LIGHTING THE WAY

LIVING WITH COVID-19

Lightstone

We simplify the complex

Contents

The Great Disruption

Like a bat out of hell

What started as a whisper of trouble with a virus in the east grew into a pandemic that shut down the world's leading economies – in a matter of weeks.

In late January China had reported its third death and confirmed its first human-to-human transmission. Cities were placed under quarantine in Hubei province but the infection rate escalated rapidly within China and to other countries, before the World Health Organisation declared the coronavirus outbreak a pandemic.

By then, an already vulnerable world economy was plunging into recession. Projections are that unemployment in the USA will hit 30%, higher than the 10% recorded in the 2008/9 financial recession and the 25% of the Great Depression of 1929 – and this despite the US economy being in good shape ahead of the pandemic.

At home, the Rand fell by more than 20% in just eight weeks against the US Dollar, Moody's downgraded SA to junk status and sees our GDP shrinking at least 6,5% in fiscal 2020. Unemployment is climbing rapidly and the media is full of stories of hunger among poor communities and incidents of social unrest.

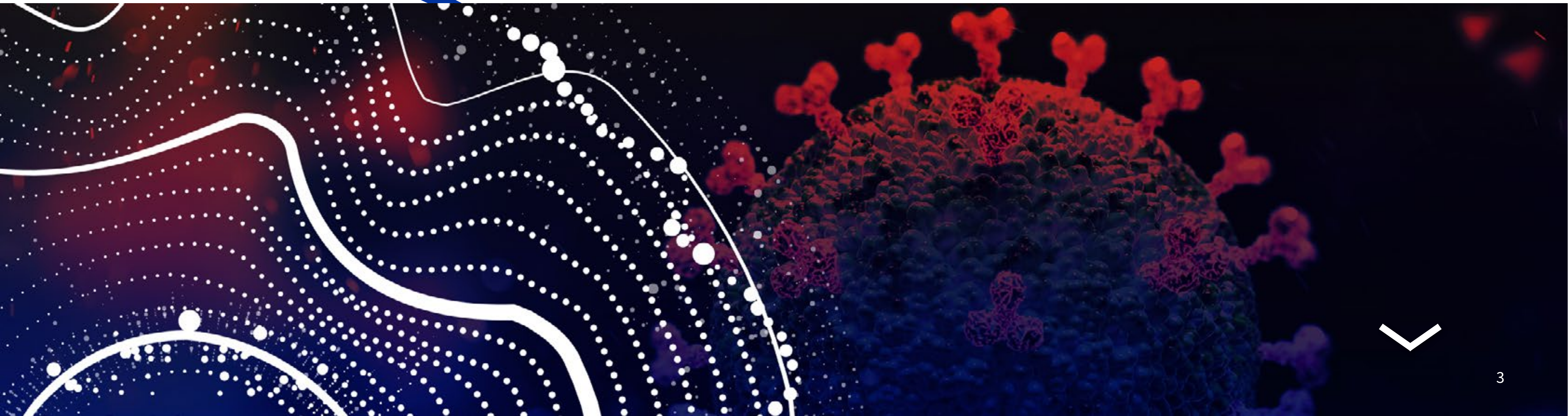
The SA Reserve Bank has cut the repo rate three times and government announced a R500 billion economic support package to help battle the impact of the pandemic – equal to about 10% of the country's annual GDP. The relief package is being used to support vulnerable South Africans, and to respond to the impact of the lockdown on workers and businesses.

Private donors and volunteers are funding and running food aid projects across the country and private benefactors have put up more than R4b to help businesses – but the truth is - the pandemic is threatening to destory many of South Africa's SMMEs and businesses which find themselves outside the support nets, or beyond their capacity.

Just as many begin counting the cost, others see a chance for a global reset.

Poverty and inequality, global warming, the damage to the environment, both on land and in the oceans … these are just some of the issues that have been bubbling for a while.

The coronavirus pandemic has thrust them to centre stage.



Winners and losers

...but everybody hurts

In every crisis, there is destruction and there is opportunity. And the winners and losers more or less reflect what's essential and what's not. So, who are the **winners**?

