

FNB Commercial Property Finance

Retail Property Insights



The Retail Property environment became a “mildly more pressured” one in the 2nd quarter, or so say the main data releases....not too surprising after the onset of rising inflation and then interest rates from late last year. Covid-19 impacts are not over yet.

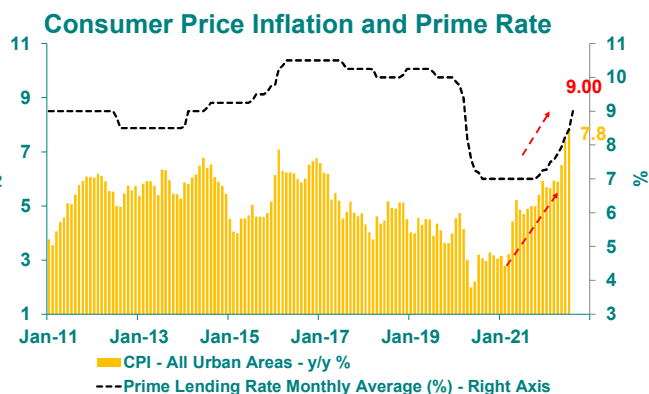
Data releases over the past month or so have been supportive of the expectation that the retail property market has been gradually moving into a tougher environment once more, as 2022 has progressed, and it is possible that we may have to wait for 2023 before clearer signs of relief emerge.

There is little doubt that this property class finds itself in a far better environment compared to the hard lockdown year of 2020, where many retail businesses spent some of that year totally shut down and without any revenue stream to speak of.

- **The “new” post-lockdown challenge of inflation and interest rate hiking**

But it has also been evident that the road back to being “fully recovered” (i.e. performing back at 2019 pre-lockdown levels) has been a challenge for the retail property class, and that a renewed challenge in the form of a recent inflation and interest rate hiking period has emerged from late-2021 onward.

Consumer price inflation, driven largely by global oil and food price surges, has accelerated all the way from 2% in May 2020 to 7.8% by July 2022. The rising inflation trend was the catalyst for the start of SARB interest rate hiking in November 2021, and to date the Bank has lifted rates by 200 basis points.



Many central banks in the world are in a hiking phase too, so the world economy was always likely to slow too.

Consumer real income growth was to be impacted via the impact of the slowing global economy on our own economy and its employment growth, via inflation eating into consumer disposable income, and via a higher cost of servicing debt taking a further piece of the consumer income pie.

- **Hints of a more challenging retail property environment did appear early in 2022**

A more challenging environment for the retail property class was to be expected. But early on in 2022 the data was not yet convincing in this regard.

There was a first hint of renewed pressure for the retail property sector in TPN’s data relating to the percentage of retail tenants in good standing regarding their rental payments. This percentage of tenants in good standing had recovered from an extremely weak 41% in May 2020, as far as 66% by late-2021, still short of the 71% level just prior to 2020 Covid-19 lockdowns. But in the 1st quarter of 2022, we saw this percentage begin to slide once more, back down to 62% by March of this year, thus not yet “fully recovered” to pre-Covid 19 levels and already beginning to decline. Interest rate hiking had probably started to take a toll on certain indebted tenants.

But at that stage, other retail market data was not yet showing increasing pressure. Our own FNB Property Broker Survey in the 1st quarter of 2022 still pointed to rising retail property sales activity, rising rental market activity, and indeed a broker perception of retail vacancy rates having declined. And so too in MSCI’s Retail Digest, the 1st quarter data showed a decline in vacancy rates across all 5 major shopping centre size categories, i.e. Super-Regional, Regional, Small Regional, Community and Neighbourhood Centres.

Year-on-year trading density growth, too, had

accelerated in the 1st quarter compared to the previous quarter in all 5 centre size categories too.

- But more widespread signs of mounting pressure have emerged in 2nd quarter data

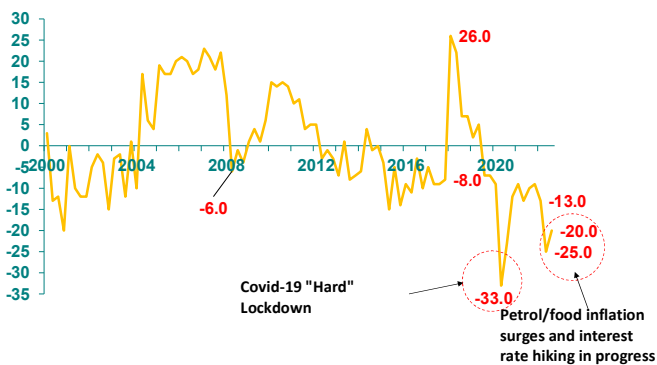
But 2nd quarter economic and retail property market data, much of it being released in the past month, has begun to paint a picture of mounting pressure on retail property.....not severe pressure yet, but increased nevertheless.

Inflation continued its upward march in the 2nd quarter, petrol prices still on the rise at that stage and food price inflation following suit. The SARB started to speed up interest rate hiking in that quarter too, jumping from earlier 25 basis points hikes to 50 basis points at its May meeting.

