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PROPERTY INSIGHTS

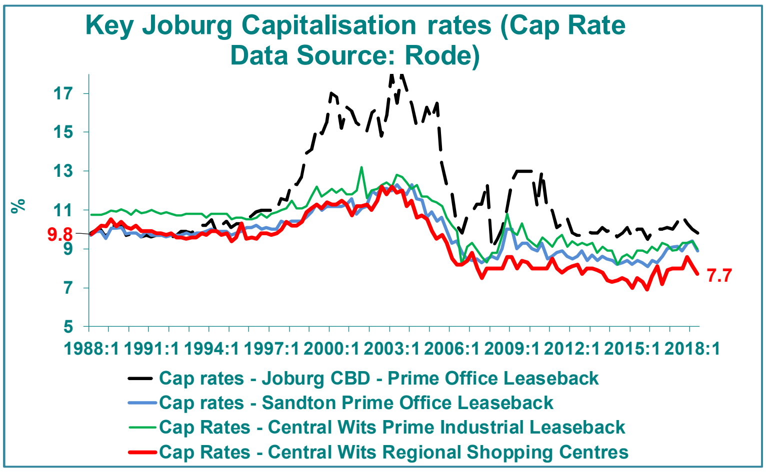
MAJOR PROPERTY SUB-SECTOR LONG TERM PERFORMANCES

Which major property sector has performed best over the past 2 to 3 decades? Retail Property, it appears, by a significant margin

8 October 2017

While the Residential Property Sector caught much of the attention during its "bubble' period from around 2000 to 2008, and was regarded as the "expensive" property category for a while thereafter, it appears to be the Retail Property Sector that has been the "outperformer" of the major property sub-sectors over a longer period spanning 2 to 3 decades, and especially in the most recent decade or so. In the process, this sector has become relatively "expensive" in every way, great from an investor return point of view, but posing a risk in terms of lifting the incentive for more retailers to look for more cost-effective alternatives.

A LONG PERIOD OF CONSUMER STRENGTH HAS SEEN RETAIL PROPERTY BEING THE TOP PERFORMING PROPERTY SECTOR OVER THE PAST 20 TO 30 YEARS



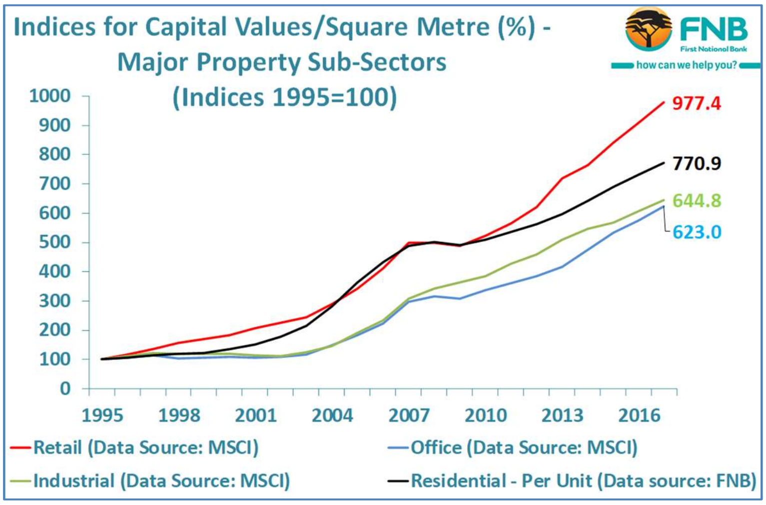
We have become used to certain categories of retail property experiencing lower capitalization rates than any other major property categories, most notably the larger categories of shopping centre such as regional shopping centres.. It wasn't always that way. Back when Rode's Capitalisation Rate (or "Cap Rate") data started in the late 1980s, Witwatersrand Regional Shopping Centre Cap Rates averaged 9.8% at the start of 1988, over 30 years ago. By comparison, Joburg CBD A Grade Office Space also had an average cap rate of 9.8%, and Sandton A-Grade Space a slightly lower average of 9.7%. Retail Property was thus not the clearly favoured property class in the Johannesburg region, and the same was true for other major regions such as Cape Town and Durban.

Over the past 3 decades or so, however, Retail Property has outperformed the Industrial and Office Property Segment, and more recently even Residential, it would appear.

