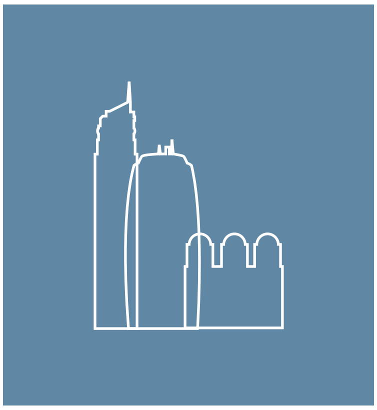

TPN Quarter 4 Commercial Rental Monitor

Guest contributor
John Loos
Property Sector Strategist
FNB Commercial Property Finance

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In This Edition:

Commercial tenant payment performance continued its recovery trend in the 4th Quarter of 2020 - some hard yards to "fully recovered" lie ahead

In the 4th quarter of 2020, commercial tenant rental payment performance continued its 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 increased to 61.62% in the 4th quarter. However, this remains well below the pre-lockdown level of 77.85% recorded in the 1st quarter of 2020, and even further below last decade's high of 83.56% reached at a stage of 2012 before the onset of a multi-year economic growth stagnation.

- Preliminary monthly tenant payment performance data up to December 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 as at December, suggesting that the pace of further improvement could be slow going in 2021.

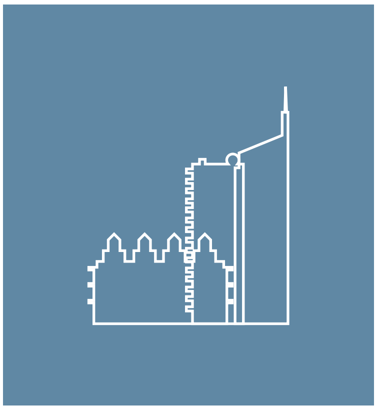
- Of the major 3 property sectors, the Retail Property Sector's tenant population has been impacted the most severely through the COVID-19 lockdown period and remains the weakest performer of the major 3 commercial property classes. Office tenants are the outperformer of the major 3 commercial property sectors, while the smaller Storage Sector significantly outperforms the "Big 3" sectors.

- While all 3 major provinces' tenant payment performances improved further in the 4th quarter, after severe knocks in the 2nd quarter "hard" lockdown, the Western Cape maintained its superior tenant performance relative to Gauteng and KZN, Gauteng continuing to show the weakest performance of the 3 regions.

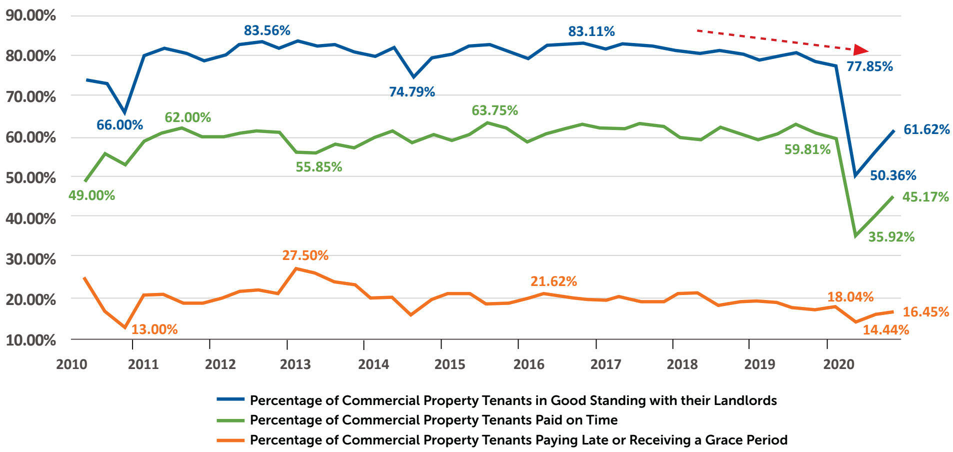
The tenant population's payment performance continued to recover in the 4th quarter of 2020, following the harsh financial impact of the 2nd quarter "hard" lockdown

In the 4th quarter of 2020, the commercial property tenant population continued the process of recovery that commenced in the prior quarter, following the extreme 2nd quarter low which was the result of 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 from 56.19% in the 3rd quarter of 2020 to 61.62% in the final quarter of the year.