- The heathcare industry
- Technology and ecommerce, particularly in delivering services to the growing home office market
- Groceries
- General merchandise
- The mining sector (a relative winner at 50% with employee control mechanisms conducive to intensive screening and isolation or hospitalisation if required.)
- Some entertainment players – The Economist pointed out new subscriptions to Netflix increased at twice their usual rate in the first quarter of 2020, with most of that growth coming in March.
- Corporates with cash on their balance sheets

Plus, there are some **silver linings** to the COVID-19 cloud…historically, markets tend to react to dynamic shocks and anecdotal evidence suggests turmoil is relatively short lived – although there are exceptions. Also the major economies have moved quickly to announce stimulus packages, and some (such as the USA) have strong economic fundamentals to confront the impact of COVID-19.

The winners will also include those who have been **building social capital** with their customers and employees. This commitment to brand building during the crisis becomes more important as the crisis wears off and broader economic activity picks up. Equally, companies that continue to **invest in growth and innovation** are typically the most successful coming out of recessions.

Putting solutions before sales during the pandemic

Customers surveyed said they want brands to step up in the fight against COVID-19

89% want consumer brands to focus on producing goods that help people meet pandemic-related challenges

89% want brands to offer free or discounted products to healthcare workers, vulnerable groups and unemployed people

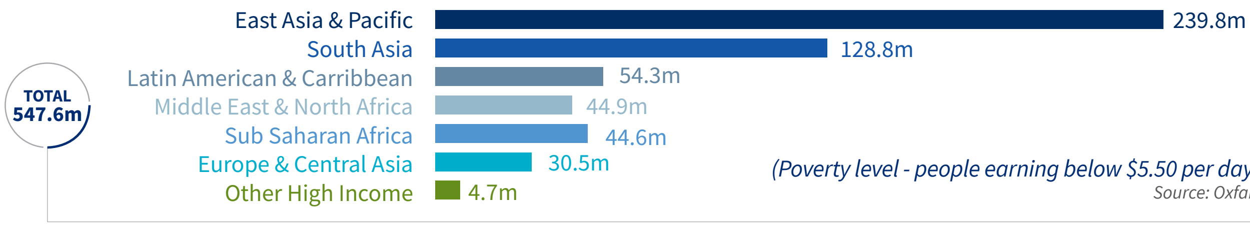
54% are only considering new products if they address coronavirus related concerns

Source: "2020 Edelman Trust Barometer Special Report: Brand Trust and the Coronavirus Pandemic"

But the losers are many, and their impact will be felt longer.

- Private citizens with **high levels of household debt** and weak or no safety nets.
- For those **already unemployed** or close to the poverty line, COVID-19 will push them there.

Additional people in poverty due to a 20% income drop caused by a Covid-19 recession



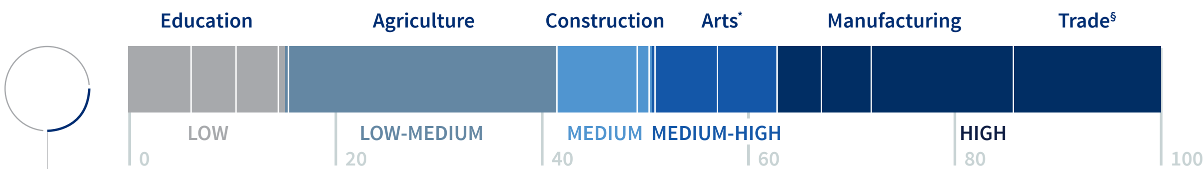
(Poverty level - people earning below $5.50 per day)

Source: Oxfam

- **Unemployment is rising quickly** – and exponentially in some places. In South Africa it could reach 40%.

Labour isn't working

Estimated impact of Covid-19 crisis on economic output, % of global employment.
By sector *(before outbreak of Covid 19)*, April 2020



**Arts, entertainment and recreation* *$Wholesale and retail trade*

Source: ILO

- Businesses with high fixed costs and high debt are vulnerable.

