

Mind the gap

How stalling market-rental growth affects tenant installation allowances

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When tenants are considering leasing new offices, they mainly consider attributes such as the location, monthly rental and grade of building when comparing various office buildings with each other. However, one crucial aspect is often overlooked and that is the internal installation cost of the proposed new office space.

Landlords normally provide incoming tenants with a tenant installation allowance (TIA) to assist tenants with the cost of building their new office space. This allowance may be used for the interior fixtures such as air-conditioning, dry-walling, flooring, kitchenettes, ceilings, etc. The formula to calculate the TIA is always negotiated, but the market norm is that landlords provide as an allowance one month's office rental per year of the lease (parking and balcony/patio costs excluded). For example, if you conclude a three-year lease for a 250 m² office at a rental of R160/m², the TIA would be calculated as follows: 250 m² x R160/m² x 3 years = R120 000 plus VAT. It is important to note that this is applicable to spaces where an existing installation is already present, i.e. "second-hand space". New buildings (with no prior/existing office installation) are treated differently. In these cases, a TIA of R3 200 to R3 500/useable m² plus VAT is provided. This may sound steep, but the incoming tenant will have to fit out the space from a raw, grey-box state to fully installed.¹ This will include the cost of air-conditioning and ceilings, which are normally present in pre-used office spaces.

The rule-of-thumb TI allowance is directly linked to the rental payable by the incoming tenant. But, if we consider that during the past 10 to 14 years we have lived through a world financial crisis, the Zuma presidency, pitiful economic growth, the Corona virus and increasing inflation levels, one does not have to be a property economist to know that office rental rates have been under pressure for many years. Since market office-rental rates have seen meagre growth over this period, it means TI allowances – when using the old rule of thumb – have been lagging construction of office interiors over the same period.

Capitol's industry colleague and contractor, François Burggraaff from Sashona Walling, has provided us with a comparison of installation costs used in 2014 vs 2022. The table below shows the cost of certain items and the resultant growth in costs over this period. And this is exactly where the "gap" has been created. Little rental growth is causing flatlining of TI allowances, while construction costs have soared over the same period. Tenants are, therefore, faced with an ever-growing gap between the TIA provided by the landlord and the cost of installing the new offices. Thus, office installation costs are one of the biggest hurdles in concluding office leases in the current economic climate. It means one should question the practice by some landlords to white-box their preoccupied office units (demolishing the interior layout when an outgoing tenant vacates an office).

¹ For a definition of grey box and white box, see [Annexure 1](#) of this issue of *Rode's Report*.

Item	TI costs/useable m ²		Increase
	2014	2022	
2,7-m high partitioning	R980	R1 640	67%
Full-height painted doors	R2 150	R3 450	60%
Normal plug	R600	R1 050	75%
Dedicated plug	R50	R1 150	53%
Data routes in partitioning	R250	R450	80%
Light switch	R 300	R480	60%
600x600 LED light panel	R600	R850	41%
600x1200 suspended ceiling (vinyl)	R220	R340	54%
Berber Point carpets	R175	R310	77%
Painting (washable acrylic)	R44	R74	66%
Painting (doors)	R380	R520	36%
Unweighted average increase			61%

In these interesting times, some landlords have incentivised tenants by granting additional TI allowances depending on the lease period, rental, and escalation rate offered. This certainly helps tenants to bridge the gap between installation costs and the old rule-of-thumb TI allowance.

Now we must consider what happened to the rental rates of A-grade decentralized offices in Cape Town over the same period. For clarity, the term “decentralized” refers to all office nodes in Cape Town, except the Cape Town CBD and the V&A Waterfront. If we consider the 61% by which construction costs have increased, as indicated in the table, the creation of the gap will make sense if the office-rental growth was lower than that of the construction costs. And so it is. The rental growth has been only 29% over the corresponding period and, using the old rule of thumb, the tenant’s TIA has also grown by

a mere 29% – much slower than the growth in construction costs, which was about 61% over the period 2014 to 2022 (see the table).

To summarize, tenants nowadays must dig much deeper into their own pockets to construct their new internal office areas, unless the landlord comes to the party. Ten to fifteen years ago, we saw that tenants comfortably managed to do a basic installation with the TIA offered, but that is no longer the case. Therefore, tenants and landlords will have to be more creative to navigate this rising phenomenon. It will have to be a partnership where both parties are prepared to come to the table with, say, a higher TIA, higher rental rates and a longer lease period, to make a transaction financially viable. Or does this signal the point where tenants wanting their own front door have to accept that generic, open-plan spaces are the future? Δ

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