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Property Insights

Is the Retail Property Market in a far-flung "platteland" farming region now in the (relative) pound seats as far as this property class goes? "Rural" towns may be the best place to be through COVID-19 ....well, some of them maybe

Virtually No part of the country will entirely escape the economic ravages of COVID-19, as it drives the SA economy into a deep recession.

But when pondering which regions' consumers, tenants and property owners will be least impacted by this crisis, could it be that those in "off the radar" rural food agricultural-driven towns may for once be in the relative "pound seats"?

Although having many other vulnerabilities, certain country towns' retail could be less vulnerable to the COVID-19 -related recession, depending on what drives their economies

When talking property markets in recent years, some have expressed confidence in rural retail properties, centres or retailers, often those providing a far more "basics" type of retail for a lower per capita income market compared to the illustrious upmarket centres of Northern Joburg and other major metros.

Examining Rode's "Platteland" Capitalisation (Cap) Rate time series doesn't make for a compelling historic argument, however. The "Platteland" average Community Shopping Centre Cap rate moved significantly higher in the previous Global Financial Crisis (GFC) recession of 2008/9, from 8% at a stage of 2007 to as high as 14% early in 2010, pointing to significant downward pressure on country area retail centres' values. By comparison, the National Community Shopping Centre Cap Rate (heavily influenced by major urban regions) rose far less significantly from 8.6% at the same stage of 2007 to a 9.9% high by the end of 2008.

But right now, in the middle of a severe COVID-19-driven recession, I suspect in certain cases the fans of rural retail may have a point....depending on what drives a region's economy and consumer purchasing power.

Most economic regions will be impacted in some way by the COVID-19 Crisis, but significant regional variations may be experienced.

It is difficult to see many (if any) regions of South Africa that can totally escape the economic ravages of the very deep recession that is unfolding as a result of the COVID-19 Virus.

The current deep recession unfolding is largely due to the COVID-19 related disruptions across most of the world's economies (though not entirely due to COVID-19, as SA was already in a milder recession prior to the lockdowns).

Besides likely being far more severe, the recession currently unfolding has two other key differences in its key drivers compared to the GFC-related recession of 2008/9.

Firstly, the 2008/9 recession had no deliberate "lockdowns: of any part of the economy, whereas the current one has had comprehensive lockdowns in many industries, including retail. Businesses in 2008/9 were all free to trade if they were able to withstand the usual recessionary economic pressures and remain solvent.

Secondly, the 2008/9 recession came with major inflation surges (predominantly oil and food price-driven), which led to a significant interest rate hiking cycle. Consumer price inflation rates are similar across the country, and interest rate hikes are applied consistently to all economic regions of the country. The co-inciding inflation rise and interest rate hikes thus "treated" most regions' consumers very similarly.

The current recession by comparison comes with very low inflation, little likelihood of a near term surge, and interest rates that have been declining.

The COVID-19 economic impact on the retailers in a

region depends on the magnitude of the retail lockdowns, which depends on the portion of retail that is seen as essential versus non-essential. In addition, it also depends on the magnitude of the shock that consumer incomes take, which in turn is dependent on the impact to that region's overall economy. Furthermore, it depends on the impact on the economy from which the region's residents derive their income...which is sometimes not the same region as where they live.

The key drivers this time around, therefore, may be significantly more regional specific than the recession of 2008/9.

Food Agriculture, Food Manufacturing and Government Sector are less cyclical sectors that a region may want to have a lot of during this crisis

With regard to normal recession pressures in a "non-lockdown" economy, there are 2 key economic sectors that can almost be described as "non-cyclical. These are the Government Sector, which would include local government services as well as those provided by the higher levels of government, including major social services such as education, health and welfare to name but 3.

The 2nd key one is Food Agriculture, and strongly related to this is Food Manufacturing, although it would be the more essential-types of food manufacturing that would be less cyclical, whereas luxury food could be more volatile. During recessions, households are more prone to cutting back on non-essentials, as well as purchases (such as durable goods) which can be postponed. Luxury food purchases can be stopped or postponed, but in the case of basic foods this is far less the case. Basic food demand, therefore, is relatively stable.