An entrepreneur research survey found that

3 out of 4 SMMEs

may not last past a July lockdown

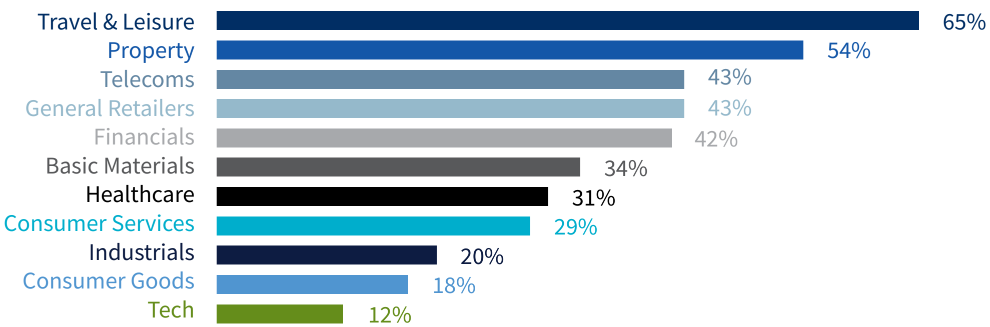
68%

of relief applications were unsuccessful

71%

said a prolonged lockdown would force them to retrench; and if they survive, most say they will embrace technology in the future.

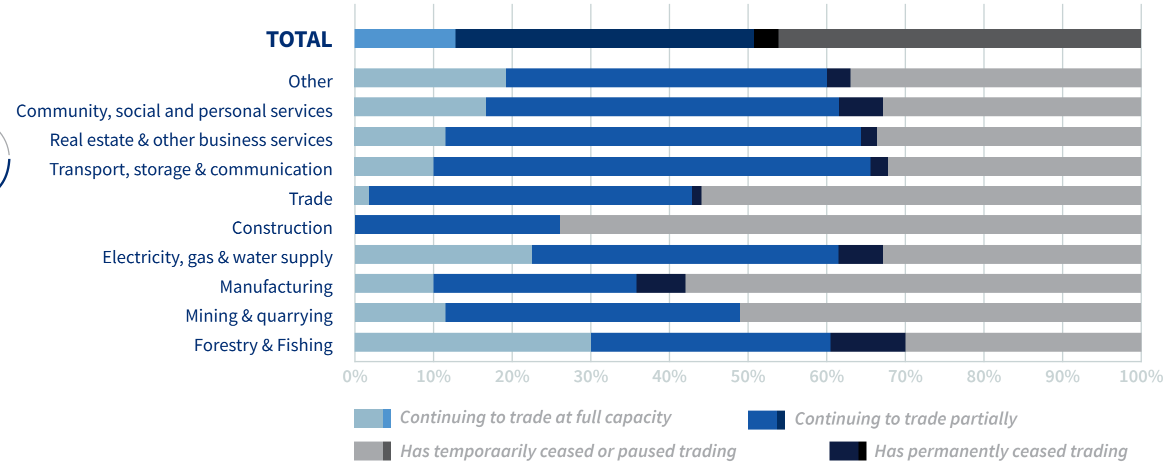
- Specifically a number of industries have been badly affected – and we haven't seen the worst yet. By late March, key industries saw immediate losses attributed to COVID-19. In South Africa, alcohol and cigarette sales were among the big losers.



Source: Capital IQ as at 24 March 2020

- A business impact study conducted by Statistics SA in mid-April of 707 businesses demonstrated that a low proportion of businesses continued to trade at full capacity. Almost half (46,4%) reported 'temporarily closed or paused trading'.

Trading status of businesses (cumulative % shown on horizontal axis)



What got dumped from the shopping basket in March 2020!