By the 2nd quarter of 2018, Wits Regional Shopping Centre Cap Rates were 7.7%, according to Rode surveys, well below Sandton A-Grade Office Leaseback's 8.9%, Central Wits Prime Industrial's 9%, and well-ahead of the now-less favoured Joburg "CBD's A-Grade Office Sector's 9.8%. Even Witwatersrand Community Shopping Centre Capitalisation Rates, at 8% in the 2nd quarter of 2018, are lower than both Sandton and Joburg CBD A-Grade Office Space Cap rates today, which was not the case 30 years ago.

Viewing performance over the past 22 years

More recently, from 1995, we have MSCI data, which provides actual estimates of capital values for the major Commercial Property categories. Taking a view of Commercial Property Sector performance over the entire 22-year period from 1996 to 2017, using this MSCI data, the Retail Property Sector appears to run far stronger than the other major property sectors.

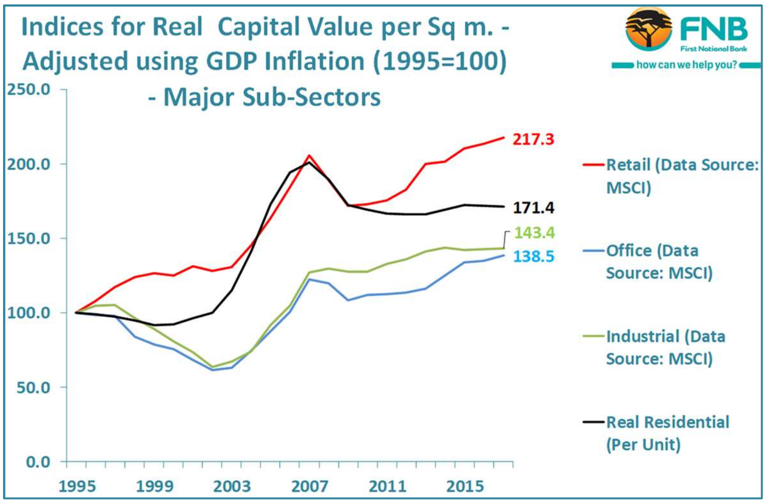


Viewing the Average Capital Value Per Square Metre by property segments, Retail Property's cumulative rise has far exceeded that of the Office and Industrial Segments over the past 22 years.

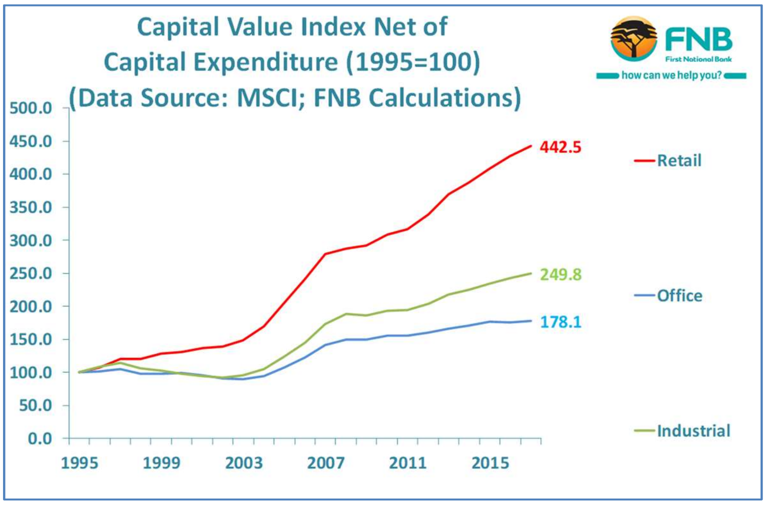
Using 1995 as the base year, the Average Capital Value Per Square Metre for Retail Property is estimated to have risen by a massive 877.4% over the 22-year period 1996 to 2017.

By comparison, the Industrial and Warehouse Sector had a more modest increase of 544.8%, and Office Space 523.0%.

