectors, should come as little surprise, given deteriorating business confidence in the 3rd quarter of 2019, and given the myriad of economic indicators pointing to economic weakness.

Admittedly, the survey history is too short to yet ascertain what the seasonal impacts throughout each year would be on activity ratings, so we need to interpret with some caution.

But viewing the SARB Leading Business Cycle Indicator in recent months, it had suggested that, after perhaps some small quarterly economic growth improvement in the 2nd quarter of 2019, weakening could return in the 3rd quarter, and this is possibly what has driven the 3rd quarter Commercial Property Broker Activity Ratings weaker.

While the Leading Indicator has remained in year-on-year decline each month since October 2018, the magnitude of decline had receded early in 2019 up to April, after some strong month-on-month increases. However, in May and June a sharp acceleration in the rate of decline had pointed to possible economic growth weakening once more towards the 3rd quarter after a 2nd quarter improvement.



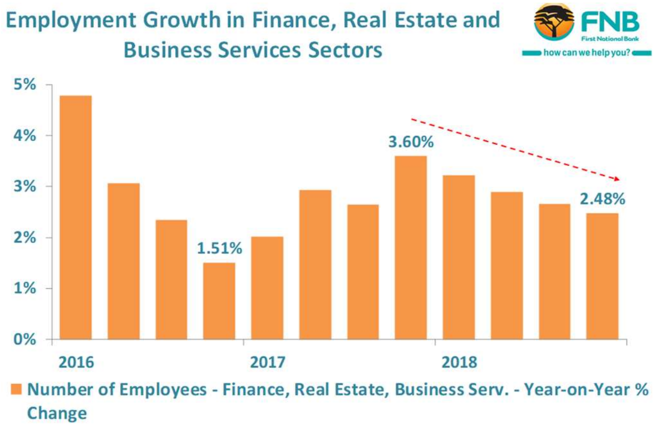
A renewed economic growth weakening could be beginning to be reflected in the more noticeable declines in all 3 property sector activity ratings in the 3rd quarter.

Examining the 3 sectors' most important related economic indicators, we see general weakness across all 3.

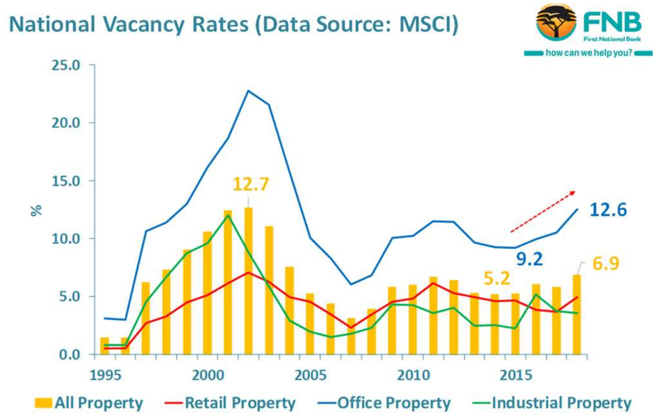
- Important Office Sector-Related Economic Fundamentals

For the Office Sector, we place great emphasis on the employment growth trend in the major Finance, Real Estate and Business Services Sector of the economy, as we believe this to be a major driver of the demand for office space.

This sector's employment growth has actually been reasonable in recent times, but has nevertheless been slowing from a multi-year high of 3.6% as at the final quarter of 2017 to 2.48% by the 1st quarter of 2019.



In addition, the employment growth rates of recent years had not been enough to drive demand to a level where a noticeable rise in the national office vacancy rate would be reversed. As it stands, MSCI data shows the Office Sector to have already experienced the most noticeable rise in vacancies of the 3 sectors in recent years, along with the weakest returns last year. Slowing employment growth in the relevant Finance, Real Estate and Business Services Sector could thus be expected to dampen Office Property investor/buyer interest.

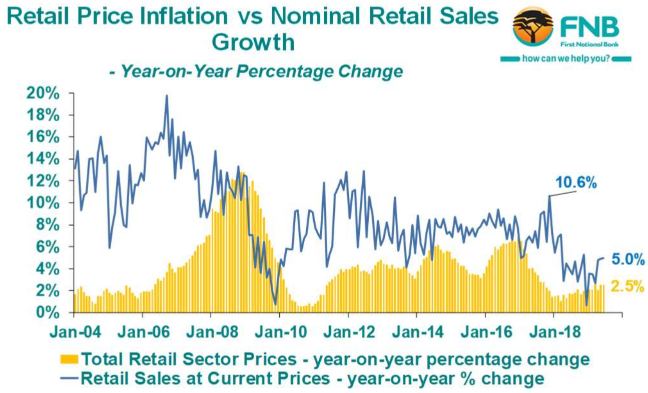


- Important Retail Sector-Related Economic Fundamentals

The Retail Property Sector, too, has seen a broad weakening in its fundamentals recently, as consumers come under increased financial pressure.

