Property brokers still perceive retail, office markets to be oversupplied - FNB survey

By John Loos

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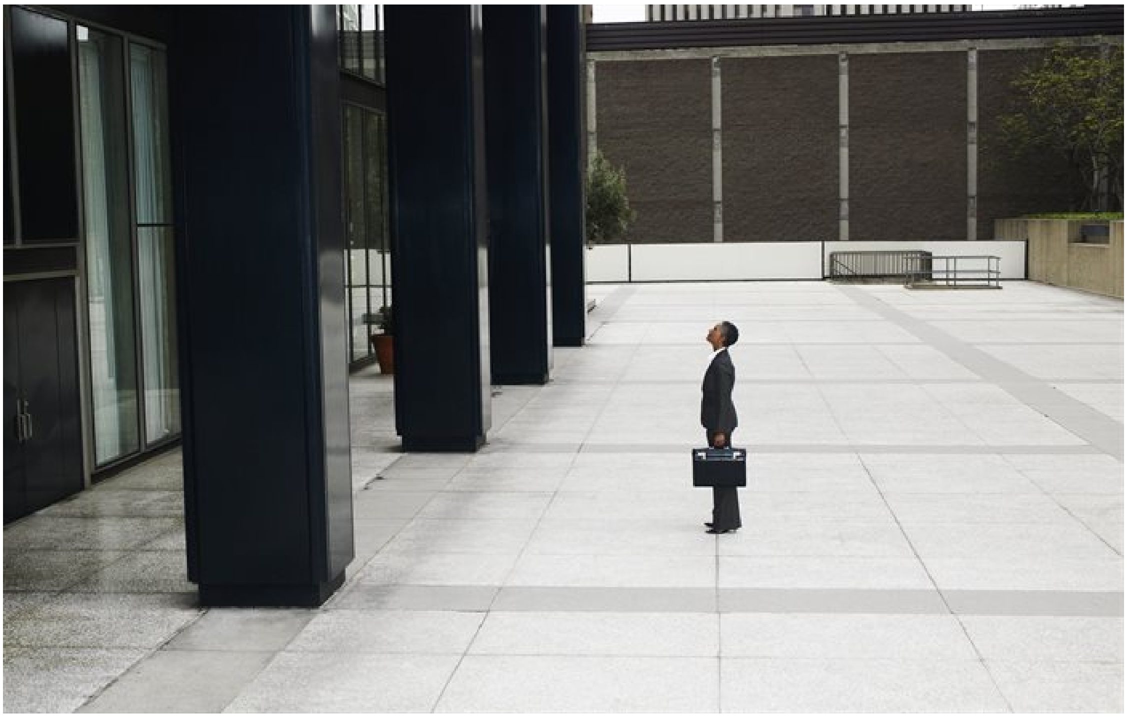
In the *FNB Commercial Property Broker Survey - Market Balance Q3 2022* report, we deal with questions relating to the perceived balance/imbalance between demand and supply of properties being transacted in the main markets. These questions include estimates of average times of properties on the market prior to sale, as well as perceptions of whether demand exceeds supply or vice versa.



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Average time on the market is only still perceived to be “noticeably” in decline in the industrial market, but even the strength of that market’s decline is perceived to be fading.

From our residential market survey, we found the movement over time in the estimated average time of properties on the market prior to sale to be 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 signalling 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 three main property classes, namely office, industrial and retail, and splitting it further by “vacant properties” vs “occupied properties”.

Industrial property market perceived to be strongest

The relative picture between the three major property sectors is still one where brokers perceive the industrial property market to be the strongest of the three classes, with an average time on the market for occupied industrial properties of 15.43 weeks being quicker than the 20.26 weeks in the case of retail and 25.25 weeks for office space.

Vacant industrial properties, too, averaged the shortest average time on the market of the three segments to the tune of 15.63 weeks, compared to 20.63 weeks in the case of retail space and 26.28 weeks in the case of office properties, in the third quarter 2022 survey.

