

23 September 2020

# Property Insights



## Property Broker Survey – Market Balance Q3 2020

**Brokers continue to see all 3 major commercial property buying/selling markets as substantially oversupplied, which appears supportive of our expectation of a near term decline in commercial property values.**

**John Loos:**  
Property Strategist

FNB Commercial Property  
Finance

Tel: 087-312 1351

Email: [john.loos@fnb.co.za](mailto:john.loos@fnb.co.za)

We continue with the 3<sup>rd</sup> quarter 2020 results of our 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, Ethekewini, City of Cape Town and Nelson Mandela Bay.

Given FNB Commercial Property Finance's strong focus on the "Owner-Occupied" Property Segment, 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 deal with questions relating to the perceived balance/imbalance between demand and supply of properties being transacted in the main markets. Market "strength" refers to a relatively strong demand level relative to supply, and vice versa for market "weakness". These questions include estimates of average times of properties on the market prior to sale, as well as perceptions of whether demand exceeds supply or vice versa.

**Key themes that emerge from the results are:**

- The Industrial Property Market appears to be the strongest of the 3 major commercial property sectors, i.e. Industrial, Retail and Office.
- However, the very weak perceived demand-supply balance in all 3 property classes has continued in the 3<sup>rd</sup> quarter survey.
- In the area of Industrial Property, it appears to be that the 3 coastal metros, i.e. Cape Town, Nelson Mandela Bay and Ethekewini, are where the relative market strength lies, with Gauteng metro regions being the area of relative weakness, with Johannesburg being especially weak.
- However, in the Office and Retail Property Sectors there is little to choose between the 5 metro regions, all of them showing very weak market balances.
- Given a greater bias towards "oversupply" in all 3 major commercial property markets, we anticipate a greater magnitude of negative All Property capital growth for 2020 to the tune of between -5% and -10%, following on a more mild -0.2% in 2019 (using MSCI historic data).
- The Office Property Sector appears to have overtaken Retail Property in terms of becoming the weakest of the 3 major property classes, with the "Zoom Boom", remote working and potential company scaling down of office requirements, overshadowing the online retail challenge to Retail Property.

## Average Time on the Market increases across all segments

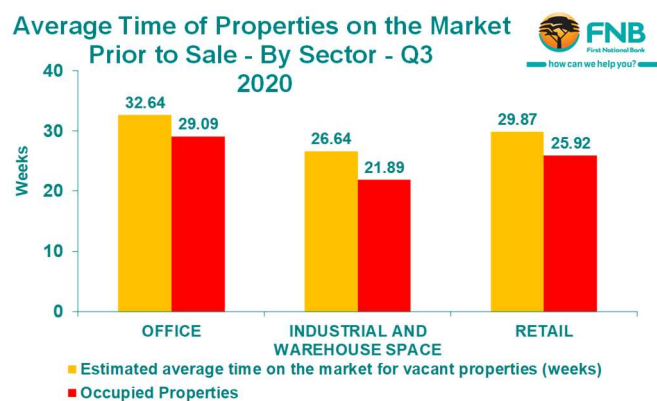
From our residential market survey, we found the movement over time in the estimated average time of properties on the market prior to sale a useful indicator of changes in the balance between supply and demand, an increase in average time of properties on the market prior to sale signaling a deteriorating demand relative to supply and vice versa.

We have attempted to apply this same questioning to our commercial property broker survey, splitting the survey by the 3 main property classes, namely Office, Industrial and Retail, and splitting it further by "Vacant Properties" vs "Occupied Properties"

In all 3 property classes, the occupied properties are reported to sell faster.

The relative picture between the 3 major property sectors is still one where brokers perceive the Industrial Property Market to be the strongest of the 3 classes, with an average time on the market for occupied industrial properties of 21.89 weeks being quicker than the 25.92 weeks in the case of retail and 29.09 weeks for office space.

Vacant industrial properties, too, averaged the shortest average time on the market of the 3 segments to the tune of 26.64 weeks, compared to 29.87 weeks in the case of retail space and 32.64 weeks in the case of office properties, in the 3<sup>rd</sup> quarter 2020 survey.



