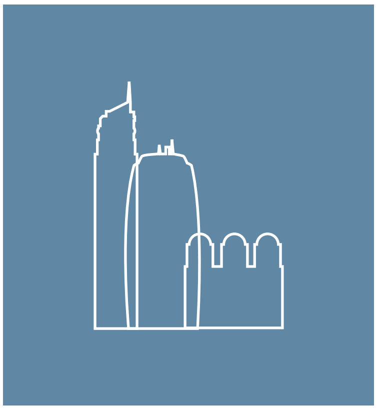

TPN Quarter 3 Commercial Rental Monitor

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Commercial tenant payment performance improved mildly in the 3rd quarter of 2020, following the sharp 2nd quarter lockdown-related drop. The situation remains weak at best, however…

- In the 3rd quarter of 2020, Commercial tenant rental payment performance began its long slow road to recovery following the sharp COVID-19-related lockdown drop in the 2nd quarter. From a lowly 50.36% of Commercial tenants being in good standing with landlords in the 2nd quarter of 2020, the level ticked up mildly to 56.19% in the 3rd quarter. Although, this remains well below the pre-lockdown level of 77.85% recorded in the 1st quarter of this year.

- Preliminary monthly tenant payment performance data up to October showed a continued recovery in the poorly performing Retail Property Sector's tenant population. However, the better performing Office and Industrial Property Sectors' tenant payment performances lacked further improvement progress from September onward, the Industrial tenant population even weakening slightly.

- The Retail Property Sector's tenant population has been impacted the most severely of the major 3 property sectors through the COVID-19 lockdown period, while the smaller Storage Sector appears to have sailed through the lockdown in significantly better shape than all of the major 3 property sectors.

- While all 3 major provinces' tenant payment performances improved mildly in the 3rd quarter, and all had taken severe knocks in the 2nd quarter, the Western Cape maintained its superior tenant performance relative to Gauteng and KZN, Gauteng continuing to show the weakest performance of the 3 regions.

In This Edition:

The tenant population is battling to recover from the harsh financial impact of the 2nd quarter lockdown

In the 3rd Quarter of 2020, the Commercial Property tenant population began the long process of recovery, following the extreme 2nd quarter financial knock emanating from the COVID-19-related hard lockdowns across much of the economy.

The percentage of total tenants that are in good standing with their landlords with regards rental payments (i.e. either they are fully paid up, paid late or in a grace period) increased mildly, from the 50.36% low of the 2nd quarter to 56.19% in the 3rd quarter of 2020. While representing some improvement, this 3rd quarter level remains very weak compared with the pre-lockdown 77.85% recorded in the 1st quarter of the year.

