

State of the property market in quarter 4 of 2003

On the whole, conditions in the non-residential property market seem to be improving. Evidence of this can be found in the continued decline of capitalization rates as well the healthy office take-up recorded in especially the decentralized office nodes. However, by the end of 2003, there was still no recovery in the *real* rentals of office and industrial buildings.

In the residential property market, flat rentals were feeling the pressure from an oversupplied rental market.

Here is a short synopsis of the major trends in the property market:

- Capitalization rates continue to thrive on the increased demand from listed property funds and property syndicators.
- Hurdle rates are still too high.
- Listed property holds on to its market-value premium relative to directly-held property.
- *Real* office rents are still in a downswing.
- Hearty office take-up recorded in the suburbs.
- Port Elizabeth industrial rentals are gaining ground on the rental levels of the other main industrial conurbations.
- Flat rentals feel the pinch from an oversupplied rental market.
- The growth in home-builders' profit margins remains unaffected by softening building activity.

Quantitative overview of the property market

Table 1.1 gives a statistical snapshot of how the property market has performed over the past four quarters by comparing the latest information (quarter 2003:4) with that collected a year earlier.

Table 1.1		
The property market at a glance at quarter 2003:4		
% growth on four quarters earlier (on smoothed data)		
	Nominal	Real*
Prime CBD office rentals		
Johannesburg	-7,4	-17,3
Pretoria	3,1	-7,3
Durban	-2,6	-12,1
Cape Town	0,7	-9,1

* Nominal values deflated by BER Building Cost Index.

Table 1.1 (continued)
The property market at a glance at quarter 2003:4
% growth on four quarters earlier (on smoothed data)

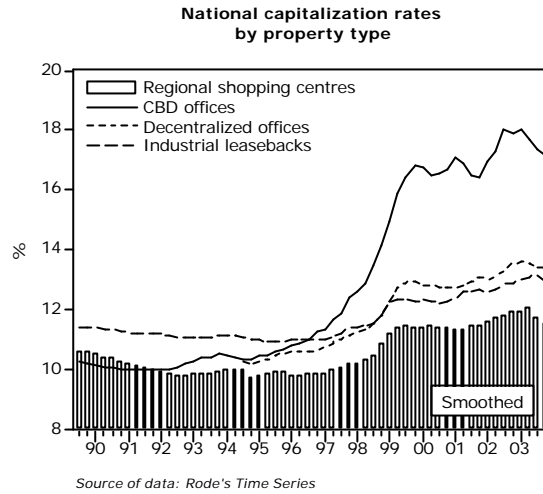
	Nominal	Real*
Prime decentralized office rentals		
Sandton CBD	-12,9	-21,5
Randburg Ferndale	6,6	-3,7
Brooklyn/Waterkloof (Pta)	18,5	6,8
Hatfield	11,4	0,5
Berea (Durban)	0,0	-9,9
La Lucia Ridge	11,0	0,1
Claremont (CT)	-23,6	-31,3
Tyger Valley	-12,9	-21,4
Prime industrial rentals (500m² units)		
Central Witwatersrand	1,3	-8,8
East Rand	12,2	1,1
West Rand	2,6	-7,5
Pretoria metro	-0,2	-10,0
Durban metro	1,0	-9,0
Cape Peninsula	7,2	-3,4
Port Elizabeth	12,5	1,3
Flat rentals (standard quality, 2-bedroom)		
Johannesburg metro	-3,0	-12,3
Pretoria metro	13,1	2,1
Durban metro	29,1	16,3
Cape Town metro	9,8	-1,0
Port Elizabeth	22,1	9,7

* Nominal values deflated by BER Building Cost Index.

Capitalization rates

On the whole, capitalization rates continued to decline in the last quarter of 2003, confirming the turnaround noticed in the previous quarter's *Rode's Report*. This implies that the tide is turning positive for non-residential directly-held property. Even the capitalization rates of industrials, the worst performing non-residential property type, started declining in quarter 2003:4, after still being on the up in the previous quarter.

This improving trend can be attributed to the sustained demand for non-residential directly-held property from listed property funds, and to a lesser extent from property syndicators. It could also be an indication that the oversupply from over-building is gradually being mopped up, which in itself implies that the prospects for market-rental growth must be improving.



Hurdle and escalation rates

The hurdle rate for buying existing properties was still around 19%, whilst in the case of developing on "spec", the hurdle rate has, on average, dropped well below 22% — the level it was still on one year ago.

However, our own investigation, using the financial market's inferred forecast for inflation, shows that the market hurdle rate is still unrealistically high.

Listed property

The last quarter of 2003 saw no noticeable change in the listed property sector's market rating relative to directly-held property, with the listed funds still standing at a market-value premium of about 5%. Still, the income yields of property unit trusts (PUTs) and capitalization rates of directly-held property both moved lower in the last quarter of 2003, but retained the same differential, implying that both listed and unlisted property's market rating improved during quarter 2003:4.

Office rentals and demand

On average, *real* decentralized office rentals continued their downswing in the last quarter of 2003. This is despite the healthy office take-up noticed in the suburbs. Still, if the robust take-up continues, it should only be a question of time before *real* office rentals start climbing again. According to our own forecasts, the turnaround in *real* decentralized office rentals should appear from the end of 2004.

In the CBDs, little has changed with respect to the secular (long-lasting) downturn, with only Johannesburg *real* office rentals showing some encouraging signs of a possible recovery. Still, our analysis of Sapoa's vacancy data shows that office take-up in the Cape Town and Pretoria CBDs in 2003 was healthy, which, if it continues, should eventually lead to increasing *real* rentals.

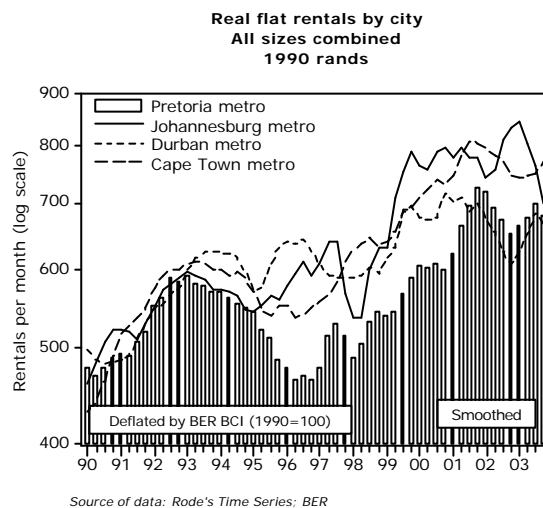
Industrial market

The upward march in Port Elizabeth's *nominal* industrial rentals continued in quarter 2003:4, boosted by a strong demand for industrial space by especially the automotive and related industries. But despite this heartening performance, Port Elizabeth's industrial rental *levels* are still lower than those in the other main industrial conurbations.

In the Cape Peninsula, the recovery in *nominal* rentals continued, whilst in Durban and on the Central Witwatersrand the performance in *nominal* industrial rentals remained muted, with little change noted from the sideways movement in rentals that has been evident since the end of 1997.

Flat rentals

Flat rentals, after adjusting for building-cost inflation, are essentially moving sideways. The exception is Johannesburg, where *real* rentals are falling sharply.



The building industry

Conditions in the building-construction industry remained favourable in the last quarter of 2003. Despite a softening in residential building activity, the mood remained positive, boosted by the present favourable interest-rate climate. As for home-builders' profit margins, there was still no end to the exuberant growth seen since 1998.

On average, building activity in the non-residential market continued to gain momentum, mainly because of the heightened activity noted in the building of industrial and warehouse buildings.

This concludes our section on the state of the property market. ■