Real Retail Sales growth has hovered at significantly lower rates in recent times, recording a 2.4% year-on-year growth rate in June after having briefly been in negative territory late in 2018. This recent growth is significantly weaker than the 8,4% multi-year high reached in November 2017.

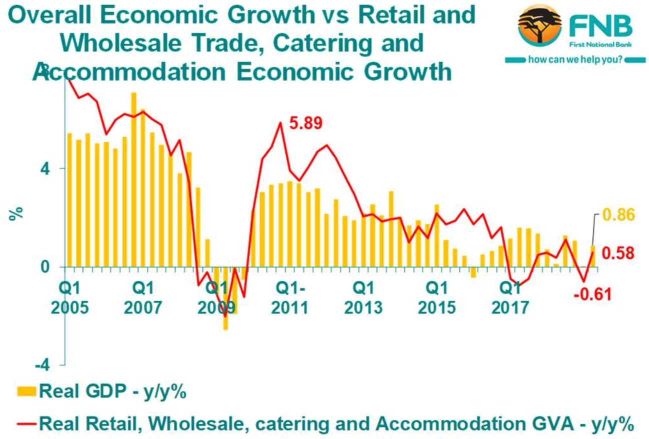
In addition, it is perhaps important to consider the slow growth rate in Nominal Retail Sales, at a lowly 5% year-on-year as at June despite some strengthening on prior months. The fact that the numbers still show positive year-on-year real retail sales growth is only due to very low retail price inflation of 2.5%, well-below overall consumer price inflation. This lowly inflation rate in prices as experienced by consumers is possibly not reflective of the inflation rate in the various input costs for retailers, especially given the ongoing above-inflation increases in municipal rates and utilities tariffs for example.



Examining Real Gross Value Added (GVA) for the Retail and Wholesale Trade, Catering and Accommodation Sector, which is more comparable with overall economic growth, we see that this sector has slowed broadly in line with economic (GDP) growth and no longer outpaces overall economic growth as it had noticeably done a few years ago.

So, whereas Real GDP year-on-year growth for the total economy was 0.86% in the 2nd quarter of 2019, the Retail and Wholesale Trade, Catering and Accommodation GVA growth rate was an even slower 0.58%, with the Leading Business Cycle Indicator having suggested possible growth slowdown in the 3rd quarter. This is a far cry from the post-2008/9 recession high of 5.89% recorded in the final quarter of 2010, a broad slide having ensued ever since.

Retail property-related fundamentals are thus very weak.



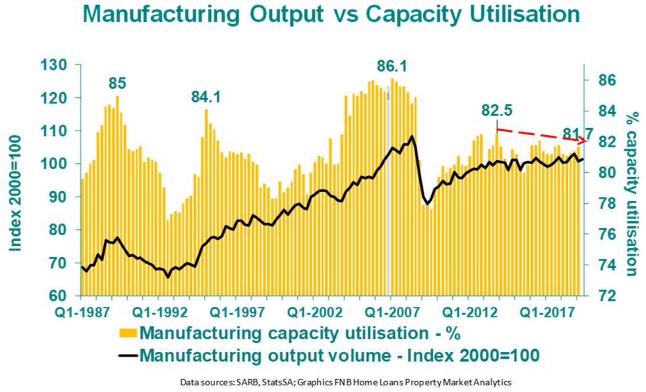
- Important Industrial Property-Related Economic Fundamentals

Finally we view the key economic fundamentals related strongly to Industrial Property, to find a similarly weak picture.