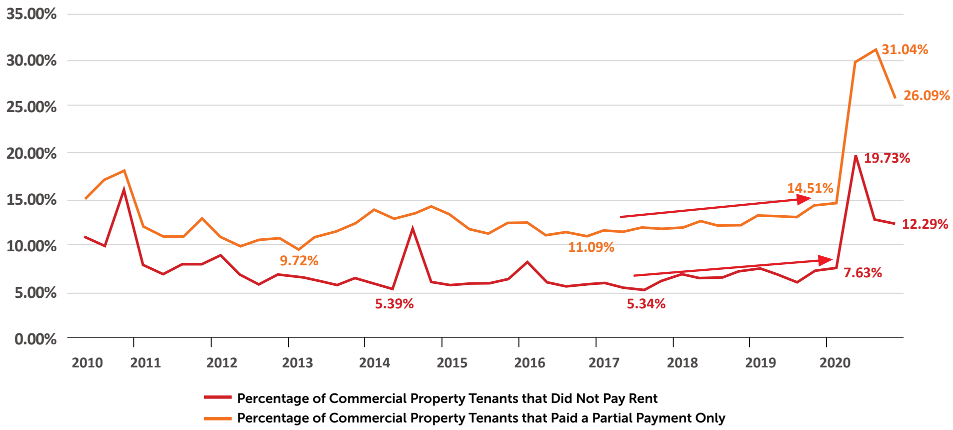
PERCENTAGE OF COMMERCIAL TENANTS IN GOOD STANDING WITH LANDLORDS



This is significantly up from the low point of the 50.36% low of the 2nd quarter, but still well below the "before-lockdown" 77.85% level recorded in the 1st quarter of last year.

Of the tenants that are not in good standing, a sizeable portion did make partial payments, i.e. 26.09% of total tenants, while a lesser 12.29% did not pay at all. The partial payments percentage in the 4th quarter represents a decline from the 31.04% of the previous quarter.

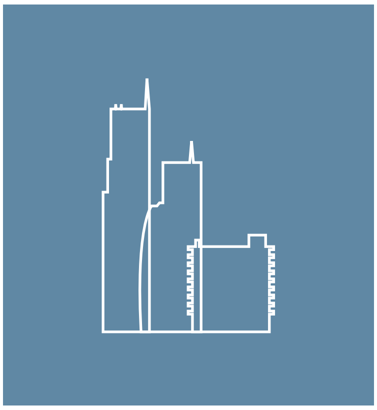
PERCENTAGE OF COMMERCIAL TENANTS THAT DID NOT PAY RENT OR ONLY PAID IN PART



The percentage that did not pay at all receded slightly from the 12.77% of the 3rd quarter, but was significantly down on the 19.73% high of the 2nd quarter of 2020.

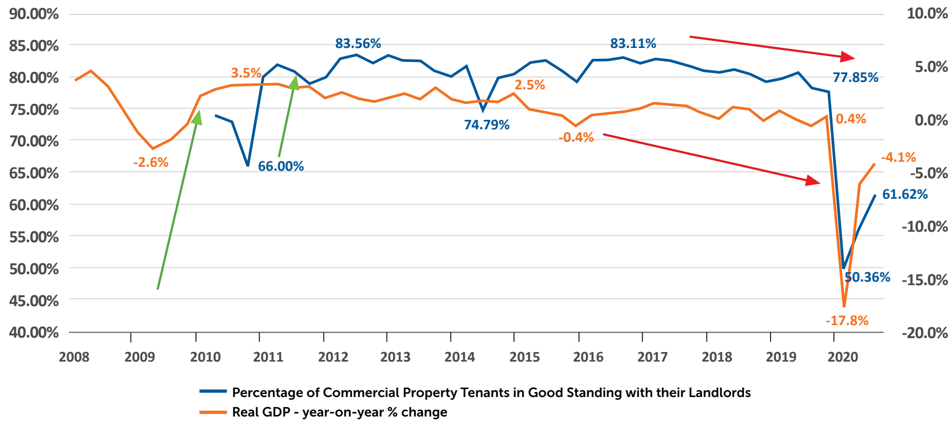
Economic indicators point towards the pace of economic recovery slowing, which could make "full" recovery to pre-lockdown levels slow going

Tenant financial, and thus rental payment performance, is strongly influenced by economic growth as measured by GDP (Gross Domestic Product).



The 2nd quarter drop of -17.8% year-on-year in GDP is 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 and 4th quarter is arguably reflected in the fact that GDP too has only partly recovered, as shown in the most recent economic data.

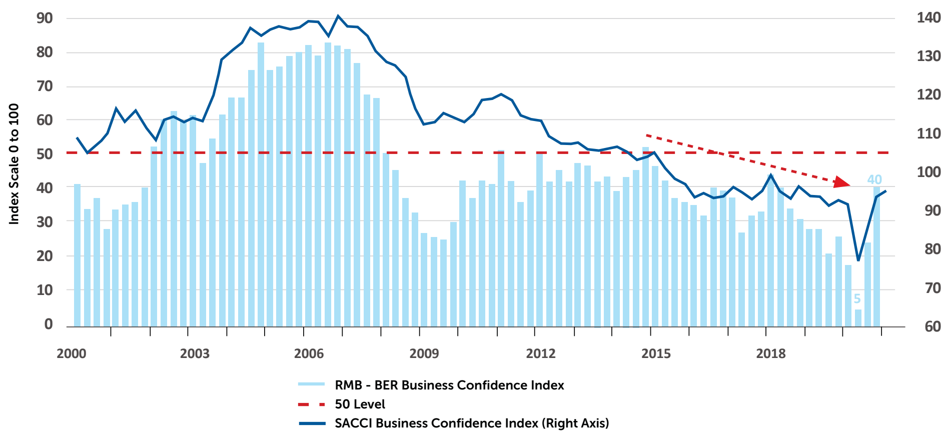
PERCENTAGE OF COMMERCIAL TENANTS IN GOOD STANDING WITH LANDLORDS vs GDP GROWTH



Therefore, we have witnessed 2 quarters of significant, but not "full" recovery in the percentage of tenants in good standing that coincide with 2 quarters of significant but not "full" GDP growth recovery (i.e. a shift towards significantly smaller negative year-on-year growth rates in GDP). By the final quarter of 2020, Real GDP growth was still negative to the tune of -4.1% year-on-year.