- In the FNB Commercial Property Broker Survey, it is seemingly more difficult to estimate average time on the market than is the case in the FNB Residential Property Estate Agent Survey

After 7 quarters of this relatively new commercial property broker survey, it is definitely tougher to determine a clear trend in the actual estimates of average time on the market by brokers. However, in an easier follow up question as to whether the past 6 months has seen average time of properties on the market increase, decrease or remain unchanged, brokers having a strong belief that the time on the

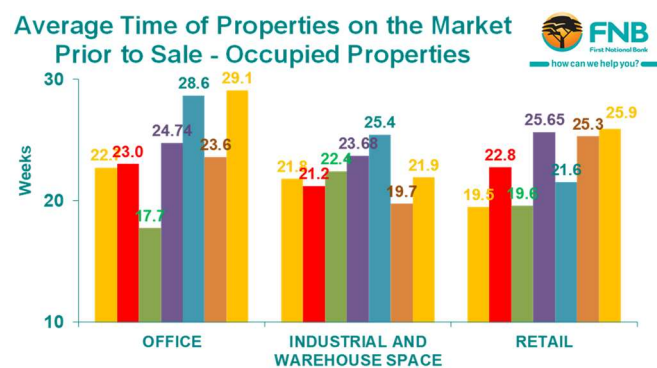
market has lengthened.

And an increase in the average time on market over the past 6 months is the response that one would expect at a time of deep recession such as the one that has unfolded in South Africa, most notably from the 2<sup>nd</sup> quarter of 2020.

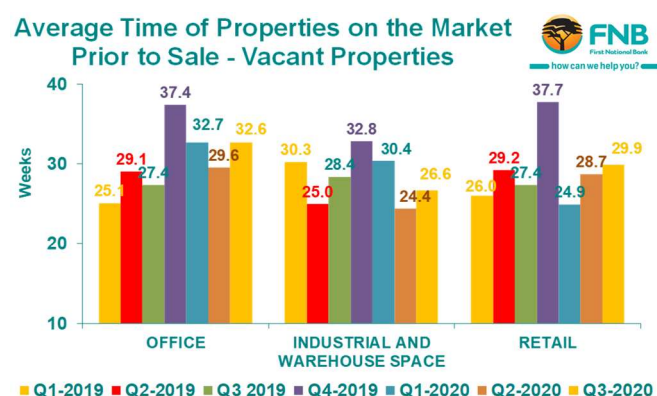
### Estimated Average Time on the Market Trend

Viewing the perceived average time on market estimates, the average estimated time that all 3 property categories are on the market for, prior to sale, has increased compared to the prior quarter in the 3<sup>rd</sup> quarter 2020 survey.

From a 23.6 week average in the 2<sup>nd</sup> quarter of 2020, the estimated time on the market for Office Property increased to 29.1 weeks in the 3<sup>rd</sup> quarter on occupied properties (while also being higher in the 3<sup>rd</sup> quarter compared to the 1<sup>st</sup> quarter's 28.6 weeks), Industrial Property average time on market increased from 19.7 weeks in the 2<sup>nd</sup> quarter to 21.9 weeks in the 3<sup>rd</sup> quarter of 2020 (but is down on the 25.4 weeks recorded in the 1<sup>st</sup> quarter survey. The Retail Property estimate increased from 25.3 weeks in the 2<sup>nd</sup> quarter to 25.9 weeks in the 3<sup>rd</sup> quarter (and also up on the 21.6 week estimate in the 1<sup>st</sup> quarter survey.



This same quarter-on-quarter directional picture was witnessed in the markets for vacant properties. The increase in the estimated average time on market for Vacant Office Property from the 2<sup>nd</sup> to 3<sup>rd</sup> quarter survey was from 29.6 weeks to 32.6 weeks (although this estimate was still slightly below the 1<sup>st</sup> quarter's 32.7 weeks).



Industrial Property's average time increased from 24.4 weeks to 26.6 weeks (but is also down on the 30.4 weeks of 2 quarters prior), while Retail Property's average time on market increased from 28.7 weeks to 29.9 weeks (and was up on the 24.9 week estimate of the 1<sup>st</sup> quarter).

