

Demand for retail space on the rise - Q1 2022 FNB Property Broker Survey

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The Q1 2022 FNB Property Broker Survey has pointed to a recent increase in demand for retail space to rent, as perceived by the brokers surveyed.



Source: www.pexels.com

This turnaround for the better, from a retailer and landlord point of view, appears to reflect the normalisation in economic activity and societal interaction in recent times, with Covid-19 fading as a threat, and lockdown regulations having largely disappeared, resulting in greater rates of new business formation and perhaps expansion.

We ask respondents the question as to whether they believe vacancy rates have increased, decreased or remained the same over six months prior?

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 -1 to a “declined” response.

The scale of the index for direction of change in average vacancy rates over the past six 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 past six 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 a “declined” response.

The retail property sector’s index level has recently moved sharply into negative (improving) territory. It had been hovering not far from zero for the prior five quarters, with the prior quarterly reading being slightly in declining territory to the tune of -12.5. Then, in the first quarter of 2022, this reading shot to -72.8, reflecting a widespread broker perception of declining retail vacancy rates, stronger even than the industrial property reading.



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Retail’s improvement largely about the receding Covid-19 threat

A normalisation in economic activity and social interaction, i.e., the way we live, work and play, has been well underway in 2021/early 2022 to date. Lockdown regulations have all but disappeared, and Covid-19 is (rightly or wrongly) perceived as a diminished threat.

During 2021, we saw significant recovery in the economy out of the recession of the 2020 lockdown year, and this appears to be continuing into 2022.

The result seems to be a proliferation of new smaller businesses emerging, demanding considerable additional space.

When asking brokers for their near-term expectations in rental market activity levels, we follow up the question with an open-ended one as to the reasons why they expect what they do. These reasons are often more insightful than the expectation itself, and a strong small business theme comes out of this.

In the retail sector survey, 27.3% of brokers made mention of “growth in the small business segment”, while 18.18% made mention of a surge in “entrepreneurs opening new businesses”, an interesting development at the current time, with consumer fundamentals still far from strong.



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Consumer confidence weak

Admittedly, the FNB-BER Consumer Confidence Index has improved significantly from the extreme low of -33 recorded in the second quarter of 2020, the quarter of “hard lockdowns” related to the Covid-19 pandemic.

But this index still languished in negative territory to the tune of -13 as at the first quarter of 2022, which represents a weakening from the prior quarter’s -9.

The Consumer Confidence Index was launched back in 1982 and has thus seen various highs and lows, including the

tough political transition of the early-1990s with its three-year long recession. And through all of the ups and downs, the long-term average index reading since 1982 is -1.2, meaning that the most recent -13 reading is very weak by historic standards.

What would likely have stalled the muted consumer confidence rebound off the 2020 low? The rebound in confidence began to stall earlier in 2021, while real consumer spending growth was proceeding reasonably up until the end of 2021.

Real household disposable income growth, year-on-year, recorded +3.79% in the final quarter of 2021.

Ignoring the abnormal growth spike in the second quarter of 2021 (due to the abnormally low base from the Q2 2020 lockdowns), this was the highest year-on-year growth rate since the first quarter of 2015, although admittedly still coming off a low 2020 base.

Real household consumption expenditure growth was a bit slower than real disposable income growth at 2.7% year-on-year, with households having been a bit more cautious in recent years, resulting in a mildly elevated savings rate.

But by the final quarter of 2021, it even looked as if the consumer was starting to become slightly “bolder” again, with the household net savings (gross savings less depreciation on fixed assets) or the disposable income ratio having declined to 0.7 from a multi-year high (albeit still very weak) of 1.4 at the end of 2020.

Mild positive for retail sales

A decline in the savings rate is not ideal from a long-term financial stability point of view, especially when savings is already so weak, but it is a mild positive from a short-term retail sales point of view.

The value of household sector net wealth started to recover after the hard lockdown as asset values recovered somewhat. The net wealth/disposable income ratio increasing from 315.2 in the second quarter of 2020 to 377.6 by the end of 2021. So perhaps it was time for households to be a bit more confident and begin to spend more and save less again.

But towards the end of 2021 and heading into 2022, further improvement in the consumer financial situation looked far from assured.

Two key supporting forces of the household sector financial recovery, i.e., low consumer price inflation and low interest rates, had been starting to turn the “wrong” way from the consumer’s short-term financial point of view.

The aggressive 300 basis points’ worth of interest rate cuts early in 2020 in response to an abnormal crisis in the form of Covid-19 saw the household debt-service ratio (the interest payment cost on all household debt expressed as a ratio of total disposable income) at a low of 7.3 by the end of 2021, a low level last seen in 2006 prior to the pre-Global Financial Crisis interest rate hiking cycle.

This low point in the debt-service ratio was despite the household debt-to-disposable income ratio having risen in recent years from an early-2018 low of 62.7 to an end-2021 66.2.



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Inflation risks now loom large

In the household financial data of the SARB, we had already seen consumer price inflation, as measured by the Private

Consumption Expenditure (PCE) Deflator, accelerate from 1.9% year-on-year as at the final quarter of 2020 to 4.8% by the final quarter of 2021.

This acceleration directly curbs real disposable income growth, eating away at an increased portion of the growth in nominal disposable income.

Examining the monthly CPI (Consumer Price Index) measure of inflation, the inflation problem got even worse going into 2022, the most recent February CPI inflation rate sitting at 5.7%.

From a low of 2% year-on-year in May 2021, the 3.7 percentage points rise in CPI inflation by February 2022 takes a very significant bite out of disposable income.

In addition, the onset of SARB interest rate hiking late in 2021, with 3 times 25 basis points' worth of hikes to date as a result of rising CPI inflation, takes an additional bite out of disposable income, with the household sector debt-service ratio likely to have risen in the first quarter of 2022 as a result.

Food price inflation had been troublesome in 2021 already, but it was a surge in global oil prices leading to high domestic petrol price inflation (reflected in the CPI for transport) that was a major driver of the acceleration in overall CPI inflation.

In more recent times, the Russian invasion of Ukraine, along with resultant boycotts and sanctions, has significantly increased risks of global and thus domestic food price inflation pressures, global energy price pressures, and broader global supply chain disruption pressures.

And even more recently, last week, the severe KZN floods not only caused major damage to peoples' homes and property, but also to businesses and transport, including disruptions to goods flows through Durban, SA's biggest port. Any supply chain disruptions from this could threaten the inflation environment still further.

Household income growth projected significantly slower in 2022

FNB's real household disposable income growth forecast is for a slowing from 5.9% in 2021 to 2.1% this year, in part due to a higher inflation forecast and gradually rising interest rates this year, and in part due to higher income base effects in 2021.

But disposable income growth in 2022 could also be under pressure from a very weak employment situation. Last year's resurgence in disposable income growth had much to do with a major resurgence in income from investments following the 2020 dip, and less to do with any meaningful employment growth. By the final quarter of 2021, total employment was still in year-on-year decline to the tune of -3.2%, and was still a massive -11.4% down on the fourth quarter of 2019.

One positive to partly offset this employment negative has been an extension of the Social Relief of Distress Grant, a special relief grant started up during the Covid-19 lockdown period. But this grant can only go so far and will be hard pressed to offset employment, inflation and interest rate hiking negatives.

Conclusion

Although retail property performance through 2021 to early-2022 appeared to be improving steadily, as expected following the relaxation of Covid-19 lockdowns, weak consumer fundamentals pose significant questions around the sustainability of this retail property recovery.

Consumer confidence remains very weak, and both consumer inflation, income and inflation risks are in abundance.

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