The stages of investor emotions and psychology throughout the market cycle

Source: Stackline / Amazon / business Insider / Euro News / CNBC

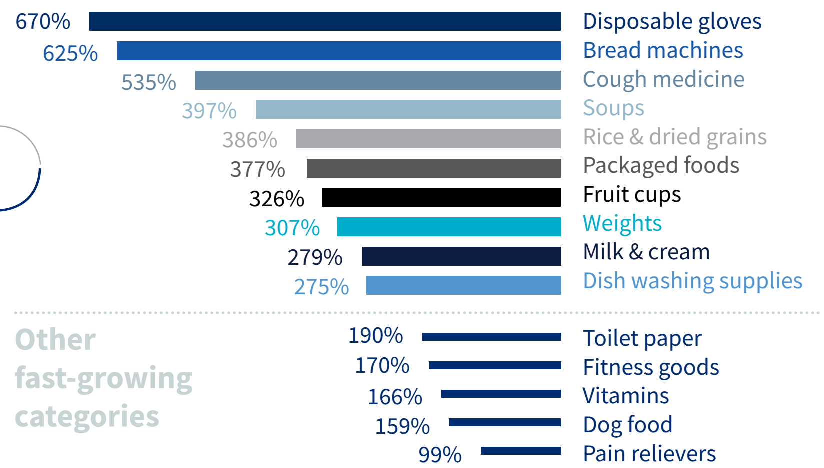
Lockdown across the world has certainly been an excellent time for some.

Locally the surge in the sale of yeast probably has less to do with home-made bread and more to do with home made alcohol.

Luggage would be the obvious one to see a dramatic fall, as depicted, given the drop in travel - it would be interesting to see whether those on the bottom see a resurgence once economies come back on line.

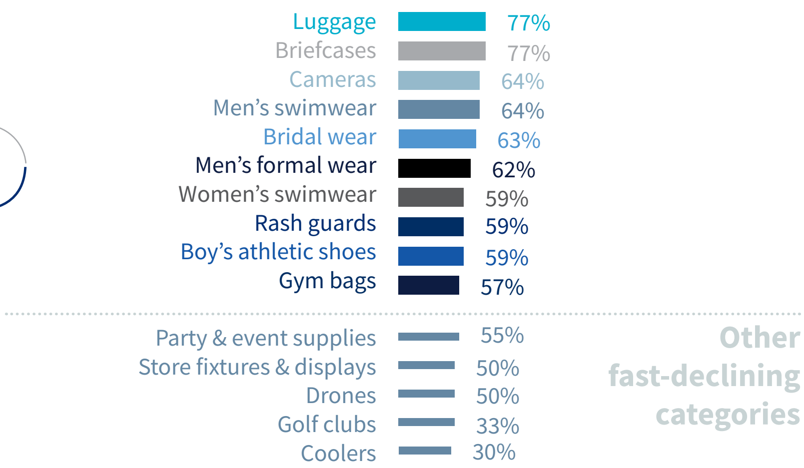
Top 10 fastest growing e-commerce product categories

(March 2020 vs March 2019)



Top 10 fastest declining e-commerce product categories

(March 2020 vs March 2019)



Source: Odyssey Capital Managers (Pty) Ltd

Amazon's best-selling bread machine, the Cuisinart CBK 110 is now completely sold out.

Grocery delivery platform instacart has seen a 150% increase in recent weeks, as well as a 15% increase in basket size.

The World Health Organisation initially announced that anti-inflammatory drugs could make COVID-19 worse, before later changing its stance claiming there is insufficient evidence to back this up.

Walmart, Amazon and Target announced they are close to selling out, due to people panic buying.

Apparel sales were already slumping even before travel adn event plans were canceled by the COVID-19 outbreak January was the worst month in apparel sales since the financial crisis in 2009.

As small businesses around North America remain shuttered, sale of items like signage and supplies have seen a steep drop in sales.

Property was already facing challenges prior to COVID-19 – and now faces tough times across most categories.

Residential

Demand for low cost / medium cost housing will rise (particularly if government goes through with its infrastructure build programme).

Homeowners, generally, are seeing the value of their houses fall; it's looking like the best buyer's market in a decade.

Retail

Malls will need imagination and investment to thrive in a repurposed world – and some may need to be recalibrated altogether.

Some chain stores are in difficulty and many tenants are not paying full rentals.