The first data-related hint of a possible slowing in the retail property market came in the form of mild decline in sales and rental market activity ratings in the 2nd quarter FNB Property Broker Survey.

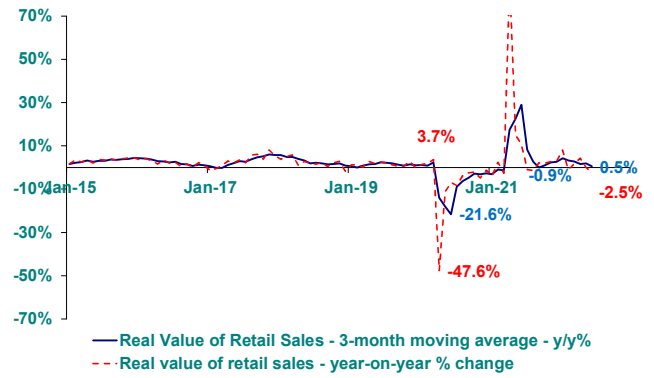
Then came the FNB-BER Consumer Confidence Index for the 2nd quarter, showing a significant drop from -13 in the 1st quarter to a very weak -25 reading, and remaining a very weak -20 in the 3rd quarter.

FNB-BER Consumer Confidence Index



Then, in monthly high frequency data, we saw real retail sales growth turn negative to the tune of -2.5% year-on-year, in contrast to having started the year with an 8.1% positive growth rate in January. Real retail sales find themselves only 0.5% above the real June 2019 level, thus having made no real progress in 3 years, a harsh lockdown dip in between.

Real Retail sales growth (2008 Prices)

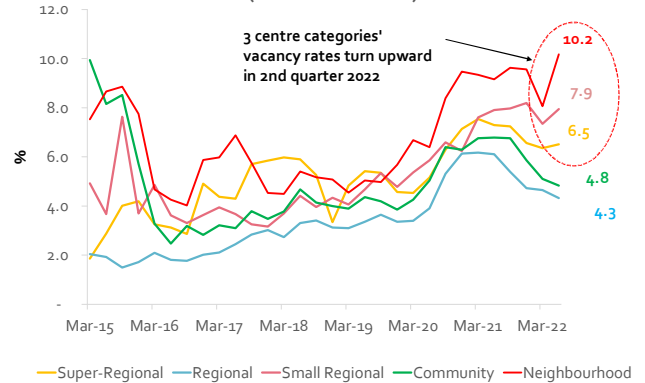


This week's GDP (Gross Domestic Product) data release by StatsSA confirmed a 2nd quarter growth slowdown. More specific to retail property, year-on-year growth in Real Retail and Wholesale Trade, Catering and Accommodation Gross Value Added (GVA) slowed from 6% in the 1st quarter to 0.66% in the 2nd quarter. This sector's GVA remains below pre-Covid 19 levels.

Real Household Consumption Expenditure growth slowed in the 2nd quarter too, to 2% from 2.8% in the prior quarter.

And then there was retail property market-specific data from MSCI, showing slower year-on-year trading density growth in 4 of the 5 centre categories in the 2nd quarter, Small Regional Centres being the exception, and a renewed rise in vacancy rates in 3 of the 5 categories, namely Super Regional, Small Regional and Neighbourhood Centres.

Average Vacancy Rate by Centre Category (Data source: MSCI)



Rentals remained in year-on-year decline in the 3 Regional Centre size categories.

Conclusion – Covid isn't quite finished with us

So, after clearer signs of renewed economy and interest rate pressure on retail property, where too from here?

Is it a case of one "unexpected shock" after the next for the retail property sector? Well, not entirely. The additional food and oil price surge emanating from the Ukraine conflict and resultant Russia sanctions was indeed a new "shock", exerting additional upward

pressure on inflation and interest rates.

But perhaps important to realise is that we are still dealing with major impacts of “normalization” after the Covid-19 lockdown period.

Much of the inflationary pressure began long before the Ukraine conflict, on the back of Covid-19 related supply chain disruptions as well as from a “normal” recovery in the economy as lockdowns eased.

And with such a “normalization” after severe lockdowns and recession of 2020, it was to be expected that central banks across the world would begin to reverse out of an abnormal situation, after they had cut interest rates to what were arguably abnormally low levels to provide support during what was an abnormal crisis.

Therefore, a significant portion of inflation surge and resultant interest rate hiking across the world is related to Covid-19 and its aftermath.

As a saying goes, “we might be finished with Covid but Covid isn’t finished with us”.

FNB’s expectation is that prime rate will peak at 10.25% late this year, implying a further 125 basis points’ worth

of rate hiking to come. If this expectation is realized, it will merely have returned interest rates to levels seen in 2019, not long before the lockdowns came. Rates are expected to peak as consumer inflation slows.

Indeed, we have started to see encouraging signs in the form of recent petrol price declines in the current quarter, with global oil prices off their earlier highs. But these inflation “positives” emerging are not expected to turn retail property’s fortunes just yet. Rather, additional retail property pressure is expected in this latter stage of 2022 given the further interest rate hiking anticipated.

Alleviation of recent retail property-related pressures may thus only come in 2023 when interest rates are expected to settle and inflation to subside.

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