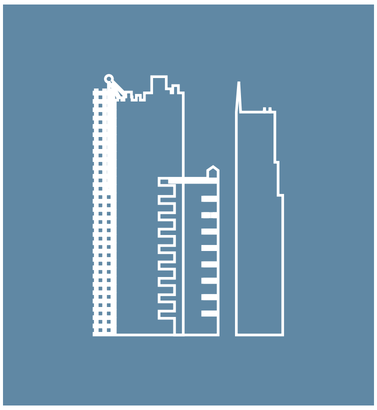
The "partial" recovery in the economy, along with a "partial" muted tenant payment recovery to date, appears to be reflected in improved but still very weak business confidence.

RMB - BER BUSINESS CONFIDENCE INDEX AND SACCI BUSINESS CONFIDENCE INDEX

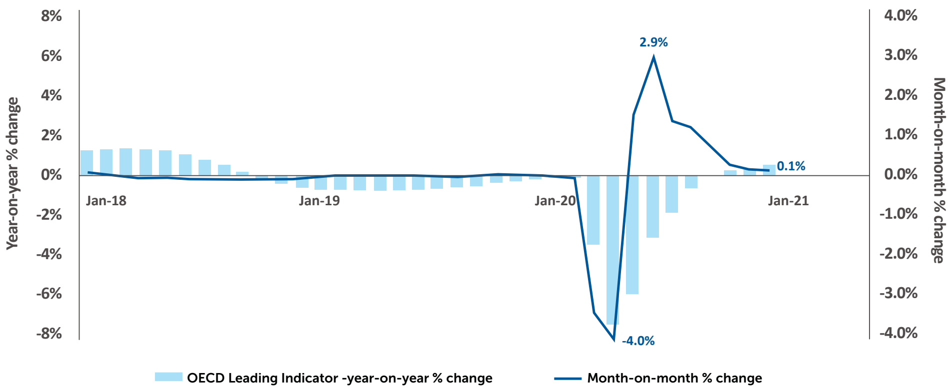


The RMB-BER Business Confidence Index rose from a very weak 5 reading in the 2nd quarter (scale of 0 to 100) to 24 in the 3rd quarter of 2020, and on to 40 in the 4th quarter.

But the Leading Business Cycle Indicators have begun to point to the pace of post-hard lockdown recovery momentum being likely to slow, both in terms of the economic performance as well as the tenant payment recovery, the 2 being strongly linked.



OECD (SOUTH AFRICAN) LEADING INDICATOR RATE OF CHANGE



The OECD Leading Business Cycle Indicator for South Africa continued to show positive month-on-month and year-on-year growth as at December 2020, the most recently available data point at time of writing.

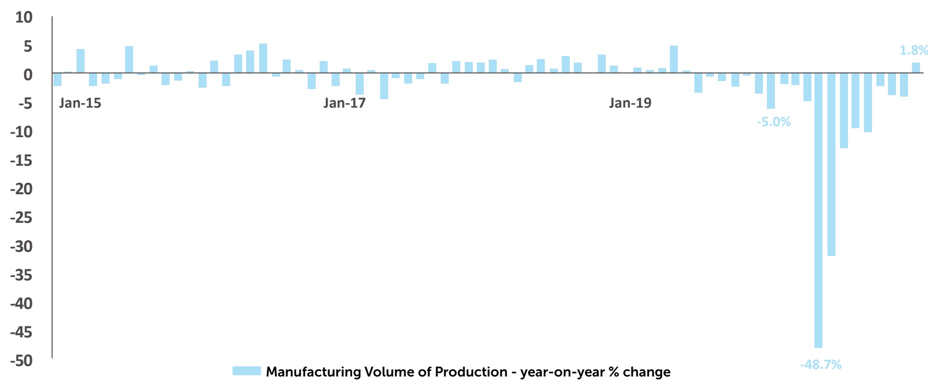
However, the month-on-month rate of growth had been slowing since the sharp rebound to a high of 2.9% as at June 2020, to record a lowly +0.1% growth rate as at December 2020, translating into a slowing rate of acceleration in year-on-year growth.

With this Composite Leading Business Cycle Indicator being a reasonably good indicator of the near-term direction of economic growth much of the time, it would appear that the pace of economic growth recovery going into 2021 was likely on a slowing path.

Mediocre manufacturing performance points to industrial property tenant performance improvement being tough to achieve

In certain of the high frequency economic indicators that are strongly linked to the major Commercial Property Sectors, we have witnessed a similar slowing pace of recovery late in 2020 and early in 2021.