The relative levels of estimates of average time on the market by major property sector appear to tie in with other survey responses, in the sense that the brokers perceive Industrial Property to be the strongest market of the 3, and this comes through in the 3<sup>rd</sup> quarter's estimated average time on the market where estimates for Industrial Property's time on the market prior to sales is the shortest of the 3 sectors.

However, certain industries' lower estimates of average time on the market compared to 2 quarters prior (i.e. compared to the 1<sup>st</sup> quarter of 2020) don't appear to always be consistent with the responses in a simpler subsequent survey question that point to a strong broker perception of an increased average time on market compared to 6 months earlier.

- **Perceptions regarding the direction in "average time on market" over the past 6 months**

The 1<sup>st</sup> follow up question to the average time on the market estimate, is asking respondents whether they believe that the average time on the market has increased, decreased or stayed the same since 6 months prior (i.e. since the 1<sup>st</sup> quarter of 2020).

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.

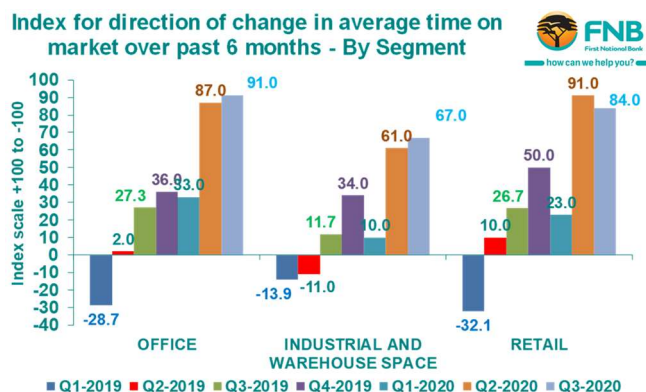
The scale of the "Index for direction of change in time on the market over the past 6 months" is thus from +100 to -100. A score of +100 would imply that 100% of respondents perceived an increase in time on the market over the past 6 months (market weakening) and -100 would imply 100% of respondents perceiving a weakening, while a zero level would mean that those providing an "increased" response equals those responding with "decline".

All 3 of the 3 property classes returned a strongly positive number, implying that the aggregate of responses points towards an increase (market balance weakening) in average time of properties on the market compared to 6 months prior.

In addition, this strong "increased" bias has been recorded for 2 successive surveys, a noticeable increase in all 3 sector indices having been witnessed in the 2<sup>nd</sup> quarter survey, the apparent market impact of a deep economic lockdown-induced shock.

Industrial recorded +67 in the 3<sup>rd</sup> quarter, marginally

up from +61 in the 2<sup>nd</sup> quarter. The Office Index also rose slightly from +87 to +91 over the same 2 quarters, while Retail was slightly lower from +91 to +84, but still very strongly biased towards an increased time of properties on the market.



Therefore, while actual estimates of average time of properties on the market is difficult, and as such the trend in prior survey responses to this question aren't always clear due to some volatility, the simpler follow-up question regarding direction in average time on market over the prior 6 months has shown a clearer trend over the history of the survey towards a strong "increasing time" bias.

We would lean towards believing that this past 6 months' directional response better reflects the direction of average time on the market of properties, in part because of the simplicity of the question, but also because the deepening recession of recent quarters in South Africa makes it unlikely that average time on market would suddenly start to decline after earlier quarters' increases.

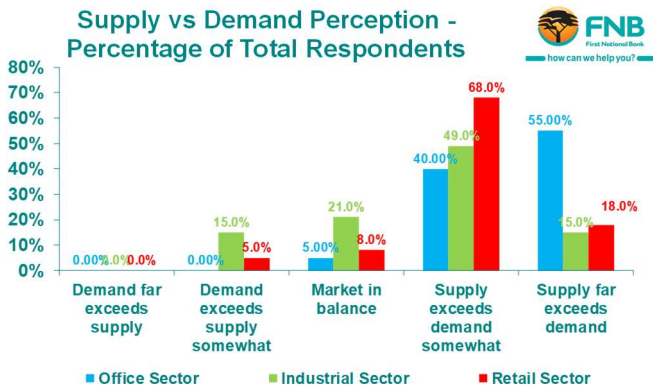
The strong leaning in the 2<sup>nd</sup> and 3<sup>rd</sup> quarter surveys by brokers towards average time on market having increased also appears to tie in with the next question which asks them for their perceptions of property demand relative to supply in the market, where they strongly lean towards an increasingly oversupplied market in all 3 property sectors.