In the FNB Commercial Property Broker Survey, it is more difficult to estimate average time on the market than is the case in the FNB Residential Property Estate Agent Survey. This is due to a far smaller sample size in the number of transactions, so from quarter to quarter, the different groups of respondents do perceive average time quite differently, and the data moves can be more volatile.

However, in an easier-to-answer follow-up question as to whether the past six months has seen average time of properties on the market increase, decrease or remain unchanged, brokers appear better able to assess the direction in average time as opposed to the actual average time itself. On average, it is only the industrial property market where brokers have a noticeable bias towards “diminishing average time on the market”, and even that bias has been fading.

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Perceptions regarding the direction in “average time on market”

The 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 over the six months prior, i.e., since Q1 2022.

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 time on the market 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 time on the market over the past six months (market weakening) and -100 would imply 100% of respondents perceiving a decline, while a zero level would mean that those providing an “increased” response is equal to those responding with “decline”.

Two of the three property classes returned a negative number, implying that the aggregate of responses in these sectors points towards a shortening (market balance strengthening) in average time of properties on the market compared to six months prior.

Of these two, however, only the industrial market’s reading was “significantly negative”.

Retail index

The retail index recorded a slightly negative -7.40, implying that on average, 7.40 percentage points more of the respondents perceived a diminished average time on the market over the prior six months than those respondents perceiving an increase in time on the market. We don't regard this bias towards declining time on market as significant.

Industrial index

However, we would perceive the industrial property market's reading to be more meaningful. It showed the strongest reading, a -19.05. However, this is the second consecutive quarter of a diminishing in the magnitude of this negative reading, suggesting that this market is running out of steam in terms of its pace of strengthening, having had a more significantly negative reading of -41.54 as at the first quarter of 2022. This was, however, the seventh consecutive quarter in which brokers indicated a bias towards declining average time on the market, thus pointing to a very significant improvement in the demand-supply balance in this market following the easing of the 2020 lockdowns.

Office index

The office index showed a slight positive (strongest) reading of +7.46 in the third quarter, after a slightly negative -8.82 in the second quarter. Neither of these past two quarters' readings are seen significantly negative or positive, and we would not regard either as "convincing" or "significant" enough to conclude that there is a clear change in average time on the market in the office market.

While the office market's direction is somewhat unclear at the moment, this doesn't change the office property market being perceived to be by a significant margin the weakest property market with the longest average time on the market.

While actual estimates of average time of properties on the market are 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 six months has shown less volatility and is thus likely a clearer indication of trends over the history of the survey.

Recently, only the industrial market's reading points to convincing evidence of a direction - that direction being a further decline in average time on the market.

Industrial property's perceived trend towards "shortening time" on the market has been particularly convincing over the past year-and-a-half. The office and retail property markets have lagged industrial considerably, however, reflecting not only the weak economic times in which South Africa still finds itself, but also the key structural challenges to both the retail and office property classes. The former market is being challenged by greater online retail along with a financially constrained consumer, and the latter has the challenge of greater levels of remote work along with improved efficiency in use of office space through hoteling of desk space.

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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).

The office and retail property classes have significantly greater portion of respondents still pointing to "supply exceeding demand", either "somewhat" or "far", compared to those pointing to demand exceeding supply.

The industrial market returns a response where respondents on average see this market as nearest to balance between demand and supply, i.e., 44.4% perceiving demand to exceed supply versus 41.3% perceiving supply exceeding demand (14.39% perceiving a balance), demand thus slightly exceeding supply. Sixty-three percent perceive supply to exceed demand in retail property and a massive 85.1% in the case of the office property market.

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.

In the Q3 2022 survey, the industrial property market returned a slightly positive +11.1 reading, which would imply that it is very near to balanced, with demand slightly exceeding supply. This is followed by retail at a still very significant negative -66.67 and office recording the weakest -129.86.