Wholesale

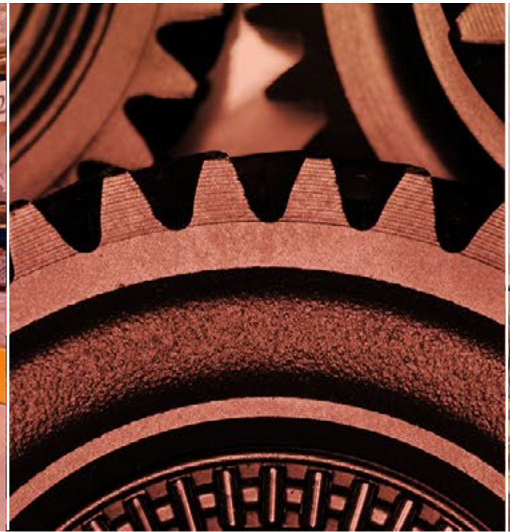
Demand for warehouses will grow as e-commerce grows.

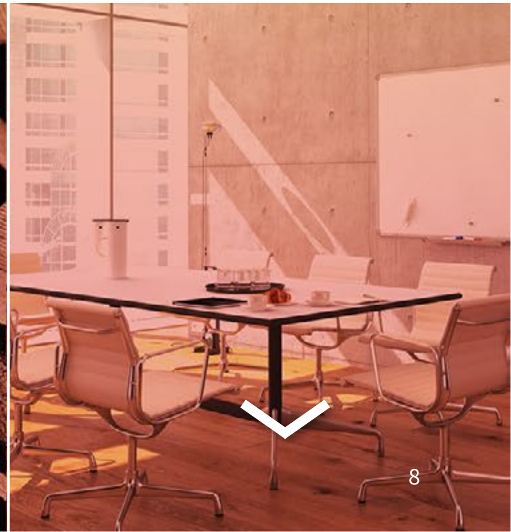
Factories

Demand for factories will grow if/as SA re-industrialises (President Ramaphosa has committed to this).

Office

The use of home offices is expected to rise and so demand for office space will decline.





This, too, shall pass

SA is bracing itself for healthcare and economic tsunamis

Global reaction to COVID-19 stemmed in part to gloomy predictions about loss of life, but the forecasts have all been progressively reduced – in some cases to a small fraction of early projections.

Countries around the world have followed a containment strategy, with lockdowns of varying degrees. And they are working: curves are flattening, new infection rates are dropping and some societies are opening up. But there's widespread recognition that recovery will take months, there will be further infections and the virus won't be totally eradicated until a vaccine is found in around 18 months.

Restrictions are being eased in some countries, and phased relaxations have started in SA – although government has said restrictions can be reimposed or varied, from region to region, as the circumstances dictate.

Clem Sunter's "Tightrope" scenario speaks about "a delicate balancing act between preserving lives and livelihoods" and that lifting lockdown restrictions are necessary to achieve both objectives.

Government's recovery phase is yet to be fleshed out, but will include an economic strategy to drive recovery, measures to stimulate demand and supply and a substantial infrastructure build programme.

But for now, the country has one eye firmly on doing what it can to prepare for the escalating infections – with the other focused on a battered economy and trying to get a glimpse of what kind of recession will follow:

- V-shaped – recovery followed by a sharp correction and a quick recovery;
- U-shaped – recovery takes longer because GDP shrinks for a few consecutive quarters;
- W-shaped – early signs of recovery are false, and growth dips into a second downward spiral; or worst case,
- L-shaped – a sharp contraction and it takes several years to recover.

The next normal?

It’s the end of the world as we know it.

Almost anyone who has an opinion agrees the world can never return to what it was. That old normal is gone. The next normal is coming.

But what will it look like?

There is a yearning for a fairer, more economically and socially inclusive world to emerge from COVID-19’s ashes, one which values the environment and humanity as much as it does economic growth, profit and political power.

Some trends which were already evident pre-COVID-19 will accelerate and other developments are likely to be catalysed. Some will be good, some bad and some a mixture of both.