### Demand vs Supply Strength Perceptions

An additional supply-vs-demand question is asked, where the respondents are asked whether they perceive "demand far exceeds supply" (option 1), "demand exceeds supply somewhat" (option 2), the market is in balance" (option 3), "supply exceeds demand somewhat" (option 4) or "supply far exceeds demand" (Option 5).

All 3 property sectors have the majority of respondents pointing to "supply exceeding demand", either "somewhat" or "far". The Industrial Market possesses the lowest percentage of respondents, i.e. 54% perceiving supply to exceed demand, whereas 86% perceive supply to exceed demand in Retail Property and 95% in the case of the Office Property Market.

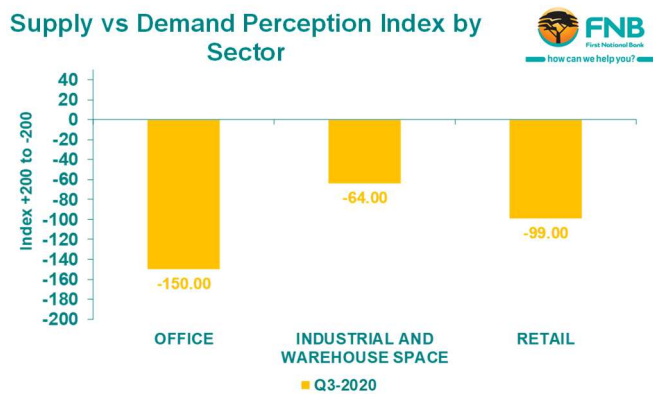




Once again we create an index from the responses, option 1 receiving a score of +2, option 2 a +1 score, option 3 a zero score, option 4 a -1 score and option 5 a -2 score.

The index is thus on a scale of +200 to -200, where +200 would imply 100% of respondents choosing option 1, and -200 meaning a 100% option 5 response.

All 3 sector indices were negative in the 3<sup>rd</sup> quarter survey, with the Industrial Property Market least so on a -64 reading, followed by Retail at -99 and Office recording the weakest -150.



In short, respondents again perceive all 3 markets to be significantly oversupplied, with the Industrial Market believed to be the least oversupplied, followed by Office and then Retail.

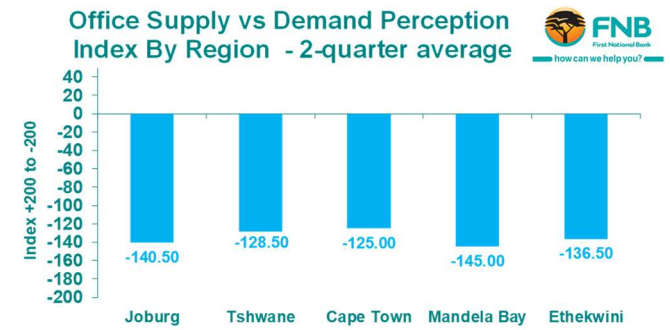
### Provincial Comparisons - Demand vs Supply Strength Perceptions

Due to smaller sample size at individual metro level, we are concerned with volatility in the surveys, and therefore opt to use a 2-quarter average of survey responses for the Demand-Supply Perceptions Indices for individual regions.

Examining the perceived market balance by major metro region, the Office Space survey points to Cape Town having the "least weak" demand vs supply balance, with its index being the least negative -125. The weakest balance is perceived to be in Nelson Mandela Bay with a reading of -145, followed by Greater Johannesburg with a reading of -127.5.

