

2010: What we can expect from SA commercial property



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While the predicted great depression never materialised, we have definitely lived through one of the great recessions of our time. Following this surprisingly wide-spread global slowdown, it will take some time to adjust to the fact that lower growth will mean less excess, higher productivity and an increased risk of failure.

Property returns tend to lag the economic cycle and we expect nothing different this time 'round. Our research shows that the commercial property segments respond differently, depending on the stage of the economic cycle and the drivers of demand and supply specific to each segment.

- The retail sector is largely dependent on consumers and their ability and willingness to spend. The large national retailers' appetite for new space is also a major contributor to increased supply.
- The industrial sector, driven by the wholesale, logistics and production sectors, has tended to show a high correlation to the retail sector, especially during an economic recovery.

- Offices depend largely on business confidence and their expansion plans, with employment trends in the "white collar" sectors influencing price paid per square metre and, importantly, the level of vacancies.

We favour quality retail, followed by industrial and then offices

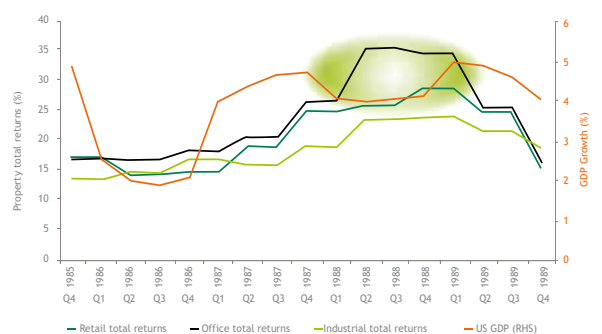
International and local trends have shown that retail tends to outperform the other segments during a sustained growth recovery, while offices tend to outperform in a more benign environment (see charts below). By once again referring to US experience we see that the recovery in retail property returns typically lags a recovery in GDP growth by between six and 24 months.

Delayed response to recovery... led by retail
United States: 1980 - 1985



Source: OMIGPI

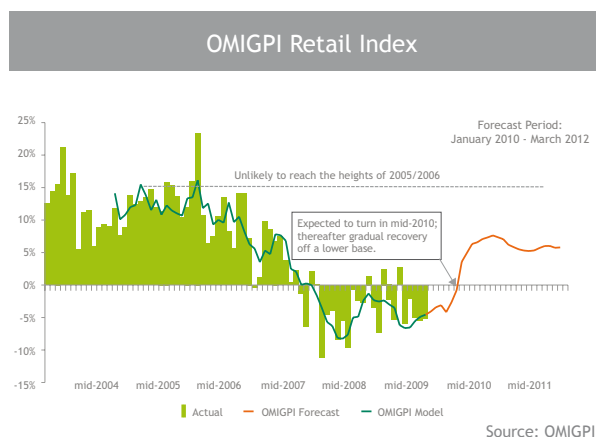
Office outperforms under benign economic conditions
Australia: 1985 - 1989



Source: OMIGPI

In line with this research, we currently favour investment in quality retail property over the medium term, followed by industrial and then offices.

The OMIGPI Retail Index, which shows a high correlation with Stats SA Retail Sales growth, indicates that December 2009 trade was much in line with November's – showing flat nominal growth and almost a 6% year-on-year decline in real terms over 2008.



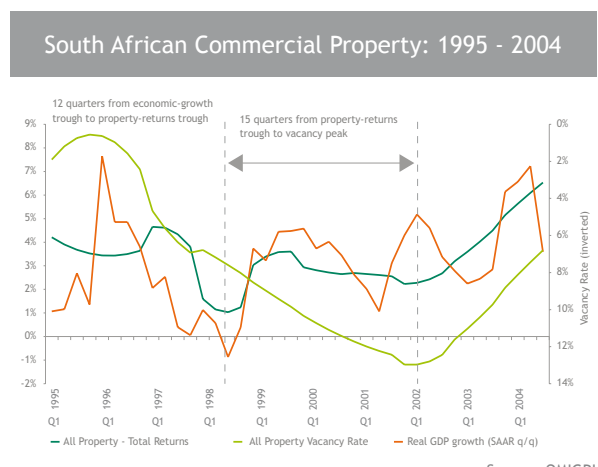
Our research indicates that **RETAIL** growth will remain under pressure through the first half of 2010, given a reticent consumer and our belief that there will be an oversupply of retail space. We also expect to see a dislocation of returns between dominant and peripheral retail centres, with a shift toward the dominant (or defensive) centres and away from smaller peripheral centres.

A smaller spending pool among consumers combined with a material increase in supply of space will lead to a geared decline in the non-defensive (smaller, less well-located or peripheral) malls, as tenants look to focus their exposure in high-performing centres. This leads to higher vacancies, negative rental reversions and an inferior shopping experience that ultimately results in fewer shoppers in the peripheral centres. Our preference is thus for defensive retail centres with a bias towards dominance and quality.

INDUSTRIAL property returns have traditionally shown a high correlation to retail returns (particularly in an economic upswing), and we believe that those with existing space will see increased demand as we move through the second half of 2010. Unlike retail and offices, the industrial segment has the benefit of relatively short gestation periods for new buildings. This has enabled the sector to limit the extent of supply overhang.

In the previous property cycle, **OFFICE** returns were severely affected by excess supply. Fortunately, available

space was at record lows going into this recession and, while we still expect high vacancies to have a negative impact, we do not anticipate vacancies of around 20% as seen in 2001 and 2002.



Office-demand growth is largely driven by employment trends in the services and financial sectors of the economy. Even though these sectors have not seen the same level of layoffs as the mining and manufacturing sectors, staff-count freezes and a potential rise in unemployment remain areas of concern. We expect to continue seeing declining employment through the first half of 2010, stabilising in the second half and showing unspectacular growth in 2011. We would warn against speculative office developments with a completion date of 2011 and 2012. Our research has shown that the time taken to work through an oversupply, once property returns have bottomed, could be anywhere between one and three years.

We warn against speculative office developments with completion dates 2011 - 2012

We believe that property markets across the world have seen the worst of the re-pricing and Europe, the Middle East and Africa are already experiencing yield compression across all three major segments. On the South African property market, OMIGPI research expects rentals to remain under pressure and vacancies to continue rising through the first half of the year, stabilising towards the third quarter before we see a strengthening of fundamentals in 2011.