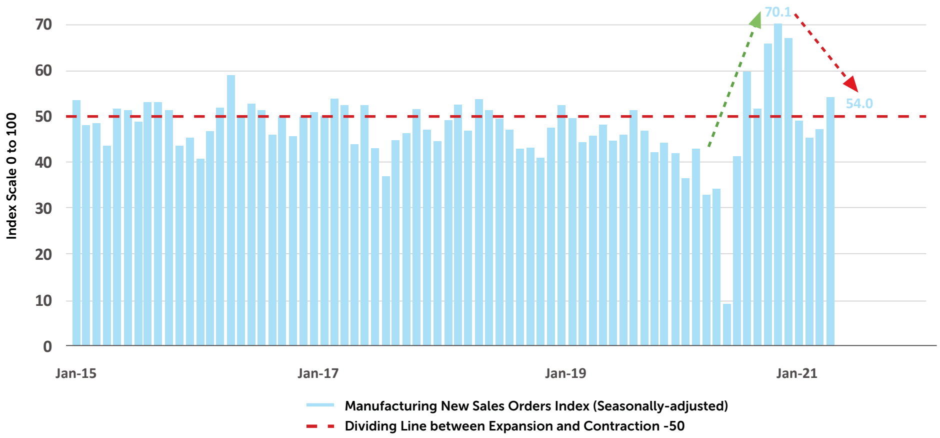
MANUFACTURING OUTPUT GROWTH



Industrial property is strongly, though not entirely, influenced by the Manufacturing Sector, whose volume of production has stuttered back to a small positive year-on-year growth rate of +1.8% year-on-year as at December, the 1st positive year-on-year growth rate since May 2019.

This sector, as the Leading Indicator suggested should be the case, battled to make further recovery progress out in the 4th quarter. From -48.7% year-on-year volume of production decline in April 2020, the rate of decline diminished sharply to only -2.2% year-on-year as at September. From there in the 4th quarter of 2020, it made mild further progress to record that weak positive year-on-year rate by December.

MANUFACTURING PMI
NEW SALES ORDERS INDEX

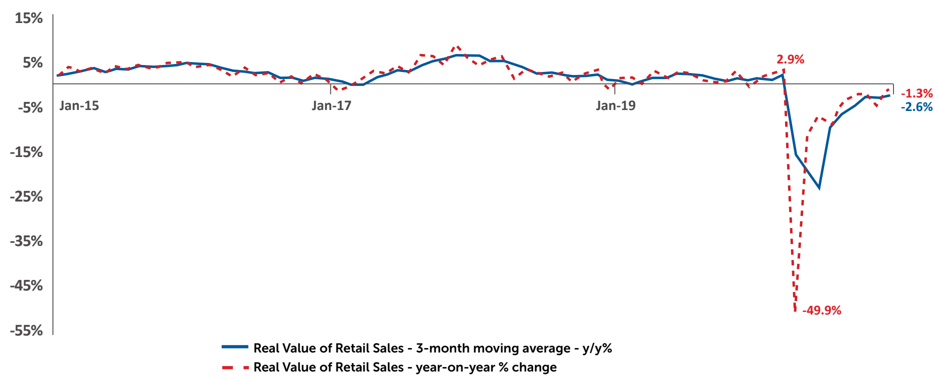


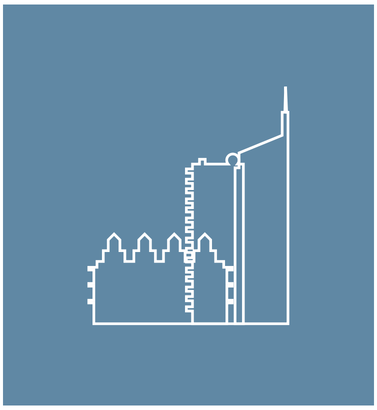
And moving into the 1st quarter of 2021, the Manufacturing Purchasing Managers Index New Sales Orders component points to mediocre performance to come. After having recovered sharply from an all-time low of 9.3 in April 2020 to 70.1 as at September 2020, 50 representing the dividing line between expansion and contraction, this index receded to record 3 months of “contraction” below 50 out of the last 4 months to February 2021. That suggests that, while manufacturing production levels have largely normalised, anaemic growth could be expected early in 2021.

Real retail sales growth slowly nearing pre-lockdown levels

In an area of the economy linked to retail property, “mainstream” real retail sales growth points to a similar picture to manufacturing, i.e. back to near zero by the final months of 2020, but battling to make further recovery progress with a mild -1.3% year-on-year decline as at December.

