Chapter 1: State of the property market

State of the property market in quarter 4 of 2022

This issue's front page depicts a South African property market that is marking time, except for Cape Town. The reality is that we live in a very uncertain world, especially regarding SA politics, the economy, and the direction of interest rates. Add to this toxic brew the collapsing Eskom, and it is clear the property market will be stuck in low gear for years to come.

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

- Capitalization rates of all directly held non-residential property all increased (worsened) in the fourth quarter of 2022. The rise reflects a riskier property market environment due to expectations of weaker global and South African economic growth in 2023, including a worsening electricity supply crisis. Another factor that has put upward pressure on cap rates is the SA long-term bond yield, which increased sharply up to November.

- The office property market is still under pressure, despite experiencing slightly better fundamentals.

- The industrial property market, especially warehouses linked to logistics, continues to stand relatively strong.

- Flat vacancy rates and rentals have improved further, but *real* rentals, like house prices, are still in negative territory.

- Building-cost inflation remains in double digits, which makes it almost impossible for rentals to grow in *real* terms, which will suppress new developments.

- Cape Town is continuing to outperform 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 2022:4) with data collected a year earlier.

Office market

The office market remains challenging due to its significant oversupply, although fundamentals are looking slightly better. Vacancy rates for grades A$^+$, A and B have stabilized at about 14% in the fourth quarter of 2022, which is marginally better than the fourth quarter of 2021. Nominal rental growth is also picking up from a low base. 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, weighted gross market rentals for decentralized grade-A space increased by 3% year on year in *nominal* terms in the fourth quarter of 2022, after rising by 2% in the third quarter. This takes rental growth for the full 2022 to 1,1% – a recovery after two dismal years of declining rentals. The average 2022 rental on a national level was still 5,3% below the 2019 level, that is, before the Covid pandemic.

The market has been boosted by the return of workers to offices, albeit in many instances in a hybrid way, with the pandemic now firmly out of many people's minds. 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. In ***real*** terms, rentals fell by a hefty 7% after deducting building-cost inflation (BER BCI), which stood at close to 11%.

Regionally, Cape Town decentralized has been the clear best performer with grade-A nominal rentals in the fourth quarter of 2022 up by a whopping 16% compared to the fourth quarter of 2021. Rentals of grade-A decentralized office space increased by 4,8% in Johannesburg and by 2% in Durban. Pretoria continued to buck the trend, with rentals down 5,3%. For readers it is important to understand that these increases are year on year, meaning the fourth-quarter 2022 level is compared to the low level of the fourth quarter of 2021. We have also noted better rentals in secondary cities, such as Bloemfontein and George. In *real* terms, only Cape Town managed to record above-inflation rental growth.

Industrial market

The industrial property market had a decent 2022, with national nominal rentals for space of 500 m^2 rising by 5,3%, well up from the 2,2% for 2021. However, the story is not so bright in *real* terms, after deducting building-cost inflation (BER BCI) of about 11%. Turning to fourth-quarter survey results, rental growth remained stable at about 5,7% compared to the fourth quarter of 2021. This means the industrial sector is still comfortably the best placed of the major non-residential sectors. The market has been boosted by continued low vacancies, especially for warehouses linked to logistics, which stems from the strong online retail sales market as well as the revolution in racking systems, which allow for automated racks of 12 m and higher.

Table 1.1
Rental performance as at quarter 2022:4
% change from four quarters earlier (on smoothed data)

	Nominal	Real*
A-grade decentralized office rentals		
Sandton CBD	3,4	-7,0
Rosebank	5,4	-5,3
Randburg Ferndale	5,9	-4,8
Centurion	-1,1	-11,1
Hatfield	-3,6	-13,4
La Lucia/Umhlanga Ridge	-0,9	-10,9
Westville	7,0	-3,7
Tyger Valley	26,1	13,3
Claremont	14,2	2,5
South Africa	**3,0**	**-7,4**
Prime industrial rentals (500 m² units)		
Central Witwatersrand	6,3	-5,6
East Rand	5,0	-5,6
Durban	3,1	-7,3
Cape Town	5,0	-5,6
South Africa	**5,7**	**-5,1**

*Nominal values deflated by BER Building Cost Index

Regionally, Cape Town performed the best in 2022, with nominal industrial rentals for prime space of 500 m² rising by 6,3% year on year. Growth did cool somewhat to about 5% year on year in the fourth quarter. The Mother City's vacancy rate remains low at 3,8%.

Nominal rentals in the Central Witwatersrand and Durban also performed well in 2022, with growth of 5,4% and 4,6% respectively. Interestingly, rental growth in Central Wits picked up further in the fourth quarter to about 6%, even outpacing Cape Town. In Durban, fundamentals are strong as the July 2021 looting and floods in 2022 have created a shortage of space in some areas. Of interest is the fact that rental growth in the East Rand also lifted to 5% from 3,9% in the third quarter after averaging about 1% in 2020 and 2021. Industrial 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 down as expected as the higher cost of living and rising interest rates eat into demand. Nominal prices grew by 3,2% in November 2022 compared to November 2021, based on FNB data. Lightstone's ultra-smoothed index shows house price growth was even lower at 2,7% in October.

Price growth was 3,6% over the first 11 months of 2022, marginally slower than the 4,2% growth for the full 2021 (FNB data). At this stage, the impact of interest rate hikes is only marginal on prices and volumes, as these remain relatively low by historical standards.

In *real* terms, house prices fell sharply as the consumer inflation (CPI) rate averaged 6,8% over the same period.

Turning to flats, the market experienced a better 2022 compared to 2021, with vacancies declining and nominal rentals picking up slowly. Vacancy rates in South Africa averaged 6,8% in the fourth quarter of 2022, down from 7,8% in the third quarter of 2022, according to Rode's residential survey data. On a regional level, most provinces and cities covered by Rode showed better vacancy rates compared to the third quarter of 2022. The Western Cape continues to stand out with its low vacancy rate of 3,3%, which is way better than the national average. Gauteng also saw a better vacancy rate in the fourth quarter, but at 8,2% it is still above the national average. All in all, house prices and rentals are still declining in *real* terms in most parts of the country. ■