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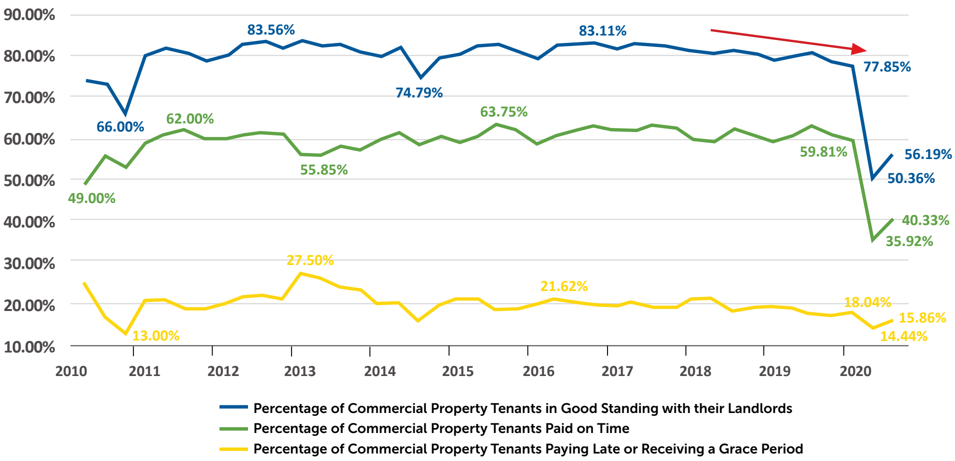
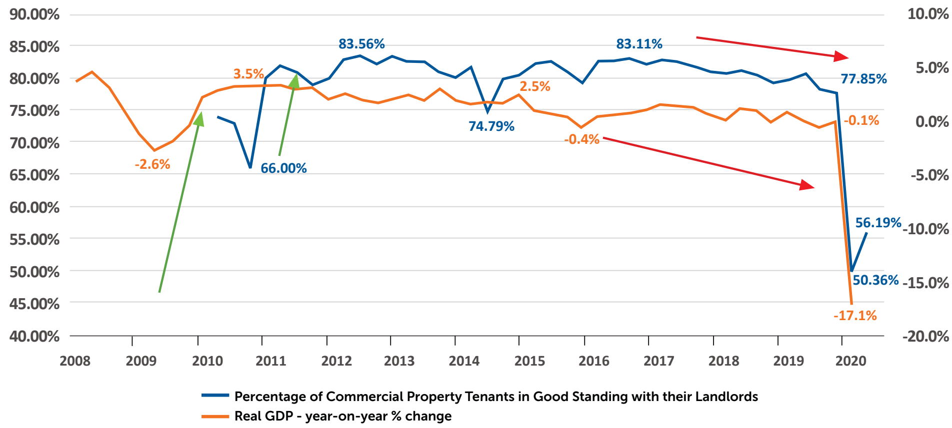
PERCENTAGE OF COMMERCIAL TENANTS IN GOOD STANDING WITH LANDLORDS



Tenant performance is strongly linked to economic growth, as measured by GDP (Gross Domestic Product).

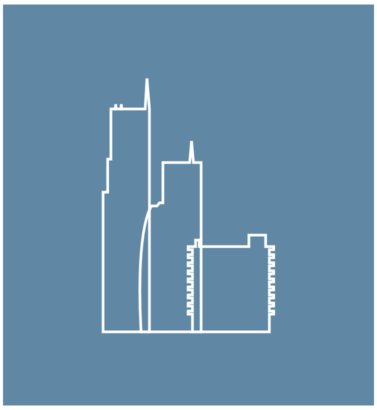
While we don't yet have 3rd quarter GDP data available, the 2nd quarter drop of -17.1% year-on-year appears very much reflected in the corresponding sharp drop in the percentage of tenants in good standing in that quarter, and the fact that the tenant population's payment performance has only partially recovered in the 3rd quarter suggests that GDP too has only partly recovered.

PERCENTAGE OF COMMERCIAL TENANTS IN GOOD STANDING WITH LANDLORDS vs GDP GROWTH

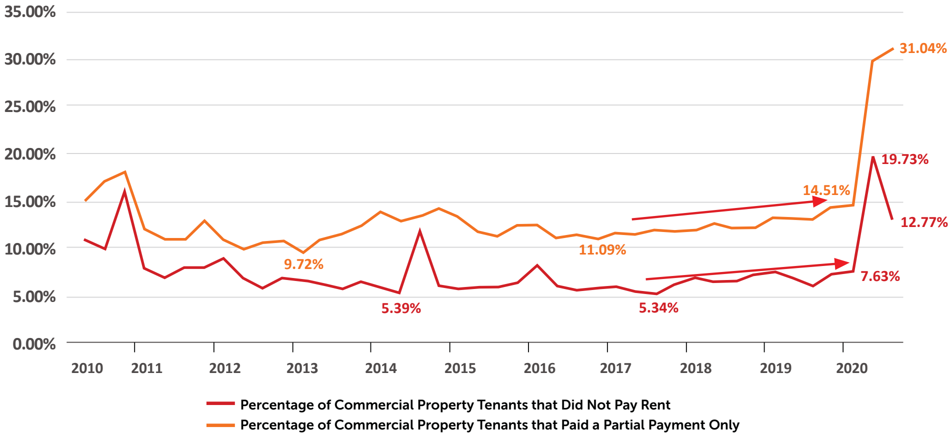


Prior to lockdown, the percentage of tenants in good standing had already been gradually declining, from an 83.11% multi-year high back in 2016 to 77.85% by the 1st quarter of 2020, on the back of South Africa's gradual long term economic growth stagnation that started back in 2012.