REAL RETAIL SALES GROWTH (2008 PRICES)

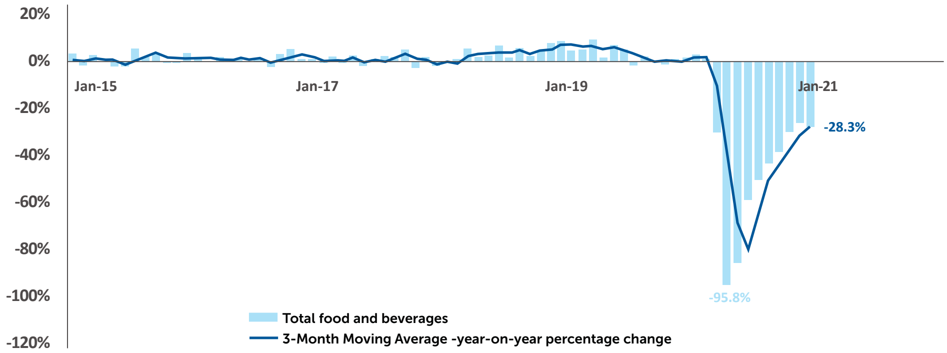




Weak Restaurant, Take-Aways and Catering sales explain a significant part of the retail tenant weakness

The weak part of retail, though, is clearly in the area of Restaurants, Coffee Shops and Catering, where real year-on-year decline was still recording an extreme rate of -28.3% as at December, having shown a weak recovery from a severe -95.8% drop in the April hard lockdown month.

FOOD AND BEVERAGE RETAIL INCOME - REAL - y/y %
(DEFLATED WITH HOTEL / RESTAURANT CPI)



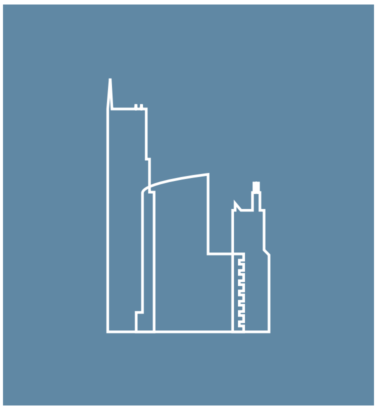
This part of retail remains constrained by social distancing regulations limiting numbers, but it is also typically a harder hit sector during recessionary times as consumers take a financial knock, it being a purchase that is non-essential in nature. The severe drop in employment numbers last year confirmed that the consumer income knock was indeed severe.

Economic indicators also “justify” the relative outperformance of office property tenants through the recession

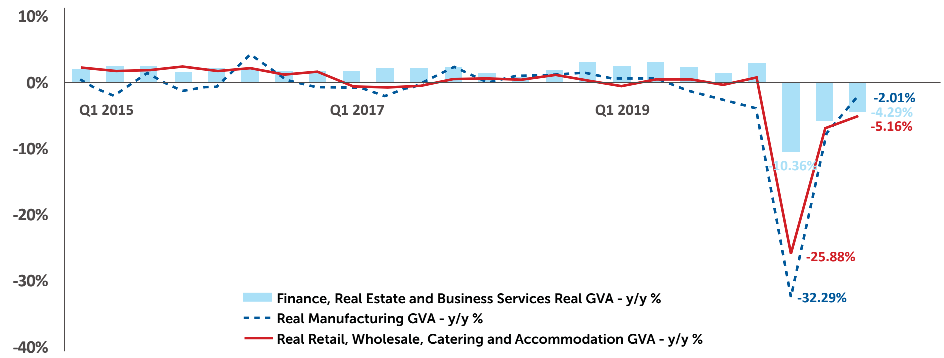
Quarterly GVA (Gross Value Added) data appears to largely explain why office property tenants have been the relative outperformers of the 3 major commercial property sectors through the 2020 lockdown period and thereafter. The Finance, Real Estate and Business Services Sector is the big economic sector that is instrumental in driving demand for office space, and the financial well-being of businesses in this sector is key to the performance of the office space tenant population.

This sector of the economy was impacted by lockdowns and the resultant deep recession, but not nearly to the extent of the Retail and Manufacturing Sectors, because much of it was allowed to continue to operate during the 2nd quarter hard lockdown, albeit with a large portion of employees working from their homes. The revenues of this sector’s businesses were thus not cut off to the same extent as retail and industrial tenants.

Whereas the Retail and Wholesale Trade, Catering and Accommodation Sector’s GVA dropped by a massive -25.9% year-on-year in the 2nd quarter of 2020, and Manufacturing GVA (strongly influencing industrial tenants) by a similar -32.3%, the Finance, Real Estate and Business Services Sector GVA dropped by a far lesser -10.4% in that quarter. All 3 economic sectors had made their way back to lower magnitudes of negative year-on-year growth by the 4th quarter of 2020, Manufacturing to the tune of -2.01%, Finance, Real Estate and Business Services to -4.3%, and Retail and Wholesale Trade, Catering and Accommodation to -5.16%.

