FNB sees flat commercial property market in 2012

The signs of economic weakness and rising vacancies point to a flat commercial property market in 2012.

John Loos, household sector and property strategist at FNB, notes that recently FNB's All Commercial Property Performance Indices have started to point to weakening performance ahead.

"The Q3 did see some rise in the All Commercial Property average price growth rate. However, the same quarter also saw a very slight rise in the average capitalisation rate, but more significantly the FNB All Commercial Vacancy Rate Index had been rising noticeably for two consecutive quarters, from an index level of 93.6 as at the Q1 of 2011 to 97.7 by 3Q, the highest vacancy index reading since the Q4 of 2005," he said.

Should this rising vacancy rate trend continue, it could be expected to dampen rental income prospects and lead to a more noticeable rise in capitalisation rates, which in turn could be expected to exert downward pressure on price growth.

Global growth: 2012 set to be weaker than 2011

Examining global leading business cycle indicators recently, along with broadly weakening industrial production, 2012 looks set to be a weaker global economic growth year than 2011.

The SARB Leading Business Cycle Indicator would suggest this to be the case domestically too. On a month-on-month basis, the Indicator has been in decline for the past three months, he noted.

"Not only would a weakening economy be expected to exert upward pressure on commercial vacancies, but concerns regarding global economic prospects also tend to exert upward pressure on long-bond yields of emerging economies such as South Africa, as investors flee for (somewhat dubious) "safe havens" in the developed world," he added.

"Indeed, SA Government long-bond yields are currently off their lows of early September, partly reflective of growing concerns regarding global economic prospects and the impact on the likes of SA. This, along with higher vacancies, leads us to anticipate an increase in capitalisation rates in 2012, which in turn could exert downward pressure on real commercial property values.

A challenging 2012

"We believe that a further sign of possible looming commercial property price weakness is the slowing in year-on-year price growth in the residential market in recent months," he added.

While commercial property is not believed to be as over-priced as residential, and its yields are estimated to be higher than residential, it is subject to the same interest rate and economic trends as residential, and thus generally tracks the direction of residential price growth trends, with something of a lag.

"Therefore, economic indications are that commercial property, too, could be in for a challenging year in 2012," he said.

After a mini-recovery in 2010, the Investment Property Databank (IPD) has already reported declining commercial property returns in the 1st half of 2011.

During this expected period of weakness, if one could generalise, it would appear that prime properties/areas look set to hold up better than the "less illustrious" ones.

Already, the IPD has reported a significantly more rapid rise in office vacancies of Central Business Districts (18.1% in H1 of 2011) compared to de-centralised nodes (10.4%).

Similarly, in the case of retail, it has been the smaller community (8.1%) and neighbourhood (10.2%) shopping centres that have seen more noticeable rises in vacancy rates, while regional (3.2%) and super-regional (2.4%) shopping centres remained at far lower vacancy rates in the 1st half of this year.