This is not to say that Food Agriculture doesn't have a volatile path, but its volatility is far less correlated to the economic cycle than Mining, Manufacturing, Construction or Durable Goods Retail (and indeed most of the economy), to name but a few examples, and more related to the likes of weather patterns either locally of globally.

This suggests that regions of the country producing basic agricultural foodstuffs or basic food manufactures, while not always outperforming in the good times, may be more insulated than the highly cyclical big city economies during a recession (provided adverse weather conditions don't co-incide with the recession), especially those cities that are highly Manufacturing-dependent.

Many of the rural areas of the country would not only have a large portion of their GDP (Gross Domestic Product) being made up of Agriculture, but also of Government Services too. Many rural economies are poorer than their big city neighbours, with relatively low GDP per capita as well as total GDP, meaning that the local government in that district is a relatively larger component of overall GDP compared to a massive economic region the size of Johannesburg When there is relatively low level of economic activity in an area, services such as government education, health care and welfare can also suddenly become a relatively significant (and stable) part of those region's economies.

So, in short, a region whose GDP composition includes a relatively large portion being Food-related Agriculture, possibly basic Food Manufacturing, and Government Sector can possibly be less vulnerable to the recessionary part of the economic cycle. This means that these sectors' employment levels are less vulnerable to recessions, and so too the household incomes (consumer purchasing power) that they generate.

The Government Sector component often goes further. Many of the poorer rural towns in the country benefit significantly from Government Social grants of varying types. These payments, too. are non-cyclical, providing a low but stable income for very basic consumer spend, a source of purchasing power that is said by some to have significantly benefited rural retail.

A longer term risk factor must be mentioned here. General government debt has been rising steadily, and the tax revenue dip that comes from this deep recession unfolding, is likely to exert even more upward pressure on the debt level. This raises questions over Government's ability to service that debt in times to come, and thus provide all of these social services. But at the current time we don't see that as a crisis that could threaten its ability at various levels to pay its salaries and grants.

Heavily Agriculture-driven economies have been significantly less affected by the lockdown phase too

Then comes the lockdown impact, on top of the deep recession. In this regard, Food Agriculture has been largely left uninterrupted, being an essential service and given that formal food retailers were allowed to remain open too.

And Government continues to pay salaries through lockdown, doesn't easily retrench, and continues to pay social welfare grants.

Once again, therefore, country towns with relatively large portions of government, basic food agriculture and possibly basic food manufacturing, appear to have

been least vulnerable to the lockdown component of the recession too.

This is not to say they are unscathed, however, as certain retail and services businesses in these towns, deemed to be non-essential, would have been forced to temporarily close, so business and personal incomes would surely have been lost here too. But a smaller portion of their economies would likely have been affected than has been the case in the bigger urban regions.

But one has to be discerning when evaluating the recession impact on retail purchasing power in the country/rural regions – Lots to Consider

But one has to be quite discerning when evaluating the recession vulnerability of country towns and regions. Many country towns/rural regions are far more linked to the highly cyclical parts of the bigger urban economies than others, and thus highly vulnerable to the recession part of the cycle. Here are some key factors to consider:

- Holiday and weekend getaway towns can be highly vulnerable to both lockdown and normal recessionary conditions.

Towns that see a significant part of their business income, and thus employment, generated from the holiday and "getaway" tourism industry can be highly cyclical and vulnerable in normal recessions, and even more so in this "lockdown recession. Their holiday property, tourism and hospitality industries were an obvious lockdown target, but even post-lockdown, these industries, and the towns they dominate, could be affected for a lengthy period, with the lagged impact of Household Sector Income loss through this recession forcing a "tightening of belts" and less holiday spend than prior to the recession.

In the housing bubble prior to 2008, we saw holiday town residential markets hit highs in house price inflation far exceeding the cities, but the dip in those markets was more severe than the major cities, with that non-essential 2nd property buying being jettisoned by many in the tough times. Tourism markets could be expected to operate the same way, thus exerting pressure on the Hotel and Accommodation Property Sector in a recession.

- Popular "Retirement" Towns can have some stabilisers.

Getaway towns, often country towns not too far from major cities such as Cape Town, can attract a significant retiree population. This can be something of a stabilizing factor for these towns' economies, consumer markets and retail, with middle to upper-income retirees normally having a retirement income stream that is not totally disrupted by any employment loss.