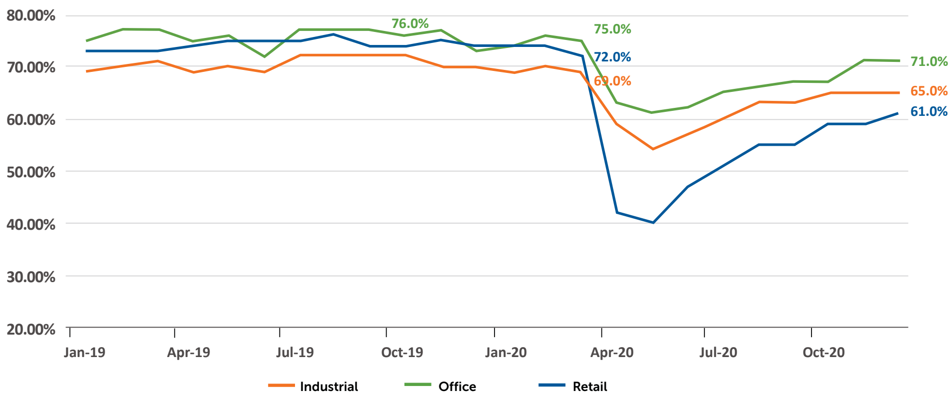


KEY SECTORAL MEASURES OF ECONOMIC GROWTH (GROSS VALUE ADDED)



And so, it is not surprising that when we examine TPN monthly data extracts of tenants in good standing by major property sector, as at December we saw office property tenants still outperforming those of industrial, while retail property tenants remained the worst performing group of the 3.

MONTHLY COMMERCIAL RENT GOOD STANDING: BY MAJOR PROPERTY CLASS



The percentage of retail tenants in good standing had partially recovered by December to a still weak 61%, from a revised low of 40% reached during May 2020.

By comparison, industrial tenants in good standing had reached 65% by December, and office tenants 71%.

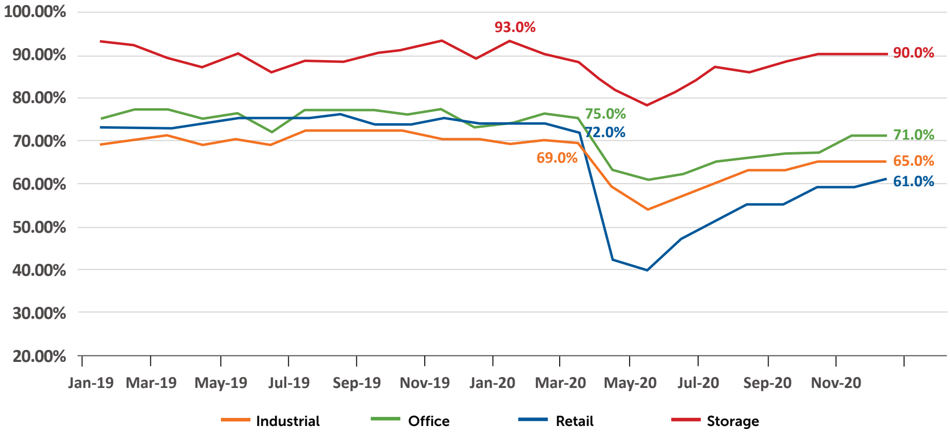
However, there have been signs that especially the performance of the industrial tenant population was battling to make further recovery progress late in 2020, having been unchanged at 65% of tenants in good standing in October, November and December. The office tenant recovery also stuttered in December, remaining unchanged at 71% from November, while retail tenant performance appeared to be improving the most rapidly off the lowest base as at late 2020.

Storage tenants continue to far outperform the other major property sectors

The smaller Storage Sector's tenant population continues to far outperform the 3 major property sectors' tenant populations, as it has right through the lockdown.

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. As at December, this percentage was 90%, unchanged from the prior 2 months.

MONTHLY COMMERCIAL RENT GOOD STANDING: STORAGE vs MAJOR PROPERTY CLASSES



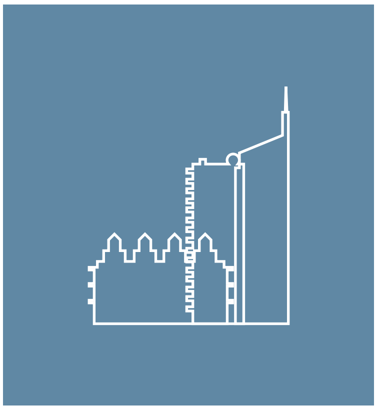
This relatively affordable property rental sector, is a consistently better performing property class from a tenant payment point of view which is said to rely heavily on the 4 d's, i.e. Death, Disaster, Displacement and Divorce. It may have benefited somewhat from "movement" in both households and businesses 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, from closures and downsizing of operations.

Major provinces' tenant performance

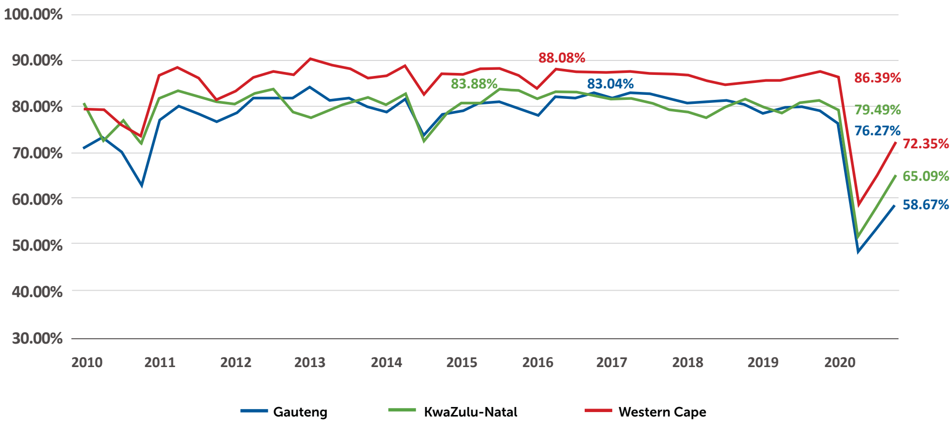
The Western Cape remains the province with the highest percentage of commercial tenants in good standing, to the tune of 72.35%, up from the 2nd quarter's 58.97%.