The pre-lockdown multi-year economic stagnation, on the back of South Africa's myriad of structural problems, is a key contributor to the current tenant payment weakness. Admittedly, the catalyst for the big drop in the percentage of tenants in good standing was the 2nd quarter lockdown. However, the economic stagnation in years prior meant that many tenants would have entered lockdown in an already financially pressured condition, limiting their ability to survive the lockdown period with little or no income.

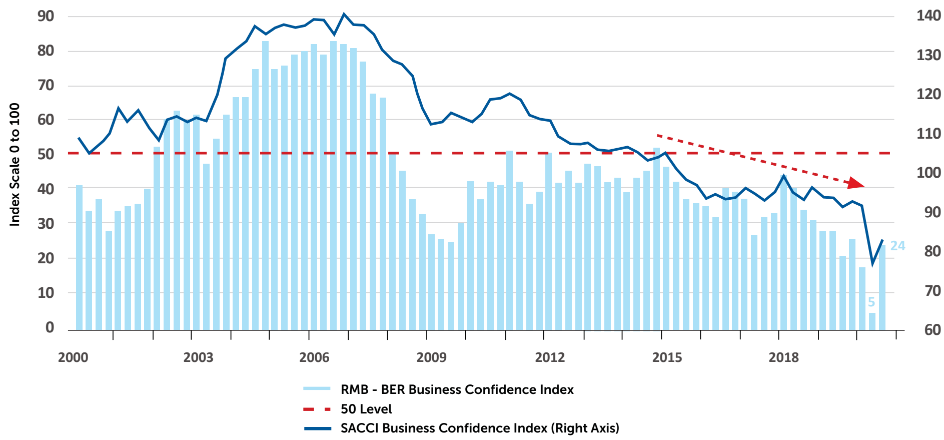


PERCENTAGE OF COMMERCIAL TENANTS THAT DID NOT PAY RENT OR ONLY PAID IN PART



Of the tenants that are not in good standing, a sizeable portion did make partial payments, i.e. 31.04% of total tenants, while a lesser 12.77% did not pay at all. The partial payments percentage in the 3rd quarter represents a further increase from the 29.92% of the 2nd quarter. However, the percentage that did not pay at all receded from the 19.73% of the 2nd quarter.

RMB - BER BUSINESS CONFIDENCE INDEX AND SACCI BUSINESS CONFIDENCE INDEX



The apparent partial recovery in the economy, along with a muted tenant payment recovery to date, is probably best reflected in improved but still very weak business confidence.

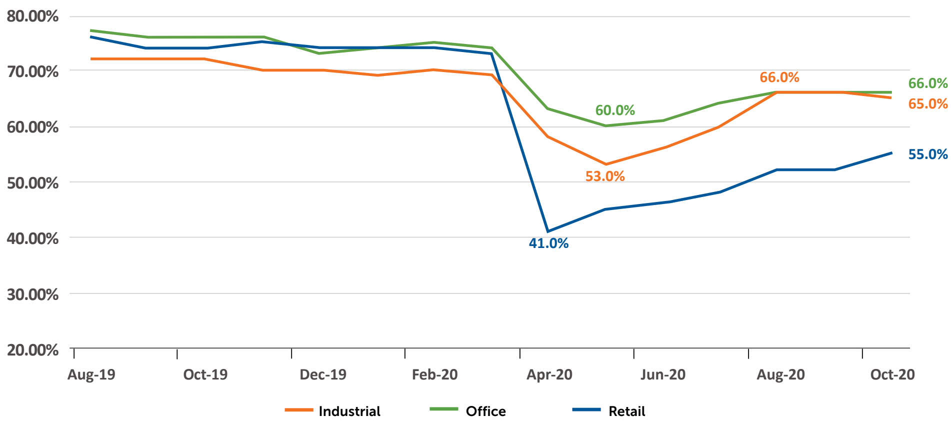
The RMB-BER Business Confidence Index rose from a very weak 5 reading in the 2nd quarter (scale of 0 to 100) to record a mere 24 in the 3rd quarter of 2020.