Economic possibilities

- Automated production will lower costs and improve quality – but will cost jobs.
- The use and application of technology will increase – one investment house calls it the new “staple”.
- The trend to work from home will increase and there will be a decline in need for office space.
- Ecommerce and online shopping will accelerate and reduce the need for traditional retail space even further – and deliveries will increase, reducing the need for face-to-face transactions.
- Telemedicine will grow.
- Online teaching will grow.
- Video conferencing will increase – Zoom said daily users spiked to 200 million in March, up from 10 million in December.
- Business travel will decrease.
- There will be some degree of deglobalisation as countries take back some industrial production. This will increase the cost of goods – but create work in counries ravaged by the economic meltdown.
- Consolidation of economic power in hands of conglomerates and the franchise chains will probably increase – and many “mom-and-pop” stores will disappear.

The road ahead

Unknown unknowns

From a public policy perspective, monetary and fiscal policies are used to boost demand – but this is not a normal recession. “There is an ‘infection externality’ to economic activity – boosting economic activity increases the spread of the virus”, says Professor Sergio Rebelo MUFG Bank Distinguished Professor of International Finance.

So in the short run, crude containment measures that have been used are giving way to ‘smart’ containment over time – and unknowns will begin to reveal themselves.

The Economist (3 May 2020) perhaps has best captured the road ahead.

It speaks of the “90% economy” emerging, with GDPs down by 10% as the post-crisis world takes shape. It will be a different world, of course, with relief at what is still available as opposed to despair at what is not.

And a 90% economy is an “astonishing achievement. Had the pandemic struck even two decades ago, only a tiny minority of people would have been able to work or satisfy their needs.” However, The Economist cautions a 90% economy is a big step down from what came before the pandemic. It will be more fragile (the virus is not contained, economic behaviour will be less predictable), it will be less innovative (social contact is conducive to creativity and innovation) and it will be more unfair (as more people are jobless with the lower GDP and damage to labour-intensive industries).

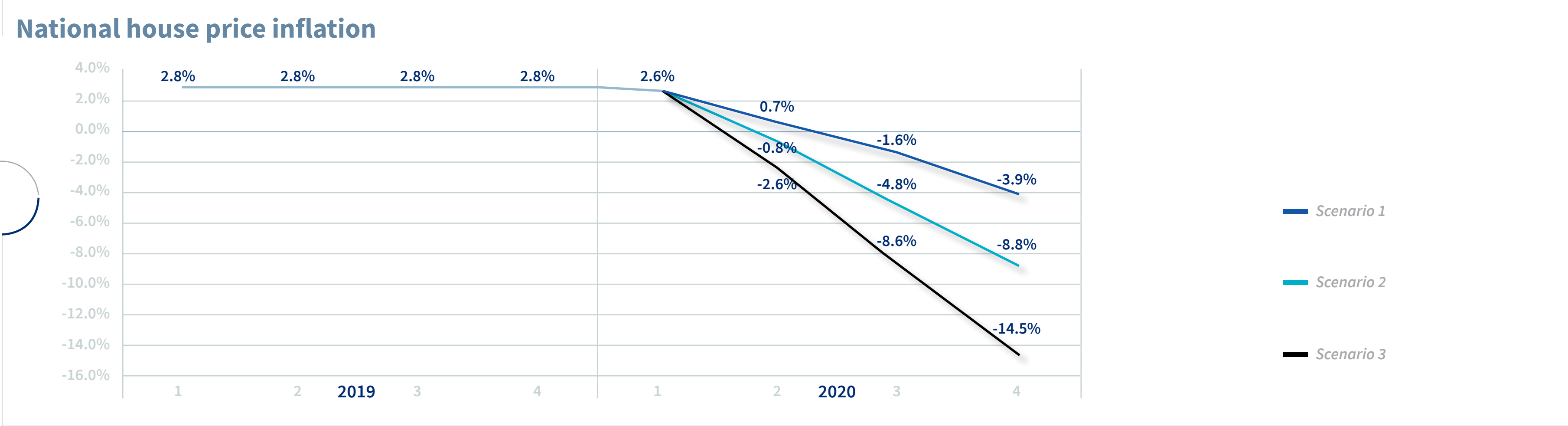
So, what will all this mean for property?

