Chapter 1: State of the property market

State of the property market in quarter 1 of 2022

The following are the significant findings or conclusions made in this issue of Rode's Report:

- The Russia-Ukraine war has raised expectations of higher inflation and interest rates and at the same time increased worries about global economic growth.
- The industrial property market continues to look best placed.
- The retail market, although not covered in detail in this publication, is performing better (see our sister publication *Rode's Retail Report*).
- The office market is still in the doldrums, but there are some positive signs emerging, like the better market rentals compared to the end of 2021 and only marginally higher vacancies.
- Flats are filling up slowly, but *real* rentals, like house prices, are still in negative territory.

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 2022:1) with data collected a year earlier.

Office market

The office market continues to be worst placed of the different property types, with the national decentralized vacancy rate (for grades A^{+}, A and B combined) increasing further, albeit marginally, to 4,4 points in the first quarter of 2022, up from 4,3 points in the fourth quarter of 2021, according to Rode's office vacancy survey. This equates to an average vacancy rate of 14,7%, still way above the long-term average of 8,8% since 2000.

The oversupply of space means tenants are spoilt for choice and clinching fantastic deals, which includes lower rentals. Rode's latest office market survey shows that, nationally, market gross rentals for decentralized grade-A space decreased by 2% year on year in *nominal* terms in the first quarter of 2022, thus declining for the seventh consecutive quarter. Encouragingly, the decline in rentals has eased gradually since the middle of 2021 when rentals fell by around 6% compared to a year earlier. In fact, rentals are up about 1% from the fourth quarter of 2021. This could be an early sign that the worst is over and that rentals are stabilising at lower levels as more workers trickle back to offices with Covid becoming less of an issue. However, there is one caveat: the above rentals are *nominal* rents, meaning no rental remissions, tenant installation allowances or a number of months rent-free are assumed. By the way, 'nominal' can also mean the rental has not been deflated (inflation taken out).

Regionally, Cape Town has been the surprise, with rentals shooting up from the low levels at the end of last year. Dead-cat bounce? However, rentals for all the major cities are still lower than the first quarter of 2021, indicating that the office market is still feeling the heat.

In the first quarter of 2022, grade-A nominal rentals (not deflated) decreased by 4,5% in Cape Town decentralised compared to the first quarter of 2021. Rentals declined by 2% year on year in both Johannesburg and Pretoria. This implies that no major city managed to record above-inflation rental growth compared to a year ago.

Industrial market

Relatively speaking, the industrial property market continued to shine in the first quarter of 2022, with nominal rental growth picking up to 4,1% year on year thanks to continued low vacancies amid a recovery in the manufacturing and retail sectors. In *real* terms, rentals increased at about the same pace as building-cost inflation (BER BCI). Looking at the bigger picture, nominal rental growth has accelerated after growing by 0,5% in 2020 and 2,2% in 2021.

This means the industrial sector is still comfortably the best placed of the major non-residential sectors, where vacancies are much higher, especially in office properties. One of the key reasons for the outperformance of industrial property is the largely non-speculative nature of developments. Within the industrial segment, logistics has been doing exceptionally well.

Table 1.1
Rental performance as at quarter 2022:1
% change from four quarters earlier (on smoothed data)

	Nominal	Real*
A-grade decentralized office rentals		
Sandton CBD	0,2	-3,5
Rosebank	-4,6	-8,2
Randburg Ferndale	-1,3	-5,0
Centurion	-12,8	-16,0
Hatfield	-1,4	-5,1
La Lucia/Umhlanga Ridge	-0,1	-3,8
Westville	-1,6	-5,3
Tyger Valley	1,6	-2,1
Century City	-5,5	-9,0
South Africa	**-2,0**	**-5,7**
Prime industrial rentals (500 m² units)		
Central Witwatersrand	4,1	0,2
East Rand	1,1	-2,7
Durban	4,3	0,5
Cape Town	6,7	2,8
South Africa	**4,1**	**0,3**

*Nominal values deflated by BER Building Cost Index

Nominal rentals for prime industrial space of 500 m² grew by 6,7% year on year in Cape Town in the first quarter of 2022, remaining above pre-Covid levels. This was the strongest growth of the major industrial conurbations. The Mother City's vacancy factor decreased sharply to 3,1 (on our vacancy scale), which implies a vacancy percentage of just above 5%. This has been the lowest vacancy rate since the end of 2020. Capitalization rates in Cape Town have also moved lower over the past few quarters, which means our panellists are viewing this sector in a more positive light than before.

Rentals in Durban and the Central Witwatersrand also continue to perform well, growing by 4,3% and 4,1% respectively, with vacancies generally still seen to be quite low (less than 5%), according to Rode's survey results. Rental growth was more subdued in the Far East Rand (+1,7%) and the East Rand (+1,1%). Vacancies remain the highest in Gqeberha (PE) and Bloemfontein.

Residential market

The housing market had a steady start to 2022, with nominal prices in the first two months growing by 3,8% year on year, albeit slightly slower than the 4,2% growth for the full 2021. However, in real terms the story does not seem so rosy, with house prices falling by about 2% so far in 2022 due to the sharp rise in consumer inflation to 5,7%. At this stage, it is highly likely that real house prices will decline for the seventh consecutive year in 2022.

Slower house price growth was expected as many of our avid *Rode Report* readers will know, given the fading impact of low interest rates amid record-high unemployment and an economy that is struggling to get back to pre-pandemic levels. In fact, interest rates have entered a rising cycle to counter higher inflation, with the prime rate ending March 2022 at 7,75% − up from its pandemic low of 7% in October last year. At this stage, the impact of the interest rate hike is not significantly slowing prices and volumes, but one would expect this to change as rates increase further. Inflation and interest rate expectations have generally been raised since our last report in December due to the impact of further increases in fuel and food prices as a result of the Russia-Ukraine war. The crucial question is by how much interest rates will be hiked and how swiftly. Nobody has a definitive answer to this one.

Turning to flats, vacancy rates averaged 9,9% in the first quarter of 2022, down slightly from 10,2% in the fourth quarter of 2021, according to Rode's residential survey data. Generally, vacancies have improved after hitting a peak of 13,1% in the fourth quarter of 2020. However, vacancy rates remain well above the 5,3% average recorded in the three years 2017 to 2019 that preceded the pandemic, implying that they are still relatively high.

High vacancy rates have put significant pressure on rentals. Official data from Stats SA show that nominal flat rentals in South Africa in the fourth quarter of 2021 declined by 0,2% compared to a year earlier − the first time rentals have moved into negative territory since at least 2009. However, PayProp data show rentals surprised on the upside in the fourth quarter of 2021, with growth of +0,8% year on year. Looking at the bigger picture, rentals are still declining in *real* terms after adjusting for consumer inflation. This means landlords are generally feeling the heat as costs are rising more than their income. Higher interest rates of course are also lifting bond instalments. ■