Examining tenant performance by major property sector, some question marks about near term direction begin to arise

TPN has more recently begun to extract monthly preliminary tenant data by major property sector in order to monitor the lockdown period in more detail and to be more current. These run one month on from the 3rd quarter, into October. In this data we see continuing improvement in Retail Property Sector tenant payment performance off a very low base.

The percentage of Retail tenants in good standing dropped to a very low 41% during April, in the middle of lockdown. We believe that this relative underperformance of retail tenants was partly about the lockdown's severe impact on sales and thus finances of tenants, but also in part about Retail Property rental and operating costs being high relative to that of Industrial Property. And so, while many Industrial Property tenants were also locked down to various degrees, Industrial Property tenants in good standing only dipped as far as 53% as at May.

TPN MONTHLY COMMERCIAL RENT GOOD STANDING: BY MAJOR PROPERTY CLASS



Many Office tenants did not see their businesses locked down. They were forced to work remotely in many cases, but business activity in many instances carried on. The lockdown impact on Office tenants was thus the smallest of the 3 major property sectors, the percentage of tenants in good standing dropping only as far as 60% by May.

However, the more recent monthly data begins to suggest the possibility of lagged impacts of the sharp lockdown-induced economic contraction still to come. Off its low base, the percentage of Retail tenants in good standing continued to increase, reaching 55% by October. However, in the past 2 months, further improvement in Office and Industrial tenant performance was distinctly lacking. For 2 consecutive months, the percentage of Office tenants in good standing remained unchanged from the August percentage of 66%. And the percentage of Industrial tenants in good standing declined slightly from 66% as at September to 65% by October.

These percentages remain noticeably lower than the February 2020 levels just prior to lockdown, where the Office and Industrial tenants in good standing percentages were 75% and 70% respectively.

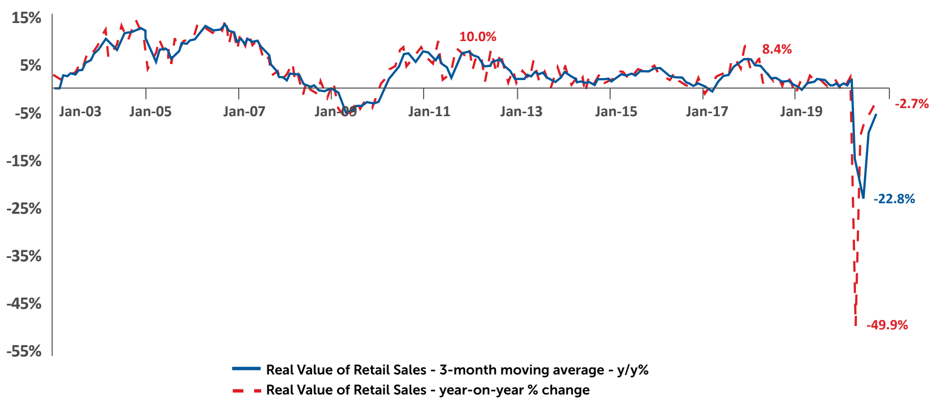
The lack of further monthly tenant payment improvement progress in the Office and Industrial Property Sectors starts to point to what we have been anticipating, i.e. that a "full recovery" for the economy (and thus for the tenant population) back to pre-COVID-19 levels of GDP will probably take some time, possibly not months but years. A portion of the economy's production capacity has likely shut down permanently as a result of the severe economic shock from lockdown. This likely means that a portion of tenants still experience sales revenues below the Pre-COVID-19 levels, due to a smaller economy with smaller production capacity and lower demand, and this may not be sufficient to sustain them. So, one can see certain businesses surviving lockdown, but bargaining on a speedy return to "full" revenue levels in order to survive. Partial recovery in sales revenues in certain instances may be insufficient for certain businesses to continue to survive and pay their rental bills, and then one may see a 2nd dip in both rental tenant performance, as well as the economy.