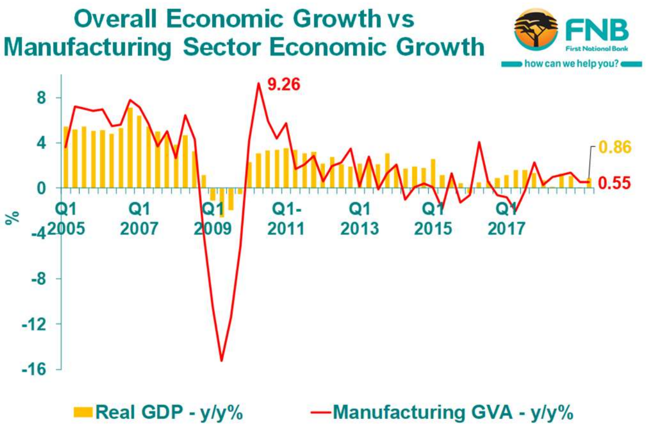
The Industrial Property Sector has a strong link to the Manufacturing Sector

At 81.7% in the 1st quarter of 2019, Manufacturing Capacity Utilisation remained down on the 82.5% recorded in the final quarter of 2013 and the 86.1% high reached in the 1st quarter of 2007.

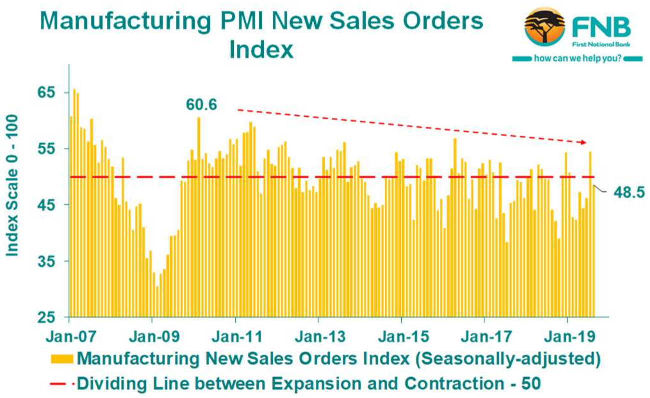
On a year-on-year basis, manufacturing Production grew by a lowly 0.9% for the 2nd quarter of 2019 as a whole, but for the months of June and July (i.e. heading towards and into the 3rd quarter) it had turned negative to the tune of -3.6% and -1.1% respectively.



Comparing overall GDP growth with Manufacturing GVA growth in real terms, weak Manufacturing growth of 0.55% in the 2nd quarter underperformed the overall economy's slightly better growth of 0.86%.

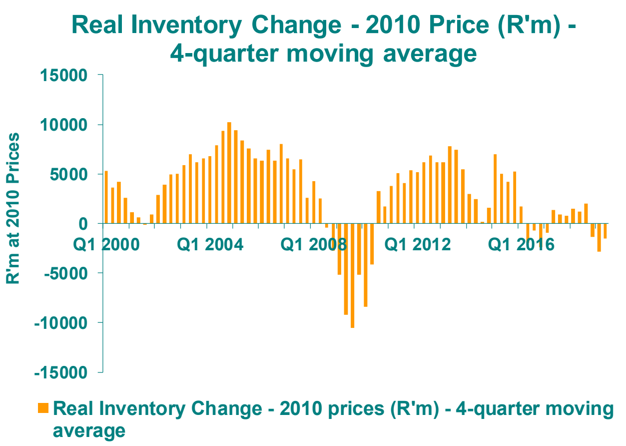


Viewing a more leading indicator, i.e. the Manufacturing Purchasing Managers' Index's New Sales Orders sub-index, we see a picture of recent weakness, with August's reading of 48.5 below the crucial 50 mark that represents the dividing line between growth and decline. In fact, the New sales Orders Index has been below 50 in 4 out of the past 15 months since June 2018, painting a weak picture for the Manufacturing Sector.



On the warehousing side of the Industrial Property Market, the need for space is strongly influenced by the need for inventory build up and management. At a macro level these fundamentals, too, have weakened in part at the hands of multi-year economic stagnation

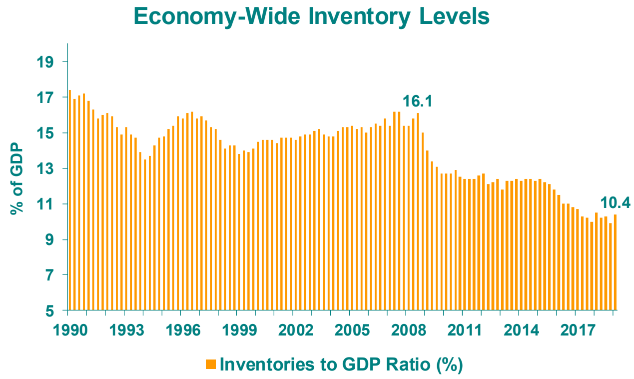
According to SARB national accounts data, recent years have recorded frequent economy-wide real inventory declines.



