Tough times for retail property as April sales show continued declining trend

By John Loos

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April retail sales, released on Wednesday, 14 June by Stats SA, showed another month of year-on-year decline in real inflation-adjusted terms. Actual retail sales value for April rose by 6.5% year-on-year, but when adjusted for high retail price inflation into "real" terms, sales declined by -1.6% year-on-year, following on a revised -1.5% year-on-year decline in March, the fifth consecutive monthly year-on-year in real retail sales.

Source: Igor Stepovik © 123RF.com

A key cause of weak real retail sales has been the sharp surge in retail price inflation from only 3.8% year-on-year in March 2022 to 8.5% in March 2023, before slowing only slightly to 8.2% in April 2023. But it is also about the underlying state of the economy, a growth slowdown being caused by a combination of high inflation and rising interest rates, a global economic slowdown affecting South Africa via its trade with the world, and heightened electricity load shedding disruptions since late-2022.

While interest rate hikes have contributed to a slower economy, which slows total household income growth, they also contribute directly to a consumer purchasing power constraint because increased cost of servicing debt means less disposable income available for cash purchase of consumer goods and services.

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Escalating electricity costs

The decline in real retail sales is only one of quite a few negatives for the retail property sector. Tenants and landlords together are required to absorb escalating electricity costs too. Not only are electricity tariff hikes continuing at above general inflation rates, but the erratic power supply necessitates costly power alternatives to keep stores running, and the high costs of diesel for generators have been widely reported by food and beverage retailers especially. In addition, we have had 475 basis points worth of interest rate hiking to date, exerting pressure on landlords, tenants and consumers alike.

The real sales decline comes at a time when retail property tenants have already been financially constrained for quite some time. Since Covid-19 lockdowns commenced, credit bureau TPN reported retail landlords as having the lowest percentage of tenants in good standing with their rental payments when compared with the office and industrial property sectors.

By early-2022, TPN reported a still-lowly 62% of retail tenants in good standing, and renewed decline in the percentage starting after a partial post-lockdown recovery. In short, retail property tenants experience significant financial pressure, and declining real retail sales are an additional source of pressure on top of higher interest rates.

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Weakening in retail property market

And so, not surprisingly, FNB's Property Broker Survey has begun to point to a weakening in the retail property market, and we would expect to see retail property vacancy rates begin to rise once more, rental growth to slow, and with it a slower year for net operating income growth in 2023.

While MSCI data had reported some decline in the elevated national retail property vacancy rate in 2021 and 2022, recording 4.7% in 2022 (down from a 5.7% multi-year high in 2020), we expect a renewed rise in the national retail vacancy rate in 2023 as tenant incomes come under greater pressure and financial pressures escalate.

ABOUT JOHN LOOS

John Loos is Property Sector Strategist: FNB Commercial Property Finance
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