It is too early to draw conclusions regarding a 2nd dip. However, the so-called W-shaped scenario has been touted as a strong possibility, and a lack of further progress in improvement of tenant payment performance in Office and Industrial is something to watch closely in the next few months.

The Retail Property Sector's tenants are still by far the weakest performers of the 3 major property sectors, this may reflect on the financial frailties of the Retail Property Sector's tenant population relative to Office and Industrial Property, along with the relative "in-affordability" of retail space. However, it was never clear that the lockdown was notably worse for Retailers than what it was for Industrial Property tenants. If one views the relative performances of Real Retail Sales vs Manufacturing Production volumes, the former being a key influence on the Retail Property Sector and the latter strongly tied to the fortunes of the Industrial Property Sector - both economic sectors took very similar knocks.

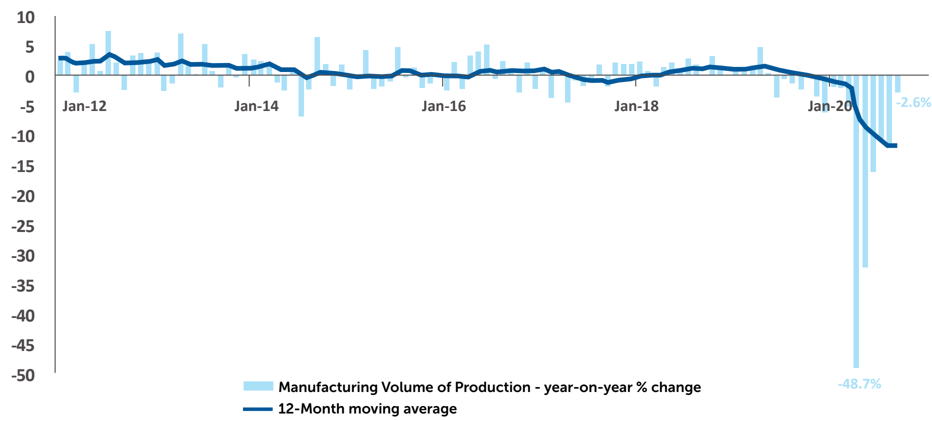
Both monthly Manufacturing Production and Retail Sales data pointed to similar year-on-year declines during the hard lockdown months and thereafter.

REAL RETAIL SALES GROWTH (2008 PRICES)



In April, Real Retail Sales declined by -49.9% year-on-year, before seeing lesser magnitudes of year-on-year decline in subsequent months. By September, the Real Retail Sales rate of year-on-year decline had receded to -2.7%.

MANUFACTURING OUTPUT GROWTH



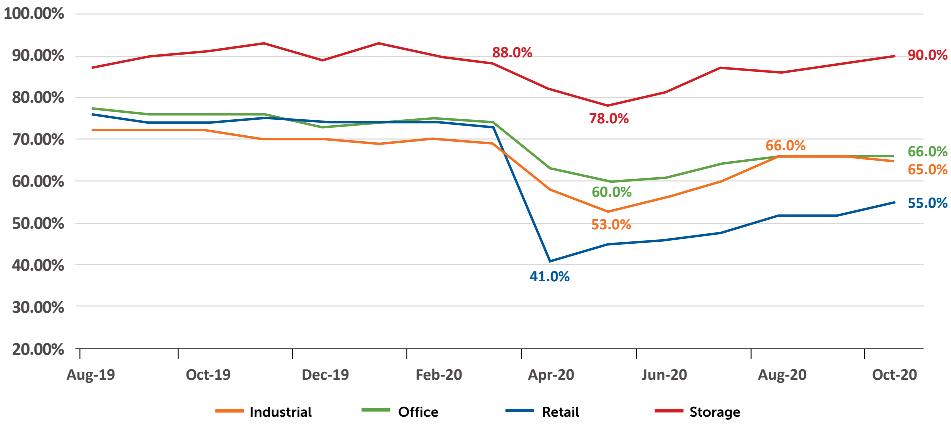
Manufacturing Production declined by a very similar -48.7% year-on-year in April too, before seeing year-on-year decline start to diminish. By September, its year-on-year rate of decline had receded to a -2.6% decline.