And an Inventory-to-GDP Ratio of 10.4% in the 1st quarter of 2019 is considerably down from levels above 12% 5 years ago back on 2014 and 16.1% registered further back in mid-2008.

Part of inventory decline, or weak accumulation, is caused by a weak economy with weak demand, while part of it can be due to improved inventory management as time goes by, technological advances assisting.

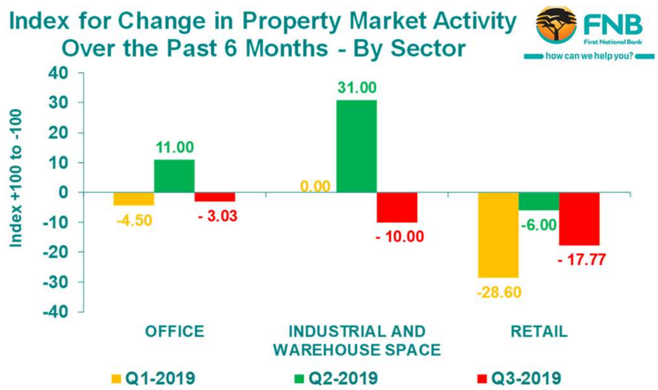
This can constrain the demand for warehouse space to hire, and thus Industrial Property returns and investment demand.



We therefore see mediocre-to-weak economic fundamentals related to all 3 major property sectors. It would thus not be surprising to see the FNB Property Broker Survey recording weak and declining activity ratings, which is the case in all 3 sectors.

Retail seen as having weakened the most over past 6 months

We ask a follow up question as to 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 3rd quarter survey, the market with the highest index reading was Office, although this was nevertheless still a weak and negative reading of -3.03.

The Industrial and Warehouse Sector Index reading was a negative of -10, implying that the percentage of respondents perceiving a decrease in activity in this sector exceeded those perceiving an increase by 10 percentage points.

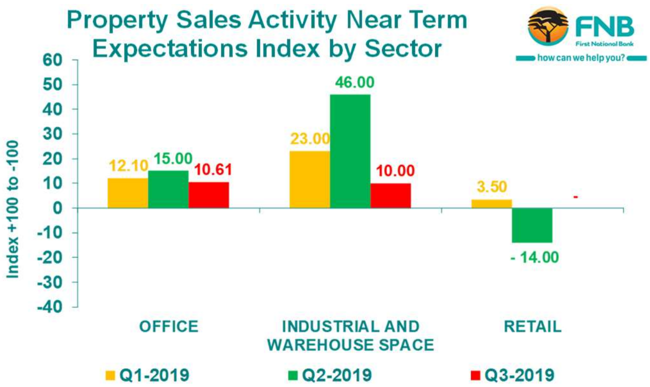
The Retail Market returned the weakest reading of the 3, a negative -17.77.

Outlook – Respondents least optimistic about Retail 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.

The respondents as a group are least optimistic about the Retail Property Market, which recorded a zero index reading, whereas the Industrial Property Market recorded a +10 and the Office Property Market +10.61

The most noticeable weakening in expectations from the prior quarter, however, is in the Industrial Property Expectations Index, whose prior quarter reading was a solid +46.



Key drivers of Brokers' Expectations – more negative perception of sentiment emerges as positive election feeling wears off

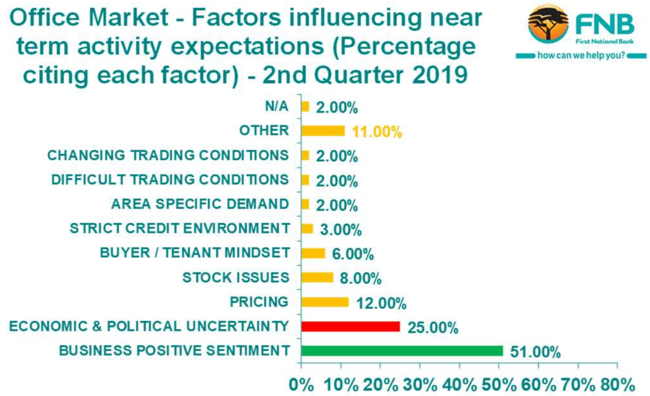
In an open-ended follow up question to the previous one regarding expectations of near term activity direction, we ask brokers to provide reasons as to why they expect the direction that they do.

