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FNB Commercial Property Finance

Property Insights

Residential Rental tenant performance deterioration – how low can it go? How long can it last?

Basing our expectations on the 2008/9 recession impact, we expect a very significant deterioration in residential rental tenant payment performance for this year, with a recession more severe than that of 2008/9 expected in 2020. While the tenant performance deterioration in response to an economic shock can be swift, the full recovery process thereafter can take a lot longer. We also anticipate some average rental through 2020 and 2021.

Severe recession in 2020 expected to have a severe impact on tenant payment performance.

During the Corona Crisis-related lockdowns, many residential rental tenants would have seen their incomes decline sharply, and in certain instances even drop to zero.

The official Coronavirus-related lockdowns add an "abnormal" component to the current recession, "normal" being where economic cyclical pressures such as the global economy or rising interest rates periodically drive the domestic economy into recession. However, there is a very "normal" component to this recession too, which was playing itself out before Corona (SA was already in recession from the 2nd half of 2019), and will likely play out for a while after domestic lock downs have ended. In other words, even as lock down hopefully is phased out, its aftermath can expected to be felt for some time, as the financially weakened Household and Business Sectors slowly work their way back to improved financial strength, something that can be expected in any significant recession.

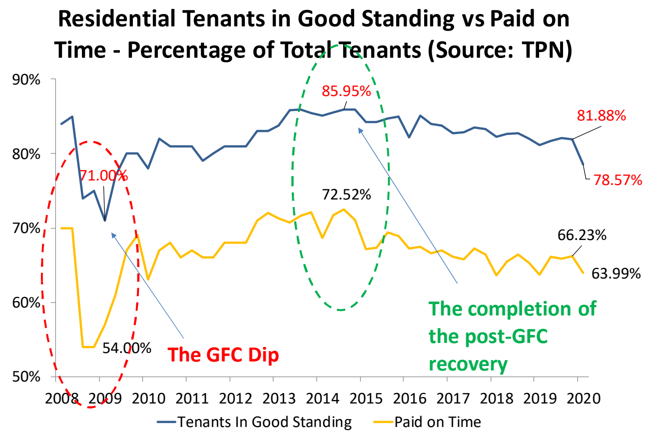
So "how low does it go" for residential tenant payment performance, and how long does it last? This is tough to answer, given that predicting the full magnitude of the current recession unfolding is near impossible, much depending on how successfully the Corona pandemic is contained both locally and globally, which will then determine how fast our economic life can return to being 100% normal.

However, there is enough evidence to suggest that we are in a deep recession this year, looking likely to be significant more severe than the -1.5% GDP (Gross Domestic Product) contraction of 2009 (in what was called the Global Financial Crisis…or GFC for short).

FNB forecasts a -4.5% GDP contraction, while certain other forecasters are more pessimistic.

There appears to be a good link between economic performance and residential tenant payment performance, as one would expect, given the economy's influence on employment and income.

So, taking the 2008/9 recession period as a benchmark for starters, and using TPN tenant performance data, we observed that a sharp dip in the percentage of tenants "in good standing" with their landlords co-incided with that recession early in 2009. From around 85% early in 2008, the percentage of tenants in good standing dropped sharply to 71% by the 1st quarter of 2009, while the percentage that paid on time dropped from 70% early in 2008 to 54% by the end of 2008.

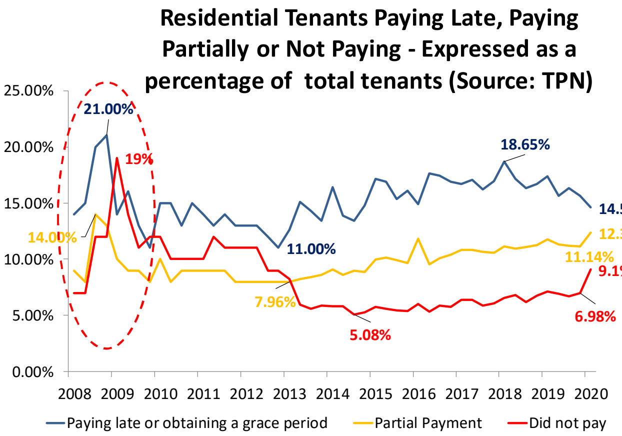


The tenants "in good standing" percentage is significantly higher than the "paid on time" percentage at any time due to the former number including the group of tenants that received a grace period for payment from their landlords.

It would thus appear that the rental market is highly sensitive to economic cycles and sharp shocks.

Viewing the 2008/9 recession tenant performance dip in a little more detail, we see that the percentages of tenants that "did not pay" as well as the percentage receiving a grace period from landlords spiked quite sharply around that time.

The Grace period percentage increased quite significantly, from 14% of total tenants early in 2008 to 21% of total tenants by the end of that year.



So if a more mild recession, including a -1.5% annual dip in 2009 caused the tenants in good standing percentage to bottom at 71% early in 2009, we should probably expect a more significant decline in this percentage in 2020, based on the more severe FNB GDP contraction forecast of -4.5%.

