S.Africa’s Commercial Property braces for Blue-chip Tenants

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Paragon Lending Solutions CEO Gary Palmer said last week that the segment of the commercial property market that focused on quality tenants was in a healthy state and was improving.

The performance of commercial properties in SA is highly dependant on the size and quality of tenants, given pedestrian economic growth and underpressure consumers, according to Paragon Lending Solutions CEO Gary Palmer.

Mr Palmer said last week that the segment of the commercial property market that focused on quality tenants was in a healthy state and was improving.

It experienced strong competition for assets and competition among banks looking to lend against these properties.

“The minute you have an income-producing asset with strong tenants and strong covenants, then that is in huge demand,” he said.

But competition and demand for these assets had driven yields to levels where the value of such investments was less attractive than before.

Mr Palmer said while quality commercial property assets were in high demand, there was little interest in new commercial and residential property developments. As building costs were “still very high”, and given slow economic growth, the rentals required to service loans on new developments were too high.

While the low interest rate meant it was a good time to borrow to fund investment opportunities, Mr Palmer said the appetite of banks to supply funding had declined.

The advent of the Basel 3 banking regulatory framework had prompted South African banks to shift their focus from earning interest income to earning non-interest income such as fees — given that Basel 3 required banks to hold more capital against loans.

Banks had also shifted their focus to other forms of income which did not require large capital holdings, such as unsecured lending. Mr Palmer said this shift was creating opportunities in the unlisted commercial property sector for shortterm non-bank lenders, which were not governed by the same stringent regulations as banks.

"There is a huge opportunity in SA for shadow banking — nonbank lenders who are prepared to take a different view and are not governed by the same requirements as banks are."

However, this was less relevant in the listed property sector, where companies had access to capital markets.

Mr Palmer said Paragon had seen "a huge uptick" in the number of inquiries for commercial property finance.

However, segments of the unlisted commercial property market were under pressure, especially properties with "nonblue-chip tenants".

With slowed economic growth, "smaller tenants are going to struggle and I'm sure you are going to see a lot more arrears", Mr Palmer said.

Meanwhile, many listed property companies have mirrored Mr Palmer's sentiment.

Emira Property Fund has cut its vacancies over the past year thanks largely to selling smaller, lower quality properties.

At the end of April, Emira's vacancy level was 6.9%, substantially down from 10.2% at the end of June last year.