

Chapter 1: State of the property market

State of the property market in quarter 3 of 2022

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

- The property sectors, like many others, continue to be negatively affected by increased concerns about global and South African economic growth due to higher inflation and interest rates. With reference to the world economy, the IMF on 11 October warned “the worst is yet to come and, for many people, 2023 will feel like a recession”.
- The industrial property market, especially warehouses linked to logistics, continues to stand strong, despite the weakening economic backdrop.
- Green shoots are appearing in the office property market, but fundamentals generally are still poor.
- Capitalization rates of the retail property market are edging up, reflecting the weak outlook for consumer spending. For more on retail trends, see our sister publication *Rode's Retail Report*.
- Flat vacancy rates and rentals have improved further, but *real* rentals, like house prices, are still in negative territory.
- Building-cost inflation remains in the double digits, which makes it almost

impossible for rentals to grow in *real* terms, which will suppress new developments.

- Cape Town is outperforming the rest of the country based on Rode's office, industrial, flats and retail data.

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 2022:3) with data collected a year earlier.

Office market

The office market continues to be in the worst position of the three major non-residential property types due to its severe oversupply. However, the results of the latest Rode survey show that green shoots are appearing in the market as vacancy rates improved further in the third quarter of 2022, while nominal rental growth turned positive. This is further illustrated by Rode's capitalization rates declining from high levels. In other words, fundamentals are poor but improving somewhat. However, do not get too optimistic about the market given the general expectation of slow economic growth and the work-from-home trend, with hybrid working models proving popular.

Nationally, gross market rentals for decentralized grade-A space increased by 2% in *nominal* terms in the third quarter of 2022 compared to the third quarter of 2021, the first year-on-year increase in two years. To put it in perspective, this increase comes from a very low base as the third-quarter level of last year was the lowest during the pandemic. Nonetheless, the market has been boosted by the return of workers 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. Maybe we should call these "façade rentals" because we do not know for sure what is happening behind this wall! In *real* terms, rentals fell by a hefty 8% after deducting building-cost inflation (BER BCI), which stood at just above 10%.

Regionally, Cape Town looks to be turning over a new leaf, but note that rentals are also edging up in Johannesburg and Durban. However, rentals for all off the major cities are still lower than pre-Covid levels, meaning that the office market is still generally feeling the pain. In the third quarter of 2022, grade-A nominal rentals increased by 7,6% in Cape Town decentralized compared to the third quarter of 2021. Grade-A rentals increased by

3,8% in Johannesburg and by 1% in Durban. Pretoria bucked the trend, with rentals down 3,3%. This implies that no major city managed to record above-inflation rental growth compared to a year earlier. In fact, with the 11% rise in building cost, *real* rentals are still deep in negative territory, apart from those in the Mother City.

Industrial market

The industrial property market continues to be the cream of the crop due to its superior rental growth and low vacancies. Nominal rental growth for space of 500 m² rose by 5,3% compared to the third quarter of 2021. The market has been boosted by continued low vacancies, especially for warehouses linked to logistics, which stems from the strong online retail sales market.

This growth compares to the 5,4% in the second quarter, which implies a slight cooling in the accelerating trend observed since the middle of 2021. Looking at the year so far, rental growth has averaged 5,1%, well up from the 2,2% for the full 2021. However, the story is not so rosy in *real* terms, as building-cost inflation (BER BCI) is still elevated at about 11%.

Table 1.1		
Rental performance as at quarter 2022:3		
% change from four quarters earlier (on smoothed data)		
	Nominal	Real*
A-grade decentralized office rentals		
Sandton CBD	3,8	-6,5
Rosebank	3,4	-6,9
Randburg Ferndale	0,9	-9,2
Centurion	-3,6	-13,2
Hatfield	-7,0	-16,3
La Lucia/Umhlanga Ridge	0,2	-9,8
Westville	4,0	-6,4
Tyger Valley	10,5	-0,5
Century City	11,0	0,0
South Africa	2,0	-8,1
Prime industrial rentals (500 m² units)		
Central Witwatersrand	4,6	-5,9
East Rand	3,9	-6,5
Durban	4,4	-6,0
Cape Town	6,7	-4,0
South Africa	5,3	-5,2

*Nominal values deflated by BER Building Cost Index

Regionally, Cape Town is looking as fresh as a daisy, with nominal industrial rentals for prime space of 500 m² up by 6,7% year on year in the third quarter of 2022, remaining above pre-Covid levels, as the demand for space exceeds supply. This was the strongest rental growth of the major industrial conurbations, despite growth slowing somewhat from the 7,2% in the second quarter of 2022. The Mother City's industrial vacancy rate also declined further.

Nominal rentals in Durban and the Central Witwatersrand also continue to perform well, with growth of 4,6% and 4,4% respectively, albeit cooling slightly from the second quarter. Fundamentals in Durban are looking better as the July 2021 looting and floods in 2022 have created a shortage of space in some areas, with its vacancy rate declining to

just under 4%, better than the national average. Interestingly, rental growth picked up to 3,9% in the East Rand from 2,4% in the second quarter after averaging about 1% in 2020 and 2021. Vacancies remain the highest in the West Rand, Gqeberha (PE) and Bloemfontein at between 5% and 10%.

Residential market

The housing market continues to slow as expected, with *nominal* prices growing by 3,3% in the third quarter of 2022 compared to the third quarter of 2021, based on FNB data. This is down from the 3,8% growth recorded in the second quarter as the higher cost of living and rising interest rates eat into demand. This brings growth to 3,7% over the first nine months, marginally slower than the 4,2% growth for the full 2021. It implies that house prices are still declining sharply in *real*

terms, with the consumer inflation (CPI) rate averaging 6,6% so far in 2022.

At this stage, the impact of interest rate hikes is only having a marginal impact on prices and volumes, as these remain relatively low by historical standards, while banks are also competing for home loans by, for instance, reducing deposit requirements. Regionally, activity in the Western Cape was perceived to be the strongest of the major provinces, but it has also slowed.

Turning to flats, vacancy rates in South Africa averaged 7,8% in the third quarter of 2022,

down from 8,8% in the second quarter of 2022, according to Rode's residential survey data. This means vacancy rates continue to improve after hitting a peak of 13% in the fourth quarter of 2020. The improvement in vacancy rates has led to better-performing nominal rentals, but note that rental growth is not shooting out the lights. This suggests that property owners have generally tried to keep rental increases low to reduce vacancies. Regionally, Cape Town's flat vacancy rate fell to 4%, to the surprise of Rode. All in all, house prices and rentals are still declining in *real* terms in most parts of the country. ■