The noticeable feature in this set of responses for the 3rd quarter 2019 survey was a very significant jump in the percentage of respondents pointing to "Economic and Political Uncertainty" and a significant decline in the percentage pointing to "Business Positive Sentiment", after a "once-off" post election 2nd quarter drop in the former and a spike in the latter.

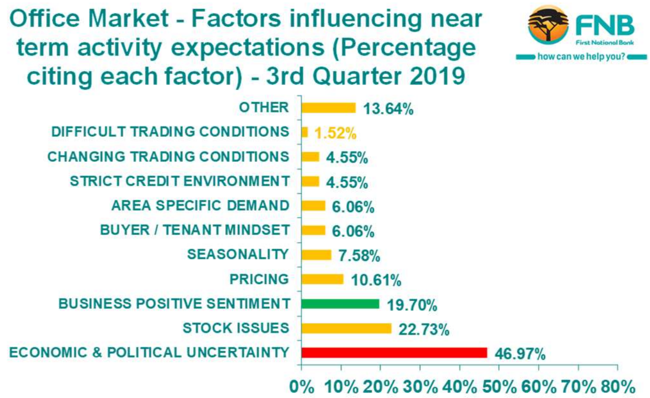
This negative "turnaround" in perceptions of market sentiment in the 3rd quarter is witnessed in all 3 major segment surveys.

- The Office Market

In the 2nd quarter survey, the Office Property component had shown 51% of respondents perceiving "Business Positive Sentiment" and a far lesser 25% perceiving "Economic and Political Uncertainty" as a key factor influencing their near-term expectations of activity.



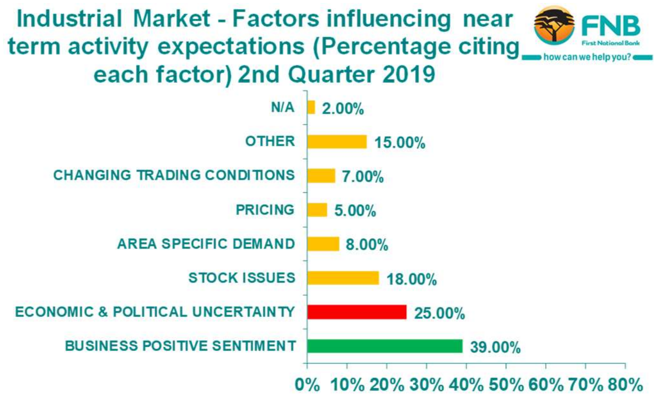
In the 3rd quarter survey these 2 percentages swung sharply in the Office Market component, with only 19.7% perceiving "Business Positive Sentiment" and a greater 46.97% citing "Economic and Political Uncertainty".



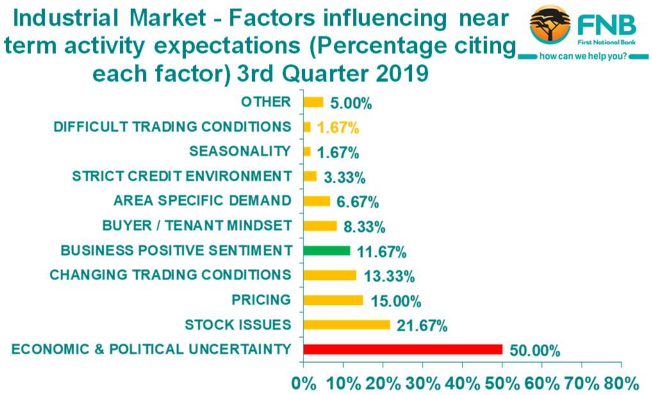
Within the "Economic and Political Uncertainty" sub-categories, the weak economy comes through most strongly as an influencing factor on near term expectations, with policy uncertainty promoting a "wait-and-see" investor attitude also significant.