But such towns are often also getaway tourism towns, which can keep them highly exposed to recession, the retiree population only being a partial consumer purchasing power stabilizer.

Many, but not only, coastal holiday towns are in this category, and remain significantly vulnerable to the COVID-19 recession.

- Popular Commuter belts in the countryside can be as vulnerable as the cities themselves

Commuter towns near to the cities, which can simultaneously be weekend getaway towns, can be vulnerable to a deep recession. Many of the incomes earned are from employment in cyclical industries in the big cities not far away, and not in the less cyclical sectors such as Agriculture. And if those towns are dominated by industries such as Real Estate, Tourism, Hospitality and Retail, for instance, and not by Agriculture, then they would have experienced a major part of their economy being locked down too.

In effect, therefore, such towns can be seen as extensions of the cities.

- Rural economies highly dependent on money repatriated from city-based relatives and "migrant" workers could be more vulnerable.

Also partially exposed to major urban economic cycles would be certain rural regions from where a significant amount of major urban "migrant labour" comes, or from where people now living in city middle class suburban areas grew up and have roots.

Many "migrant" workers and middle class former residents are said to repatriate significant portions of their incomes, earned in the cities, back to their country homes towns. Many of these incomes may either already have been lost in the lockdowns or could still be lost in the recession and aftermath.

- Mining Towns have had lockdowns, currently being relaxed though, and non-Gold Mining towns run risks from weak global commodity prices that are largely a function of the global economic cycle

Mining is a highly cyclical industry, and many Non-Gold Mining towns could feel the impact to their economies from significant drops in global mineral demand and low commodity prices.

While Gold mining towns have longer term economic pressures, a relatively strong gold price through this crisis period suggests that they may not be at high risk specifically to this COVID-19 recession shock

- Towns on major transport routes may feel it

Key transport and accommodation-focused towns on the major national roads, especially the N1 and N3, could feel a significant economic impact from a likely slow pace of traffic visiting these towns' garage, food retail and accommodation facilities.

Conclusion

In short, the least vulnerable retail property regions from this deep COVID-19 related recession could be country towns whose economies are highly dependent on farming of basic foodstuffs along with a significant portion of their GDP being Government Sector services. While many of their retailers and other non-essential services suffered lockdowns similar to those in big cities, their economies as a whole appear in many cases less disrupted.

Farming has largely been exempt from lockdowns, and even in non-lockdown recessions normally proves to be less cyclical.

And with interest rates and CPI inflation this time around not having surged as in 2008/9 (possibly having a more consistent negative impact on consumer purchasing power across regions back then than this time around), this recession may see a significantly more varied economic and consumer performance across regions depending on their economic "make-up".

But picking regional "winners" from country regions is complex. Perhaps, at the moment, it could be a region doesn't rely on a significant portion of its households earning incomes from "migrant" family members in big cities, and isn't overly dependent on incomes being repatriated by its former middle class residents who now reside in those cyclical cities. Such sources of income may be subject to the recessionary pressures of the big cities in which these people work.

Towns with a strong dependency on getaway tourism and holiday home residences, too, are likely to be at a relative disadvantage through this tough economic time, and their consumer spending power could be significantly dented, while non-Gold mining towns appear strongly tied to global recessionary forces.

But with regional variations in lockdown levels looming, it is possible that many country towns move to a lower level of lockdown quicker than the major metros, the latter being the regions with higher population density and higher apparent COVID-19 infection levels. And with COVID-19 infection rates in rural regions seemingly less, consumer fear of "crowded" retail spaces may be less too, all serving to normalize retail and spending more quickly than in the big cities post-lockdown.

Country retail in many instances is not as glamorous as many of the retail centres and malls of the big cites. But in certain instances, perhaps it is less vulnerable than the more illustrious city addresses, in part because it is less glamorous. In the near term, retail, and property will be in many ways about one simple word…."basics"…not only about "basics" with regard to what the retail centres themselves sell, but with regard to what their regional economies sell. While not claiming that any region will escape totally unscathed, when we look back in a few years time, we may just see the likes of retail property in a heavily-Agriculture-dependent Eastern Free State regional centre such as Bethlehem, or an Upington in the Northern Cape, coming through this period less impacted than retail in the major cities.

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