Since the commercial property 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 58.67% of tenants in good standing, as at the 4th quarter of 2020, was noticeably lower than the Western Cape, as well as experiencing a weaker tenant performance than KZN's 65.09%, although all 3 provinces have seen noticeable improvement since the 2nd quarter low.



COMMERCIAL RENT GOOD STANDING: BY MAJOR PROVINCE

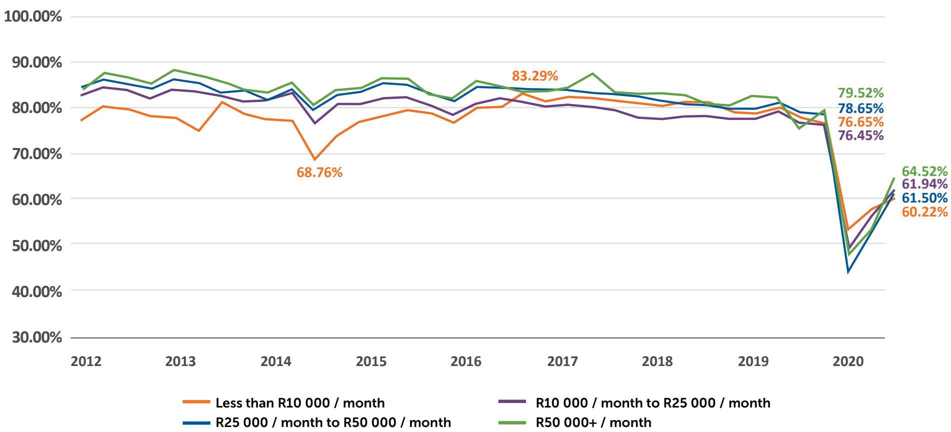


These 3 relative regional tenant performances appear to be a replication of the relative performances during the last crisis period, the aftermath of the 2008/9 GFC recession, where Gauteng was the weakest performer by a noticeable margin too.

Tenant performance by Rental Value Band

We have previously been of the opinion 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, however, 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.

COMMERCIAL RENT GOOD STANDING: BY RENTAL VALUE BAND



From 2012 to 2016, 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 over much of that period. 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, would be the most vulnerable to recession.

However, through the COVID-19 recessionary period to date, the “winners and losers” by size category are not that clear. Each of the 4 segments saw a severe drop in the tenants in good standing percentages in the 2nd quarter, but it was the second highest rent/month categories, the R25,000/month category (44.8% of tenants in good standing in the 2nd quarter), and the R50,000+/month category (48.34% tenants in good standing in the 2nd quarter of 2020) that bottomed out with the weakest tenant performances.

On the recovery, the relative positions appear to have switched to the lowest “Less than R10,000/month” category being the weakest at 60.22% of tenants in good standing. However, this is followed by the R25,000-R50,000/month category at 61.5% of tenants in good standing, then the R10,000-R25,000/month category with 61.94% of tenants in good standing, and the highest R50,000/month category with the best performing 64.52% of tenants in good standing.

At this stage, therefore, it appears that the higher rental/month segments have dragged themselves up from the bottom positions, but there is not a strong indication that they are destined to be the outperforming segments in the near term.

Conclusion – retail tenants remain the worst performer with industrial and office tenant performance showing a slowing rate of improvement late in 2020

In the 4th quarter of 2020, the TPN commercial tenant payment performance data showed a further improvement from the 3rd quarter, the 2nd consecutive quarter of improvement since the low of the 2nd quarter. However, payment performance remains significantly weaker compared with the pre-lockdown 1st quarter period. This is not entirely surprising given the magnitude of the financial shock to businesses from the 2nd quarter lockdown and sharp GDP contraction.

Key economic indicators suggest that the pace of economic recovery is slowing, following a sharp initial improvement directly after the 2nd quarter hard lockdown, and that the attainment of “full” recovery, i.e. GDP level returning to pre-lockdown levels of 2019, might take some time. Business confidence remains low albeit improved following the big financial shock of the lockdown recession, and existing businesses will be slow to make expansions to capacity to fill the supply side-gap left by businesses and their production capacity that closed down during the recession.

Using TPN monthly preliminary data extracts on a sectoral basis, the poorest performing Retail Property Sector tenant population continued its gradual improving path. However, the better performing Industrial and Office Sectors’ tenant payment performance lacked further improvement during the 4th quarter months, the industrial tenant performance treading water at the same in good standing performance for 3 consecutive months and the office tenant performance for the last 2 months of the year. Like the economic numbers, the rental data has also begun to show signs of a slowing pace of recovery late in 2020.