Although estimates of average house price growth are not exactly comparable, because they are done on a per unit basis instead of a per square metre basis, it would appear that Retail Property has even outperformed Residential Property over 2 decades. Our FNB Long Term House Price Index has inflated by a lesser 670.0%, the Residential Market having run "neck and neck" with Retail capital growth up to 2008, but "underperforming" thereafter

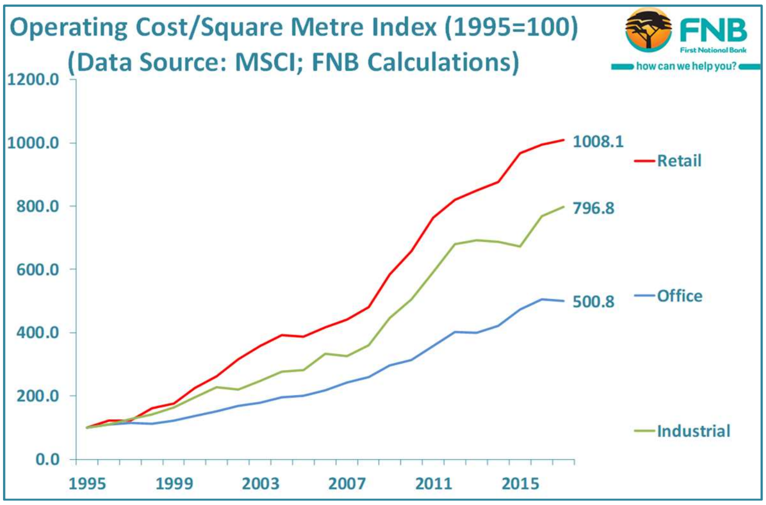


In real terms, using economy-wide price inflation (as measured by the GDP Deflator) to adjust for "general inflation" in the economy, Retail Property's rise in Average Capital Value per Square Metre was an impressive 117.3% from 1996 to 2007, Residential 71.4%, Industrial Property 43.4% and Office Space 38.5%.



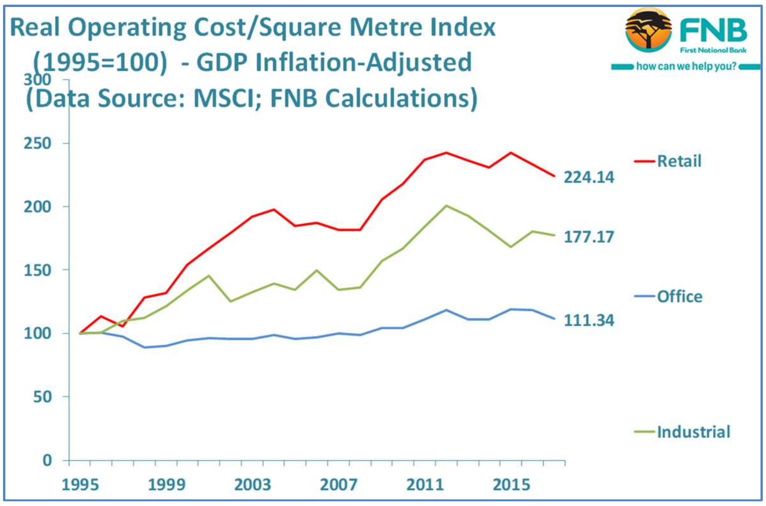
It may be argued that the true performance of a property class should be measured using data which estimates capital growth net of capital expenditure on the properties over the period.

Even by this measure (not possible to do for residential given the data available), Retail Property strongly outperformed, with cumulative capital growth net of capital expenditure totaling 342.5% from 1996 to 2017, compared to 149.8% in the case of Industrial Property and 78.1% for Office Space.

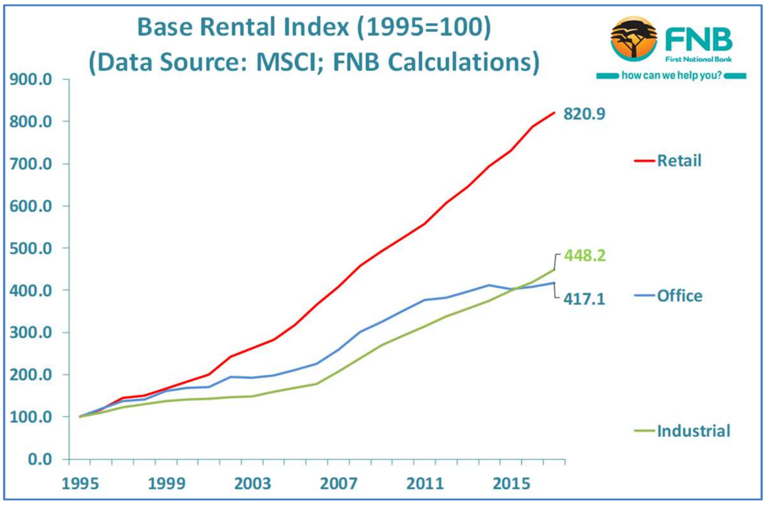


In ways other than capital value, Retail Property has also seen its affordability deteriorate significantly more than the other 2 major commercial property classes.