Sales expectations

Three scenarios

Earlier this year, we predicted national house price inflation would drop below 0% for the first time since 2008; but in a COVID-19 world, we expect less. Given the flux we find ourselves in, we've developed three scenarios to help you try and make sense of property values in the months ahead.

"With little or no certainty on how this Black Swan event will play out, we modelled three scenarios around the impact of COVID-19 and the lockdown based on the GDP dropping between 3% to 10%," says Analytics Director, Paul-Roux de Kock.

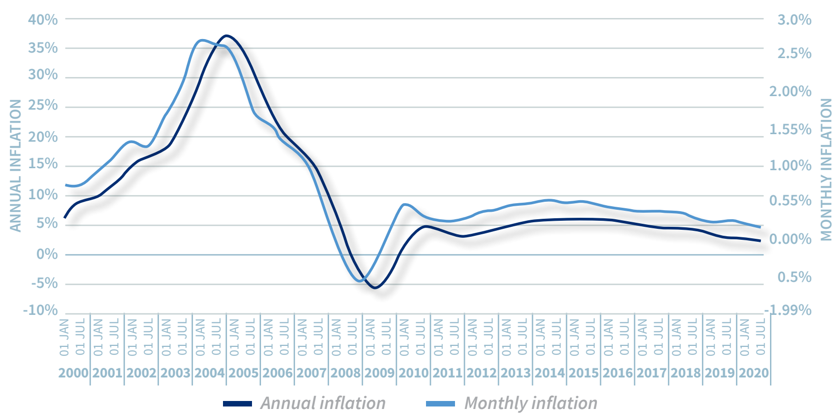


In Generic Recession,
our first scenario, house price inflation is forecasted based on the assumption that the GDP may decline by 3%, with a subsequent deflationary effect on consumer price inflation. The reduction in CPI inflation leads to a further drop in interest rates making goods bought on credit more affordable. In this scenario, we expect house price inflation will end the year off at -3.9%."

In Unchartered Territory,
our second scenario, we see a negative house price growth of 8,8%. This sounds alarming, but remember house price inflation dropped to -5,4% during the 2008 crash, when economic activity only declined by 1,8%. This scenario assumes a drop in GDP of 6% without a noticeable reduction in CPI inflation, leaving limited moving room for further interest rate adjustments.

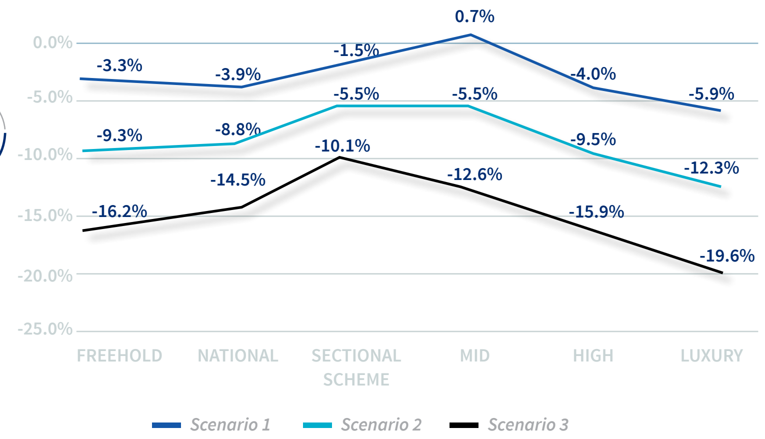
In Event Horizon
our third scenario, we assumed GDP would fall 10%, with an increased reliance on expensive imports due to the weaker currency ultimately driving CPI up and forcing the Monetary Policy Committee to reverse the downward interest rate cycle. In this scenario, house price inflation could end the year at -14.5%. The truth is, in this scenario, it's impossible to call the usual predictive interplay between GDP growth, CPI inflation, interest rates and house price inflation.

Lightstone national monthly inflation vs annual inflation



Actual national inflation rate from 2000 to 2020

House price inflation per value band and property type



Clearly, the property industry will have to adjust to new ways of working.