However, there really is little to choose between the

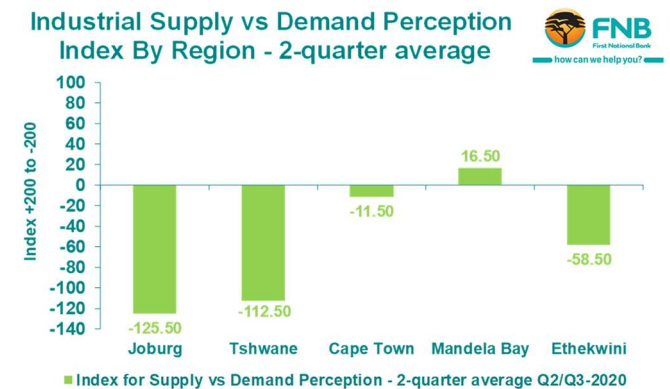
major metro office markets, with brokers in all of them biased strongly in favour of oversupply.



Index for Supply vs Demand Perceptions - 2-quarter average Q2/Q3 2020

In the Industrial Property Market survey, the 3 coastal metros come out relatively stronger than the Gauteng Metros, with Nelson Mandela Bay having a positive reading of +16.5, followed by Cape Town with -11.5 and Ethekwini with -58.5.

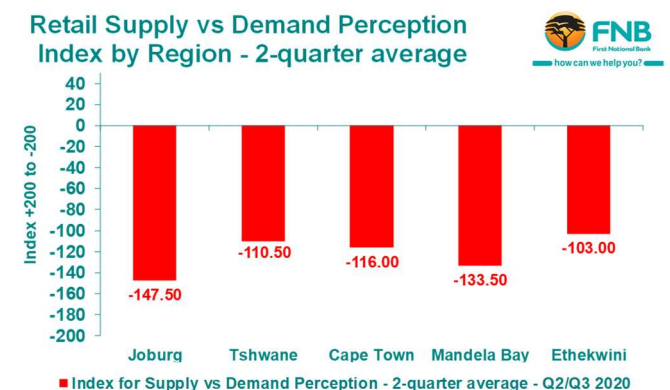
At the weakest end of the Industrial Property Market is Greater Johannesburg, with a negative index reading of -125.5, followed by Tshwane with -112.5.



Index for Supply vs Demand Perception - 2-quarter average Q2/Q3-2020

In the area of Retail Property, the survey points to significant oversupply across all 5 metro regions.

Joburg is the weakest market, with a negative reading of -147.5, followed by Nelson Mandela Bay with -133.5. The "least weak" of the 5 was Ethekwini with a -103 reading, followed by Tshwane's -110.5 and Cape Town's -116.



Index for Supply vs Demand Perception - 2-quarter average - Q2/Q3 2020

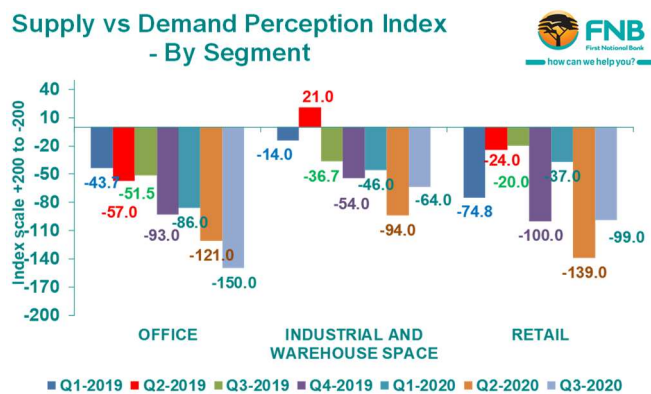
## Conclusion

Although data for estimated average times on the market is proving to possess a degree of volatility, all 3 major commercial markets surveyed showed quarter-on-quarter increases in estimated average time of properties on the market prior to sale, both in the vacant properties and occupied properties categories.

