TPN Credit Bureau's Q3 Commercial Rental Monitor shows stall in tenant payment performance

According to TPN Credit Bureau's latest Commercial Rental Monitor, commercial tenant rental payment recovery stalled in Q3 of 2021, with a slight decline in the percentage of tenants in good standing. This comes on the back of four prior quarters of strong recovery out of 2020's hard lockdowns and deep recession.

Source: Mchal Bednarek © 123RF.com

TPN's data reveals that in the second quarter of 2020, only 50.36% of commercial tenants were in good standing with their landlords. The percentage of total tenants that are in good standing with their landlords with regards to rental payments – those that are either fully paid up, paid late or in a grace period - decreased slightly from 67.12% in the second quarter of 2021 to 66.69% in the third quarter.

This percentage continues to remain well below the pre-lockdown level of 77.85% recorded in the first quarter of 2020, and even further below last decade's high of 83.56% in 2012 which was achieved before the onset of a multi-year economic growth stagnation.

Significant portion did make partial payments

Of the tenants that are not in good standing, a significant portion (22.36%) did make partial payments, while a lesser 10.96% did not pay at all. The partial payments percentage in the third quarter represents a slight decline from the 22.53% of the previous quarter. The percentage that did not pay at all increased slightly from the 10.35% of the second quarter, but was still significantly down on the 19.73% high of the second quarter of 2020.

After four consecutive quarters of growth in real GDP following the second quarter 2020 ‘hard lockdown dip’, the third quarter of 2021 saw a quarter-on-quarter decline in seasonally adjusted GDP to the tune of -1.5%, reveals John Loos, commercial property economist at FNB and the guest contributor of the TPN Commercial Monitor for the third quarter of 2021.

“This quarterly decline had much to do with a sharp drop in agriculture GDP, a sector that fared very well through the 2020 recession. A large -5.5% drop in retail and wholesale trade, catering and accommodation may also be reflecting the retail-related unrest and looting impact in KwaZulu-Natal and Gauteng in that quarter, as well as some impact of the third Covid-19 wave in tourism and accommodation,” he says.

6 commercial property trends to watch out for in 2022
15 Dec 2021

Strong correlation to economic growth

Tenant rental payment performance has a strong correlation to economic growth. Economic indicators in the third quarter point towards South Africa’s economic recovery ‘stalling’ at levels weaker than pre-lockdown levels.

Loos says the decline in third quarter GDP may explain the small drop in commercial tenants in good standing. “The fact that there has only been a ‘partial’ recovery in the economy since the end of hard lockdown, with GDP still noticeably lower than pre-lockdown levels, goes some way towards explaining why the tenants in good standing percentage remains significantly below 2019 pre-lockdown levels. Ongoing financial pressure in the economy continues to reflect in weak business confidence.

The RMB-BER Business Confidence Index rose from a very weak 5 reading in the second quarter of 2020 (on a scale of 0 to 100) to 50 by the second quarter of 2021, but has since receded to a level of 43 in the latter half of 2021.

Payment performance data up to September showed a lack of further recovery in recent months in all three major commercial property classes. Loos says a meaningful improvement in tenant performance in the near term is not expected, particularly given gradually rising interest rates.

Rate hike

The first rate hike was announced in November 2021 in response to elevated consumer inflation which is currently around 5%. Higher interest rates not only increase the cost of debt repayment for many businesses, but also keeps economic growth and the business environment constrained.

Economic indicators in all three major commercial property classes suggest that tenant performance should still be battling at below pre-Covid-19 levels. This is borne out by quarterly gross value added (GVA) data, along with relevant employment data, which reveals that tenant performance continues to remain weaker than pre-lockdown levels, points out Loos.

“Even the economic sectors underpinning the relative outperforming property class, industrial property, are significantly weaker than 2019 pre-Covid-19 levels. The manufacturing sector and economy-wide inventory levels, are key economic drivers of demand for industrial space, along with financial performance of industrial tenants. The third quarter seasonally-adjusted real GVA for the manufacturing sector declined from the previous quarter, and despite a significant recovery following the 2020 hard lockdown remains -11.1% down on the multi-year high of the final quarter of 2018."

The part of the economy related to the retail property class appears similarly weak. Despite a significant recovery in the retail and wholesale trade, catering and accommodation sector since the 2020 hard lockdown, this sector's GVA remains -10.2% down on the end-2018 high.

Air quality an important differentiator for commercial property in 2022

SFI Group 8 Dec 2021

Retail sector's tenant population remains weakest performer

According to the TPN Commercial Monitor, the retail property sector's tenant population was the most severely impacted by lockdowns and remains the weakest performer of the of the three major property sectors.

Office tenants, on the other hand, are the outperformer of the major commercial property sectors. "In the office market space, employment trends are a major driver of office space demand and performance," explains Loos. "For four consecutive quarters up until the first quarter of 2021, this sector's employment number dropped year-on-year by more than -7%. It was only in the second quarter of 2021 that the rate began to stabilise near to zero. However, the drop in employment reflects a major financial impact on this sector, and would in all likelihood mean that the office tenant population has experienced a significant economic and financial knock."

While the office market currently represents the best performing tenants, this sector of the market remains the most troubled with a rising vacancy rate as a result of tenants downscaling their office space needs.

The smaller storage sector still significantly outperforms the big three sectors.

Given the current environment, it is perhaps not surprising that the major property classes' tenants have battled to make any progress recently in terms of improving their rental payment performance with only two-thirds of tenants in good standing with landlords.

The office sector's 71% of tenants in good standing in September 2021 remains below the 75% of tenants in good standing in March 2020 just prior to lockdown. Similarly, the retail sector's 64% of tenants in good standing remains well below the 72% of tenants in good standing in March 2020.

Shift to greater online retail

The industrial sector, however, recorded 70% of tenants in good standing, which is back at the pre-lockdown level of 70% in February 2020. This may be partly the result of this sector's rentals being the most affordable of the three property classes, while also perhaps benefiting from the structural change towards greater online retail.

While manufacturing is weak and economy-wide inventories low, the shift towards greater online retail at the partial expense of in-store retail may have been the boost for industrial property demand, and for some tenants' performance. Although its tenant performance is not strong, it is back to its pre-Covid 19 levels, unlike the other two sectors and is perceived to have a declining vacancy rate.