- The Industrial and Warehouse Market

The picture was similar in the Industrial and Warehouse Property Market component. After 25% of respondents cited "Economic and Political Uncertainty" and 39% perceived "Business Positive Sentiment" in the 2nd quarter survey,

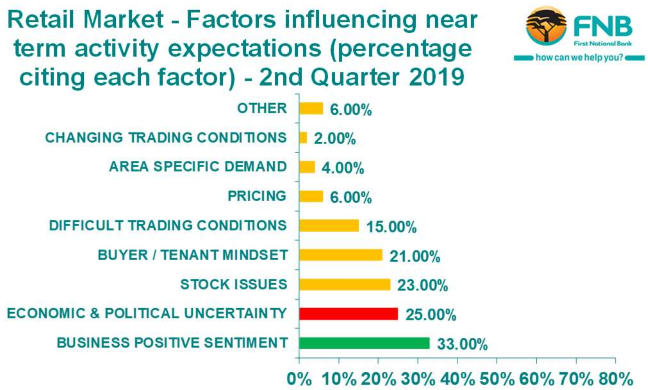


the 3rd quarter survey swung sharply to 50% citing the former and only 11.67% of respondents pointing to the latter as key factors.

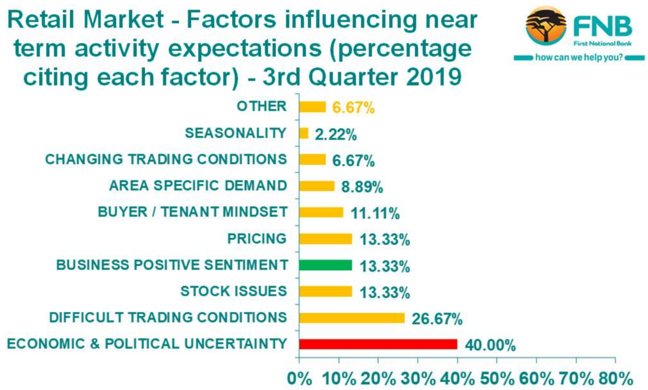


- The Retail Property Market

In the Retail Property Market component, after 25% of respondents cited "Economic and Political Uncertainty" and 33% perceiving "Business Positive Sentiment" in the 2nd quarter survey,



the 3rd quarter survey saw a swing to 40% citing the former and 13.33% of respondents pointing to the latter factor.



Online Retail seen as having less of an impact than the state of the economy at this stage

In recent times, while acknowledging that online shopping is having some impact on retail and retail property, we have been of the belief that the weak economy and resultant weak consumer financial situation has had more of a negative impact on this sector.

The FNB Property Broker Survey appears to echo this sentiment.

26.67% of respondents in the Retail Property Survey component pointed towards "Difficult Trading Conditions" in the 3rd quarter survey, up from 15% in the previous quarter. Within this major category, 17.78% of total respondents pointed to "Shoppers moving online" (compared to 10% in the 2nd quarter survey) as a factor driving less feet in malls, with the younger generation in particular preferring online shopping.

This is becoming a key factor in the survey, although not quite seen as big an influence on activity as the economic conditions.

By comparison, 26.67% of respondents cited the weak economy (a sub-category of "Economic and Political Uncertainty") as a negative influencing factor in their near term expectations..

The weak state of the economy thus still appears to me more of a concern to the respondents than the online shopping challenge to traditional retail, although online shopping is becoming significant.

Conclusion

In this 1st part of the FNB Property Broker Survey, which relates to perceived market activity, there has been a clear deterioration in perceptions regarding recent activity as well as near term expectations.

This shouldn't come as a surprise as SA's long term economic stagnation continues.

A noticeable change in the 3rd quarter was a perceived weakening in activity in the Industrial Property Sector. This sector had bucked the weakening trend in the Retail and Office Property Sectors in the 2nd quarter, with respondents having perceived a 2nd quarter strengthening in the Industrial Property Market.

But ultimately the weak economic fundamentals related to Industrial Property could be expected to dampen demand for this property class, and thus market activity, and in the 3rd quarter survey this appeared to happen.

Although the respondents perceived the Industrial and Warehouse Property Market to be weakening too, their perception is that this market still has the strongest activity level of the 3 markets, followed by the Office Market, with Retail being the weakest.

Compared to 6 months prior to the 3rd quarter survey, the respondents on aggregate perceived all 3 markets to have weakened in terms of activity levels, with the Industrial and Warehouse Market having weakened the most significantly off the highest base.

Looking ahead to expected activity in the coming 6 months, the group expects moderate increases in the Office, and Industrial and Warehouse Markets' activity and unchanged Retail Market activity.

However, sentiment in the 3rd quarter has deteriorated markedly compared to the 2nd quarter, with any perceived election-induced positivity having seemingly worn off, and the stagnating economy has once again become the key focus and driver of expectations.

Finally, while online shopping is perceived as a potential negative impact for retail property, the weak state of the economy still appears to be seen as a more significant factor.

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