Office Property tenant performance is strongly tied to the performance of the major Finance, Real Estate and Business Services Sector, for which there is no monthly high frequency data. However, a sizeable portion of this sector, notably the Financial Sector, was able to continue to operate throughout the hard lockdown period with staff working from home, so it does not surprise us that Office Property tenants have been the best rental payment performers on average through the COVID-19 lockdown period.

Storage tenants come out of COVID-19 best

Coming through the COVID-19 dip significantly better than the 3 major property sectors was the smaller Storage Sector. Using the TPN provisional monthly data, the lockdown-related financial knock saw tenants in good standing in the Storage Sector dip more moderately than the major sectors, to bottom out at 78% of total tenants in May. By October, this percentage was back up to 90%.

MONTHLY COMMERCIAL RENT GOOD STANDING: STORAGE vs MAJOR PROPERTY CLASSES



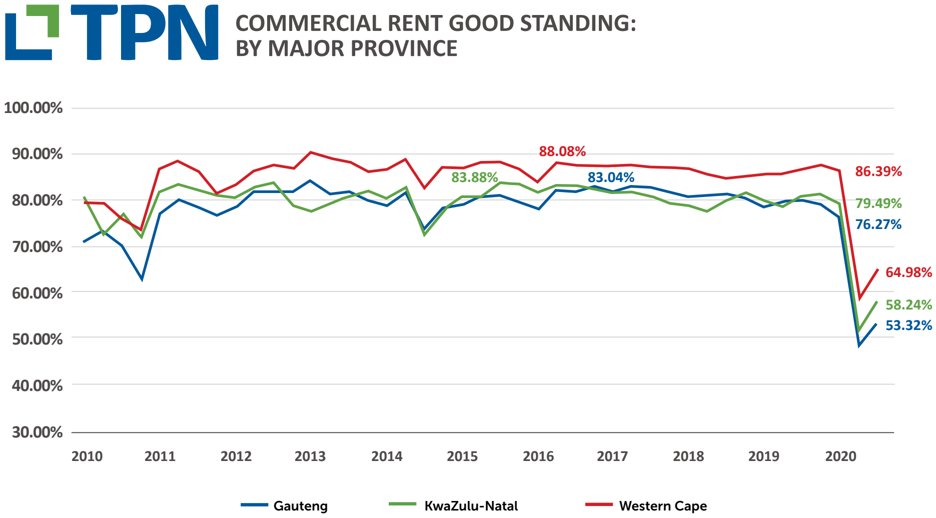
This form of space in a relatively affordable property rental sector, is consistently a better performing property class from a tenant payment point of view, and is said to rely heavily on the 4 D's, i.e. Death, Disaster, Displacement and Divorce. It may have benefited somewhat from "movement" in both households and businesses after the lockdown, with greater residential home buying and movement evident, and possibly some financial pressure related residential downsizing, while on the business side, in some instances due to closures and downsizing of operations.

While its tenant population took a noticeable knock during the lockdowns, the recovery in payment performance was far more swift than the 3 major property sectors.

Major provinces' tenant performance

While all 3 major economic provinces experienced sharp deteriorations during lockdowns, and all 3 were battling to recover in the 3rd quarter post-lockdown, the Western Cape remains the province with the highest percentage of commercial tenants in good standing, to the tune of 64.98%, up from the previous quarter's 58.97%.