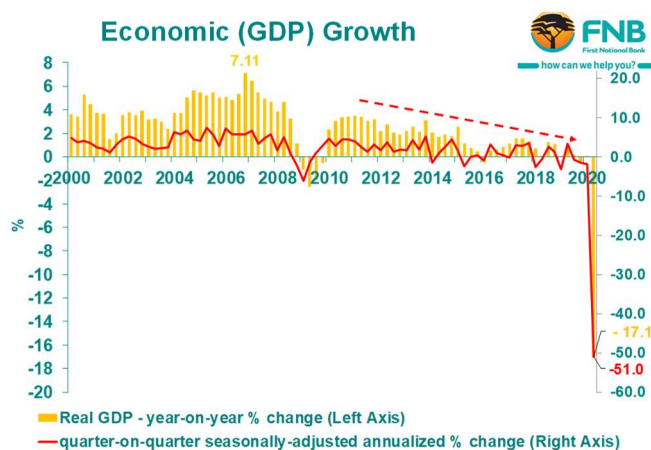
In addition, the follow up question as to perceptions in direction of average time on the market over the previous 6 months shows a very strong bias of the group of respondents towards “increased” average time on market.

Furthermore, the 2<sup>nd</sup> and 3<sup>rd</sup> quarter 2020 surveys, which cover the COVID-19 lockdown period, show a noticeably greater bias by brokers towards “oversupply” in the buying-selling markets in all 3 major property classes compared with quarters prior to the lockdown period. Nevertheless, even in those pre-lockdown quarters, there was a consistent bias towards an “oversupplied” market right from early 2019 when the survey started, albeit a smaller bias than that from when the lockdowns kicked in.

### Supply vs Demand Perception Index - By Segment



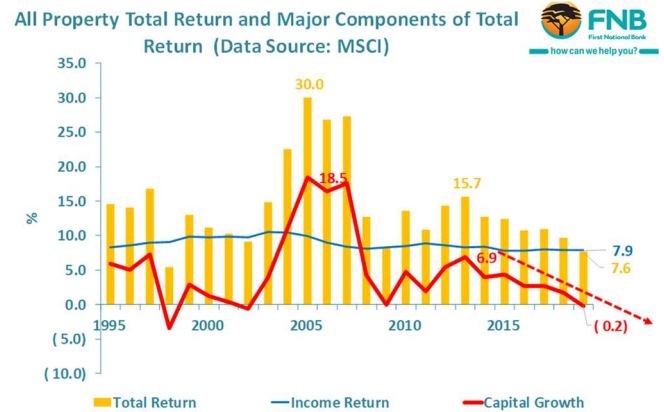
The strong “oversupplied market: bias comes as little surprise, given the depth of South Africa’s economic contraction in the 2<sup>nd</sup> quarter, when Real GDP (Gross Domestic Product) declined by a massive -17.1% year-on-year.



That shock, coming after prior quarters of mild recession, promises to lift vacancy rates in all major property classes further, which would likely dampen

the enthusiasm of a portion of potential property investors for a while.

As it was, MSCI data had already begun to show mildly negative All Property Capital Growth in 2019 to the tune of -0.3%. The far deeper recession that has emerged in 2020 to date would suggest significantly more negative capital growth in 2020 and possibly a further lagged impact in 2021.



And the most recent 2 quarters’ property broker survey responses pointing to a more significantly over-supplied market than before would seemingly support this view.

Therefore, we project negative all property capital growth of between -5% and -10% for 2020.

The sectoral picture that emerges from the survey component pertaining to market balance/strength is one of Industrial Property being the strongest market of the 3 major commercial property classes, i.e. Industrial, Office and Retail, but with all 3 markets showing significant oversupplies of property relative to demand.

Within the Industrial Property Market, it would appear that the 3 coastal metros’ Industrial Property Markets have been outperforming the 2 Gauteng Metros significantly, but in the Office and Retail Markets there is little to choose between regions, all 5 major metro regions being very weak.

Finally, what has been noticeable in many of the survey question responses is that the Office Property Market appears to have surpassed the Retail Property Market in terms of being perceived by the brokers as the weakest of the 3 major markets.

This is not too surprising. Since the start of lockdown, not only has the Office Property Market had the deep recession to contend with, but a high percentage of respondents have pointed to companies planning to downscale on office space requirements, with the success of the forced remote working experiment during lockdown having been highly successful in many ways. The “Zoom Boom” and remote working appears to have overshadowed the online retail challenge to Retail Property, and Office Space looks set to be the “weakest link” in the near term.

# Disclaimer

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