Recently, under the rules of Level 4 lockdown, the deeds offices started opening so real estate agents can lodge and register properties again, and possibly close existing and prospective deals. However, as things currently stand, estate agents will only be allowed to function fully under Level 2 so agents who traditionally depended on physical viewings with clients are resorting to more creative and digital ways of serving their clients, such as virtual viewings and making use of our valuation reports to conduct negotiations between buyers and sellers.

Unfortunately, our value bands suggest the luxury market segment will continue to suffer even more than it did in previous years under any of our scenarios. But again, with little insight into government thinking or being able to accurately predict how COVID-19 will play out in SA, we can only work harder and smarter as we head to the post-lockdown phase. And we will all need to be agile, responding to scenario changes as they play out.

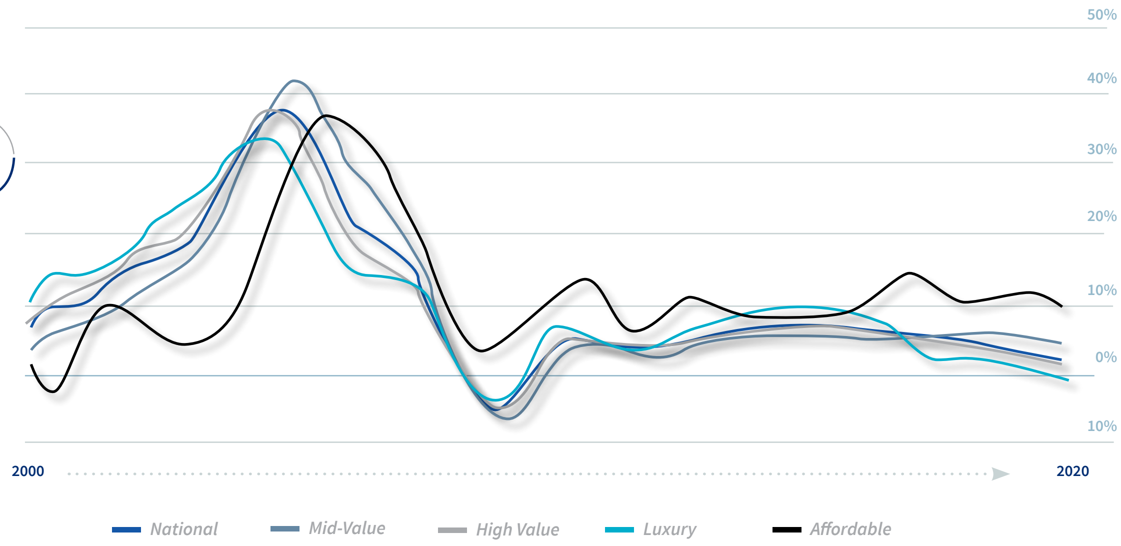
It's off to work we go!

Tips for locked-down estate agents

COVID-19 has certainly turned our lives upside down. It is going to be a tougher world that emerges, but there will be opportunity. People will downsize, others will take advantage of great buys as they move up the ladder, work-from-home will create demand, there will be those who change or find new jobs and need to move home …

Interestingly, it is the affordable and mid-value houses which held up well after the 2008/9 recession, and indications are that they are the bands holding up better now too. Perhaps that is where the real opportunity is in the short term?

House Price Growth by segment



So, it's time to shake off the cobwebs and start …

- Making contact with homeowners in your area to get a sense of their expectation of property values – and remember, we can help with contact details.
- Providing homeowners in your area with property values on a monthly basis (by using the EVM), so they have a sense of how values will change once transactions start happening again.
- Connecting with your previous clients and find out what they are thinking.
- Getting a sense from owners who might have to move after the lockdown (financial distress), providing them with insights (distressed property report) and understanding where they might want to move to (area) – and then start sourcing potential properties for them to consider!
- Finding the gems that will interest your investor clients.
- Having virtual show days.
- Following up with clients you met before lockdown and see if they are still looking to buy or sell. Let them know the deeds office is open!
- Growing and cleansing your database.

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