Since the Commercial tenant data history started in 2010, the Western Cape has had the highest percentage of tenants in good standing of the Big 3 Provinces for most of the time, reflecting well on its longer-term relative economic strength as far as South African economic regions go.



Gauteng, with 53.32% of tenants in good standing, as at the 3rd quarter of 2020, was noticeably lower than the Western Cape, as well as experiencing a weaker tenant performance than KZN's 58.24%, although Gauteng and KZN both saw some mild improvement on the lows of the 2nd quarter.

These 3 relative regional tenant performances appear to be a replication of the relative performances during the last crisis period, the aftermath of the 2008/9 GFC recession, where Gauteng was the weakest performer by a noticeable margin too.

Tenant performance by rental value band

We were previously of the view that smaller tenants in the lower rental/month value bands may be the most vulnerable on average to a deep recession. The segmentation of the data in this way only began in 2012, so it is not possible to properly assess the relative performances of the segments' tenants back in the 2008/9 GFC recession and immediately thereafter.

In 2012, the lowest rental segment, i.e. the "Less than R10,000/month segment was the weakest performer, while the highest "R50,000+/month segment was by a small margin the top performer. We suspected that the relative order of segment performances was a legacy from the impact of the GFC a few years prior, and that it was likely that the lowest rental/month segment, which would house on average the smallest sized businesses, and would be the most vulnerable to recession.

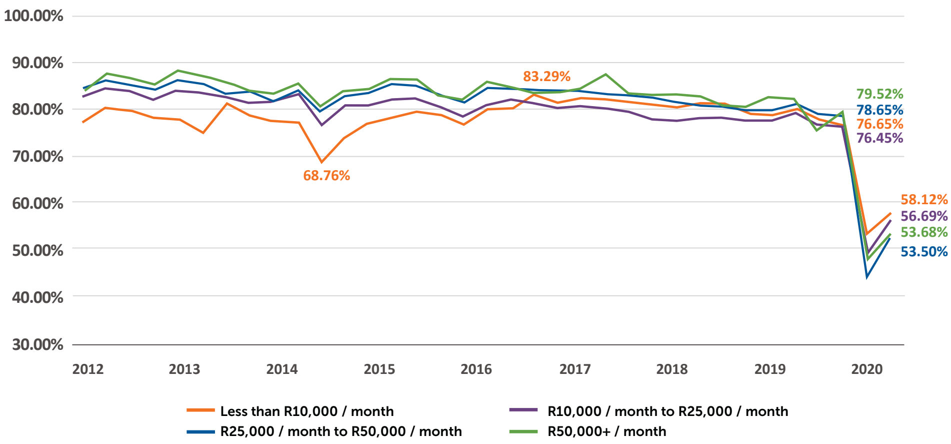
However, to date during this recent recessionary period, this does not appear to be the situation so far.

While all 4 segments have suffered severe drops in the tenants in good standing percentages in the 2nd quarter, and all 4 showed some partial recovery in the 3rd quarter, the lowest rental value segment, less than R10,000/month, recorded the highest percentage of tenants in good standing to the tune of 58.12%.

This was followed by the R10,000-R25,000/month segment with 56.69%, the R50,000+/month segment with 53.68% and the R25,000-R50,000/month segment with the lowest percentage of 53.50%.

At this stage, therefore, it appears that the highest 2 rental value segments have had the worst tenant performance during the 2020 COVID-19 shock to date, but a few more quarters worth of data would be required to draw hard conclusions.

COMMERCIAL RENT GOOD STANDING: BY RENTAL VALUE BAND



Conclusion

Retail tenants remain the worst performer but Office and Industrial tenant performance improvements are also showing signs of struggle.

In the 3rd quarter of 2020, the TPN commercial tenant payment performance data showed a modest improvement off the lockdown low of the 2nd quarter. However, payment performance remains significantly weaker compared with the pre-lockdown 1st quarter period. Given the magnitude of the lockdown shock to the economy and to business finances, we wouldn't expect a rapid recovery in tenant payment performances. A portion of economic production capacity has likely closed down permanently, and many businesses sales revenues are likely still well-below pre-lockdown levels.