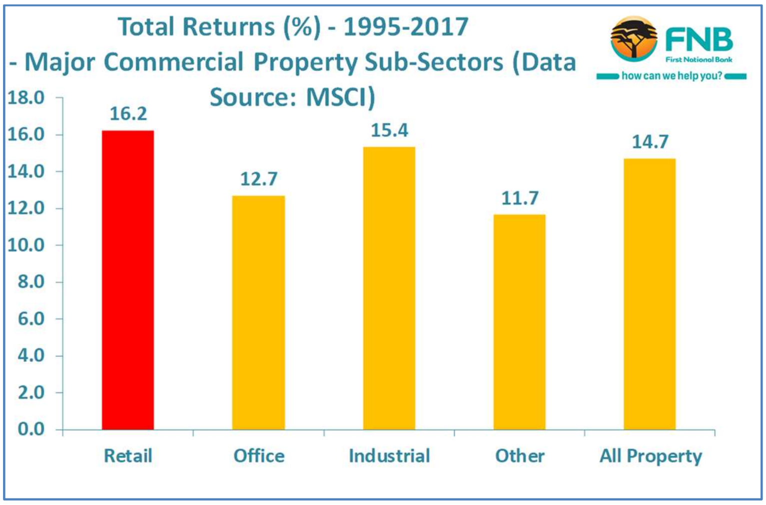
Its Operating Cost/Square Metre has risen cumulatively by 908.1% from 1996 to 2017, compared to Industrial Property's 696.8% and Offices' 400.8% over the same period.



Most important, is that this cumulative operating cost inflation has far outpaced economy-wide inflation as measured using a GDP Deflator. Therefore, even in real terms, Retail Operating Cost/Square Metre as at 2017 was a massive 124.14% above its 1995 level (albeit starting to moderate), whereas Industrial was a more modest 77.17% higher and Office Space a marginal 11.34% higher. Sharp Municipal rates and Electricity Tariffs increases have been key contributors here.



The strong capital expenditure and operating cost growth could be sustained over the period due to a high level of "pricing power" of shopping centres, as reflected in the cumulative inflation rate in retail base rentals to the tune of 720.9% over the 22 year period, compared to 348.2% for Industrial Property and 317.1% for Office Space.



The cumulative result of this strength in Retail Property's "pricing power" over the past 22 years was that it was had the top average per annum total return of all the Commercial Property Sectors over the 1996 to 2017 period, measuring an average annual 16.2% total return, followed by Industrial Property's 15.4% and Office Property's 12.7%.

CONCLUSION

In short, for a few years following the end of the pre-2008 property boom, there was a perception amongst some that it was the Residential Property Market that had "overshot" the mark the most during those prior boom years, while Commercial Property remained relatively "cheap". That may still be so in the case of Office Property, and even to a lesser extent Industrial Property. However, Retail Property began to outpace Residential Property significantly after the 2008/9 recession, and appears to have become SA's "expensive" property category.

Given the data available, the Retail Property Sector appears to have been the strongest "cumulative" performer of the 3 major Commercial Property Sectors over the past 22 years from 1996 to 2017, according to MSCI historic data, and possibly even over the past 30 years judging by Rode's Cap Rate data.

It has achieved superior capital growth even excluding all the capital expenditure on properties over the years.

The Retail Sector's Operating Cost per square metre has also outpaced the others, as well as far outpacing general economy-wide price inflation. The Sector has been able to recoup much of its capex and rise in operating costs through its recoveries as well as having the strongest rental inflation rate over the 2-decade period too.

However, having entered a more stagnant economic period in recent years, the big question is whether this general affordability deterioration in the Retail Property Sector hastens the search for cheaper alternatives for retailers, notably online retail as well as greater use of Warehouse Property?

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