As such, we expect the quarterly bottom point to likely be in the 50-60% range, possibly in the 2nd or 3rd quarter of 2020. However, the annual average percentage may look a little less severe, due to the 1st quarter "in good standing" percentage to keep the annual average up somewhat, with the 1st quarter not yet seeing much of the major lock down measures. The TPN preliminary 1st quarter "tenants in good standing percentage was 78.6%.

Nevertheless, the 2020 annual average forecast for the percentage of tenants in good standing is still a weak one at 67%, and this is likely to include a very significant rise in the percentage of tenants being given a grace period to get through the lockdown period too.

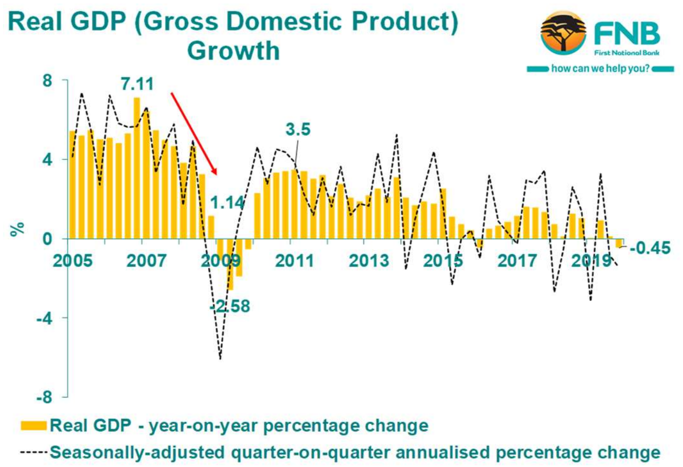
And the Full tenant recovery process can take some years

The next question is how long should we expect the market to take to recover? Again, we look to the recovery out of the 2008/9 recession for a benchmark.

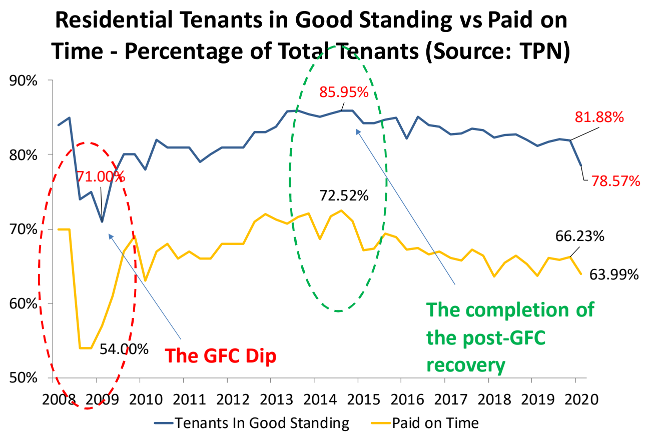
While it would appear that there is very little time lag between an economic shock and the decline in the percentage of tenants in good standing, there does seem to be a considerable time lag involved in the tenant recovery process thereafter.

Examining quarterly year-on-year GDP growth back around the 2008/9 period and during the immediate aftermath, we see that the GDP rate of year-on-year decline bottomed at –2.58% in the 2nd quarter of 2009, one quarter after the "tenants in good standing" percentage hit rock bottom.

GDP growth then began to benefit from massive global and domestic policy stimulus, recovering to a peak of 3.5% in the 1st quarter of 2011, near to 2 years after the bottom.



But while the GDP post-recession peak was early-2011, the residential tenant population took significantly longer to fight its way back to health, the post-recession peak in the percentage of tenants in good standing only being achieved at a level of 85.95% in the 3rd quarter of 2013, over 2 years after the economic growth recovery peak.



Therefore, while the initial performance of the tenant population towards the end of the recession improved quite sharply (from 71% of tenants in good standing in Q1 2009 to 80% by late that year,), thereafter the "2nd phase" of the improvement took another 3.5 years to complete.

This time around, one could probably expect a similar trajectory, with a rapid initial improvement in tenant performance coming late in 2020 assuming lock downs are ended and many incomes can resume. But the 2nd stage of the tenant recovery could once again take a few years, and the 3.5 year benchmark for post-GFC recovery is perhaps a useful perspective on how long we should expect the full process to be.

Hence, despite the economy forecast to return to its stagnant low positive growth rate between 0% and 1% as from 2021, by 2023 we only project the percentage of tenants in good standing to reach as high as 76% by 2023, not yet near to the last peak above 85% back in 2013 a decade before.

One aspect that could make the tenants "in good standing" number surprise us on the upside is the possibility that many landlords are sympathetic to the problem many good tenants face during lockdown, and may far more accommodating this time around (compared to 2009) in terms of granting grace periods to tenants.

We also pencil in some rental deflation

Finally, in this period of weakness, we would also expect to see some average rental deflation in the TPN average rental numbers, penciling in -3% in 2020 and -4% in 2021.

Forecast Summary	2019	2020	2021	2022	2023
GDP Growth (%)	0.2	-4.5	0.5	0.5	0.6
CPI Inflation (%)	4.1	3.6	4.2	3.9	4.4
Prime Rate (Period end) (%)	10.00	7.75	7.75	8.75	8.75
Residential Rental Property					
- Rental Tenants in Good Standing with Payments	81.40	67.00	68.00	71.00	76.00
Rental Inflation - TPN	3.00	-3.00	-4.00	1.00	2.00

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