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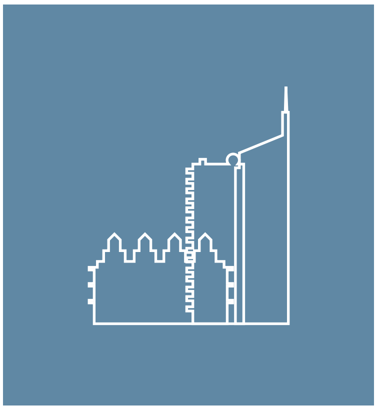


Best performing tenants, but ominous signs for the Office Market

While the Office Property Market still shows the best tenant payment performance of the 3 major commercial property sectors as at the end of 2020, that is not to say there doesn't exist significant financial constraints on this sector. However, it appears likely that a portion of the financial pressure in the Office Sector is to be seen in tenants downscaling on their office space needs, translating into a rising vacancy rate through 2020 and likely into 2021.

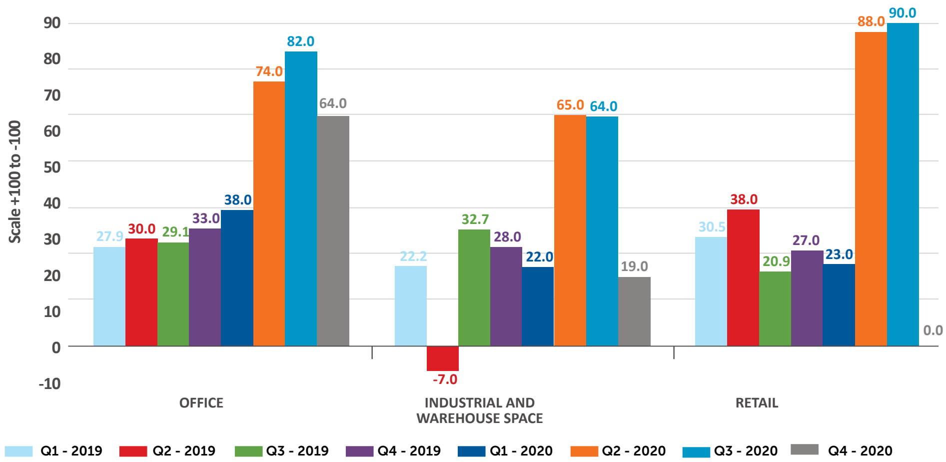
Businesses occupying office space can take greater advantage of the work from home shift, following the impact of lockdowns which forced much of the Services Sector into a highly successful remote work "experiment".

As always, a part of tenant financial pressure is reflected in the percentage of tenants in good standing, and a part of it in vacancy rate trends, and this seems likely to be most pronounced in the case of the Office Market.

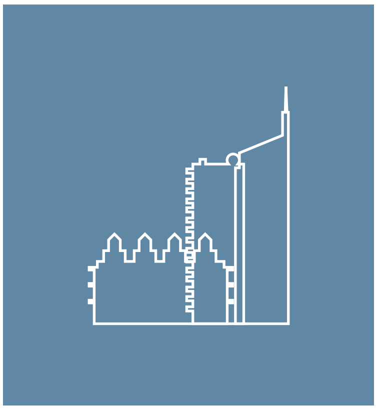
We take a look at the FNB Property Broker Survey for indications of vacancy trends. When surveying the sample of commercial property brokers regarding these vacancy rate trends, one of the questions asked is whether they perceive a rise in, fall in, or unchanged average vacancy rates in each of the 3 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.

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



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.



Here, the most recent 4th quarter 2020 survey has begun to show the Office Property Sector as likely to be the weakest one going into 2021.

The respondents in the Office Property Sector are very strongly biased towards perceiving rising vacancy rates, 64% more respondents indicating a rise in vacancy rates (i.e. a +64 index reading) in this sector than those pointing to a decline.

Industrial property was also perceived to have a rising vacancy rate, but with a more moderate index reading of +19, while retail property's 4th quarter index reading was a pleasantly surprising zero.

Therefore, the brokers as a group were significantly more pessimistic on office property than on the other 2 classes. While office tenants didn't experience the severe financial shock of hard lockdowns that many retail tenants experienced, financial pressure is likely significant enough to see many businesses downscaling on office space, which in turn is reflected more in a rising vacancy rate than in a weak tenant in good standing percentage.

In short, although we have seen some further improvement in tenant payment performance in the 4th quarter, the level of performance remains well below "fully recovered" to pre-COVID-19 levels. Examining the major property sectors, we see office tenants still performing best as a group, arguably helped by not having had to lock down as severely as the Retail and Industrial Sectors earlier in 2020. But one must not be fooled. Financial pressure in the Office Sector is significant, and we believe that a portion of tenants are scaling down on office needs, opting for greater levels of remote work since working from home became more accepted with the commencement of lockdowns. This is likely to be reflected in a further increase in average office vacancy rates.