Chapter 1: State of the property market

State of the property market in quarter 2 of 2021

The listed property market continued its recovery in the second quarter of 2021, with share prices of JSE-listed companies ending June about 16% higher compared to the end of 2020, boosted by higher global economic growth and better-than-expected company results. No doubt the low base of 2020 played a role in the increase, but it indicates that the worst is behind us. However, we are without a doubt not out the woods yet due to the weak economy and because another Covid-19 wave hit South African shores in June. Besides, property fundamentals, such as vacancy rates and rentals, are generally still under significant pressure. This implies that it will not be plain sailing ahead.

The move to lockdown level 4 from 3 and the associated restrictions will put further pressure on property owners as many tenants, like restaurants and cinemas, run into more financial difficulties. A high prevalence of Covid-19 also means the trend of shoppers generally shunning malls and shopping closer to home at community and neighbourhood centres will continue. The leisure industry will be especially hard hit, while workers will largely avoid going to the office where possible. The critical point is that the country needs to vaccinate as many people as quickly as possible to avoid further Covid-19 waves from damaging the economy. On 30 June, three million South Africans (or about 5% of the population) had received a first vaccine dose, while worryingly only 480 000 had been fully vaccinated.

Fundamentally, industrial property is still in the best position compared to the other non-residential property types, which suffer from a large supply overhang. The office market remains the riskiest. A summary of the main findings by property type follows.

Quantitative overview of the property market

Table 1.1 on the next page provides a snapshot of how the property market has performed over the past four quarters by comparing the latest information (quarter 2021:2) with data collected a year earlier.

Office market

The results of Rode's first office vacancy survey point to a high and rising amount of empty office space. The national decentralized vacancy rate was close to 14% in the second quarter of 2021. The oversupply continues to give tenants the upper hand in lease negotiations, leading to benefits such as longer rent-free periods, and much lower rentals.

Nationally, nominal rentals for decentralized grade-A space decreased by 6% year on year in the second quarter of 2021, declining on an annual basis for the fourth consecutive quarter. Market rentals decreased by 10% in Cape Town and 7% in Johannesburg compared to the second quarter of 2020 – the worst declines of the major cities. Rentals declined by 5% in Pretoria. This implies that no major city managed to record rental growth above inflation.

The percentage of workers who worked from home in South Africa in the first quarter of 2021 reached 7%, continuing to declining after peaking at 17% in the second quarter of 2020 during the strict lockdown, according to Stats SA data. However, this was before the third wave hit South Africa in June. The virus resurgence will likely hold back the return to office of more workers in the next few months. However, one would expect more workers to return to offices as the virus subsides with more people vaccinated, but it is safe to say that ultimately more workers will be working from home on a long-term basis than before the pandemic started.

Industrial market

The industrial property market is continuing its slow recovery, with nominal rentals in the second quarter of 2021 growing by 0,8% year on year amid continued low vacancies. This is somewhat better than the 0,5% growth achieved in 2020, but still well below the 5% rental growth of 2019. The slow rental growth shows that the industrial market is continuing to feel the effects of the weak economy, albeit not so much as the office and retail property markets.

Table 1.1
Rental performance as at quarter 2021:2
% change from four quarters ago (on smoothed data)

	Nominal	**Real***
A-grade decentralized office rentals		
Sandton CBD	-5,1	-9,4
Rosebank	-5,0	-9,3
Randburg Ferndale	-5,7	-10,0
Brooklyn/Waterkloof	-3,6	-8,1
Menlyn	-4,7	-8,9
La Lucia/Umhlanga Ridge	-1,4	-5,9
Westville	2,7	-2,0
Claremont Upper	-0,8	-5,4
Century City	-15,0	-18,8
South Africa	**-6,2**	**-10,5**
Prime industrial rentals (500 m² units)		
Central Witwatersrand	1,7	-3,0
East Rand	1,7	-3,0
Durban	1,9	-2,8
Cape Town	-1,7	-6,1
South Africa	**0,8**	**-3,8**

*Nominal values deflated by BER Building Cost Index (2016 = 100)

Rentals for prime industrial space of 500 m^2 grew by about 2% in Durban, Central Witwatersrand and the East Rand. In these conurbations, vacancies declined in the first half of 2021 compared to 2020 and are generally still seen to be quite low (less than 5%), according to Rode's survey results.

Nominal rentals continue to buck the trend in Cape Town, falling by 2% year on year in the second quarter. The Mother City has seen its vacancy factor move above level 3 on the Rode scale of 1-9 (that is, higher than about 5%) since the third quarter of 2020, thereby prolonging downward pressure on rentals.

Residential market

The housing market, which has defied the odds during the Covid-19 pandemic, is starting to cool. Nationally, house prices increased by 4,1% year on year in May 2021 based on FNB data, slowing from 4,5% in April and failing to beat consumer inflation (+5,2%) for the first time this year. This is a sign that the interest rate-induced demand may have peaked.

Looking at the trend for 2021 so far, prices grew by 4,3% over the first five months compared to the same period in 2020, implying that for the year price growth is still positive in real terms as inflation was 3,8%.

The cooling house prices do not come as a surprise to us given the weak economy, which will take a further hit from restrictions to combat the third Covid-19 wave, and high and rising unemployment. The prospect of rising local interest rates from 2022/23 also does not bode well for house prices over the medium term.

As for the flats market, vacancy rates in South Africa declined further to 11,4% in the second quarter of 2021 from 12,1% in the first quarter of 2021, according to Rode's residential survey data. However, vacancy rates are well above the 5% average recorded in the three years (2017 to 2019) that preceded the pandemic, implying that they are high compared to historical levels. High vacancy rates have put enormous pressure on rentals, which should continue in the short term as tenants remain under significant financial pressure.