In short, respondents as a group strongly perceive the retail and office markets to be oversupplied, but the industrial market very slightly undersupplied, not far from balanced.

The market balance readings in all three property classes have strengthened from the second quarter survey, but with sales activity ratings having declined of late, the pace of strengthening in demand vs supply may be set to slow or even stall in this recently more pressured economic and interest rate environment.

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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 two-quarter average of survey responses for the demand-supply perceptions indices for individual regions.

Examining the perceived market balance by major metro region for the winter quarters of 2022, the office space survey points to Nelson Mandela Bay having the weakest demand vs supply balance, with its index being the most negative at -169.05. We should caution that this metro has the smallest survey sample size. It could thus experience more volatile movements from quarter to quarter.

Of the bigger metro regions, Greater Johannesburg still has the weakest demand vs supply balance by a significant margin, with its index recording a negative -159.52. This reading is significantly weaker than Tshwane (-124.388) and eThekwini (-144.55), with Cape Town being the “least weak” of all the regions with a negative reading of -97.14.

In the industrial market, Greater Johannesburg is the weakest market, with a negative reading of -104.54, followed by Tshwane with +42.72. The strongest of the five were the three coastal metros, eThekwini with a slight +6.94 positive reading, Nelson Mandela Bay with +40.63 and City of Cape Town the strongest with +67.5.

In the area of retail property, the survey also points to the weakest demand-supply balance being in the Greater Johannesburg region, while Cape Town is the strongest.

Greater Johannesburg showed a negative reading of -172.31, followed by eThekwini with -91.66 and Nelson Mandela Bay with -84.28. Tshwane was next with -60.72, with Cape Town the “least weak” -22.16.

Conclusion

Perceptions regarding demand relative to supply remain weak in both the office and retail markets, but not in the industrial property market, which is perceived as almost in balance.

In recent quarters' surveys, there are some indications that the pace of market strengthening has begun to slow.

In the third quarter 2022 survey the bias towards a decline in average time of properties on the market had slowed noticeably compared with the first quarter of 2022, and had even shown a slight bias towards "increased time on the market" in the case of office space.

Early signs of a loss of strengthening momentum in the average time on market trends is believed to be the result of an apparent economic weakening in recent months, global and local economic pressures emanating notably from high energy prices, broader inflation surges and rising interest rates in response.

But in terms of demand vs supply perceptions, we have yet to see any sign of an end to a strengthening trend in this market balance.

However, both the retail and office property markets remain perceived as very significantly oversupplied, with only the industrial property market showing a slight bias towards demand being stronger than supply.

The industrial property market remains the strongest one in terms of demand-supply balance, followed by retail, with the office market being the weakest. The office market has the most significant challenges. Finance, real estate and business services sector employment numbers are showing very little growth, and this sector's employment trends are key drivers of demand for office space.

'Structural' changes

Then there are also the key "structural" changes to the way we work and manage office use. Greater levels of remote working compared to pre-lockdown levels are believed to be constraining demand for space, while the more effective management of desk space via "hoteling" of such desk space could also lead to many companies having less office space needs in future.

At the strong end of the spectrum, industrial property benefits from a gearing up for greater online retail and all the warehousing and logistics requirements that this brings. However, this sector too may have some "constraining forces" arriving in the form of a weak economy with less need for inventory build-up, while the strongly influential manufacturing sector has been in contraction in recent times. These are key macro drivers of demand for industrial space.

Most positive sentiment towards Western Cape

At a major metro region level, the two winter quarters of 2022 reflected what has been widely spoken about for some time, i.e., that both business and household sentiment is the most positive in and towards the Western Cape region (as seen in strong skilled labour semigration numbers to that region). This has seen it appearing to seemingly becoming an economic and property market outperformer.

The Western Cape returned the strongest perceived demand-supply balances in all three major commercial property markets in the winter quarters of 2022.

The Greater Joburg region returned the weakest market balances in the industrial and retail markets, while being the second weakest in the office market.

ABOUT JOHN LOOS

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