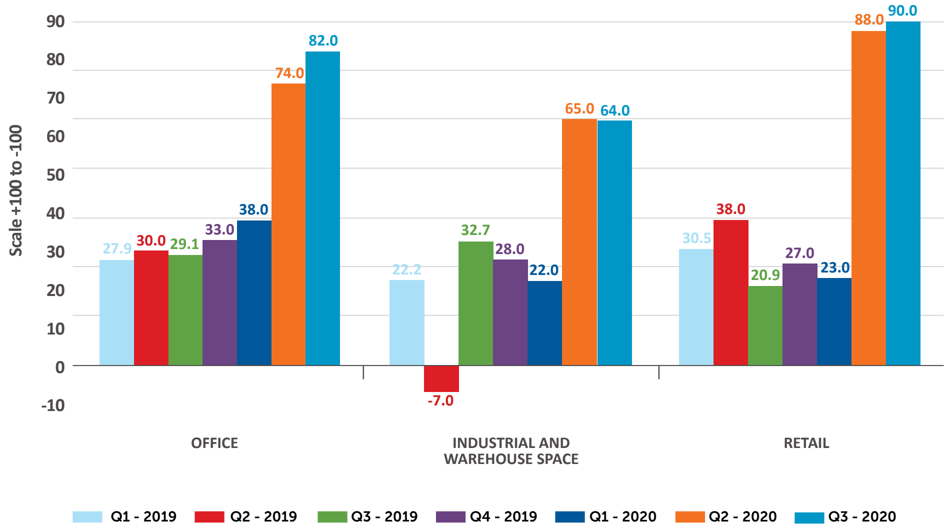
Using TPN monthly preliminary data extracts to take the picture forward into the 4th quarter, on a sectoral basis, the poorest performing Retail Property Sector tenant population continued its gradual improving path. However, the better performing Office Sector's tenant payment performance lacked further improvement from September to October, while the Industrial Sector's tenant population performance weakened slightly in September/October. This begs the question as to whether some lagged impact of the lockdown still needs to feed into the tenant payment numbers, and whether the recovery may take the form of a W-shape.

In the meantime, it would appear that tenant finances are likely still too weak to stem the tide of production capacity cutbacks and resultant rising vacancies.

We take a look at the FNB Property Broker Survey for indications of vacancy trends. When surveying the sample of Commercial Property brokers regarding these vacancy rate trends, one of the questions asked is whether they perceive a rise in, fall in, or unchanged average vacancy rates in each of the 3 major property sectors from 6 months prior to the survey. 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 vacancy rates 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 vacancy rates over the prior 6 months 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”. 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.

INDEX FOR DIRECTION OF CHANGE IN VACANCY RATES OVER THE PAST 6 MONTHS (Source FNB)



Here, there remains little to choose between the property sub-sectors in the 3rd quarter survey results, with the respondents in all 3 sectors strongly biased towards a rising recent vacancy rate trend. The bias towards rising vacancy rates remains virtually as strong as what it was in the 2nd quarter survey.

The brokers as a group were slightly more pessimistic on Retail Property vacancy rates than those of Industrial and Office, which is very much in line with Retail Property having the weakest tenant performances too.

The Retail Property Sector had the most extreme 3rd quarter reading of +90, similar to the +88 recorded in the prior quarter.

The Industrial Property reading of +64 was the least extreme of the 3 sectors, while the Office Property reading was the 2nd highest with +82.

The aggregate perception of rising vacancy rates is thus very strong across all 3 property sectors, which appears to reflect a significant weakening in tenant financial situations and payment performance.

In short, although we have seen some modest improvement in tenant payment performance in the 3rd quarter, the level of performance remains weak. And tenant financial performance would seem still too weak to drive the demand growth for space necessary to end a rising vacancy rate trend just yet.