State of the property market in quarter 2 of 2009

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

- Modest *real*-rental growth to hold back cap rates
- Still fairly good office-rental growth, but decelerating trend picking up
- Flat rentals flat-lining
- Signs of a nominal recovery, but *real* prices most likely to continue heading south

Quantitative overview of the property market

Table 1 provides a snapshot of how the property market has performed over the past four quarters by comparing the latest information (quarter 2009:2) with that collected a year earlier.

Table 1
The property market at a glance at quarter 2009:2*
% growth on four quarters earlier (on smoothed data)

	Nominal	Real**
Prime CBD office rentals		
Johannesburg	14,2	24,4
Pretoria	2,2	11,1
Durban	11,4	21,3
Cape Town	5,8	15,0
Prime decentralized office rentals		
Sandton CBD	1,4	10,2
Randburg Ferndale	15,0	25,2
Brooklyn/Waterkloof (Pta)	17,2	27,8
Hatfield	21,9	32,8
Berea (Durban)	7,3	16,6
La Lucia Ridge	14,4	24,5
Claremont (CT)	-7,8	0,8
Tyger Valley	13,1	23,1

* Unless otherwise specified
** Nominal values deflated by BER Building Cost Index; however, house prices are deflated using the Haylett Index.

Table 1 (continued) The property market at a glance at quarter 2009:2* % growth on four quarters earlier (on smoothed data)		
	Nominal	Real**
Prime industrial rentals (500m² units)		
Central Witwatersrand	9,2	18,8
Pretoria metro	-3,9	4,8
Durban metro	-1,2	7,6
Cape Peninsula	3,6	12,8
Port Elizabeth	0,3	9,3
House prices (all classes)* **		
Johannesburg metro	1,1	-0,3
Pretoria metro	-4,1	-5,4
Durban metro	-9,9	-11,2
Cape Town metro	-3,1	-4,5
Port Elizabeth	-18,3	-19,4
Flat rentals (standard quality, all sizes)		
Johannesburg metro	4,5	-3,5
Pretoria metro	0,4	-7,2
Durban metro	6,8	-1,3
Cape Town metro	3,2	-4,7
Port Elizabeth	3,8	-4,1

* Unless otherwise specified

** Nominal values deflated by BER Building Cost Index; however, house prices and flat rentals are deflated using the Haylett Index and the Consumer Price Index respectively.

*** Based on Absa's house price indices

Capitalization rates

In the second quarter of 2009, capitalization rates on retail and industrial properties moved sideways from the previous quarter's levels. Capitalization rates on prime office properties in the decentralized nodes of Johannesburg and Cape Town strengthened marginally, while those on office buildings in the decentralized areas of Pretoria and Durban also trended sideways. A notable exception is CBD office cap rates, which are – again – screaming northwards. This suggests that – unsurprisingly – secondary nodes fare worse than prime nodes during times of stress.

Office rentals

Although some office nodes are still recording fairly good growth in market rentals, the underlying trend seems to be one of deceleration in these growth rates.

In the decentralized office nodes of Johannesburg (+8%), Cape Town (+8%) and Durban (+6%) growth in market rentals has already cooled to the single digits. Even though decelerating growth was also observed in Pretoria decentralized, market rentals were, on average, still up by an impressive 15%. Over the same period, building-cost inflation – as measured by the BER BCI – is expected to have *contracted by* about 8%, which implies still-strong *real* rental growth in all of the decentralized areas.

Industrial market

In the second quarter of 2009, the Central Witwatersrand (+9%) recorded the best growth, while in the Cape Peninsula (+4%), Port Elizabeth (0%) and Durban (-1%) the impact of poor demand conditions on rental growth has become more evident. Nonetheless, these growth rates were still good enough to outperform building-cost inflation, which is expected to have contracted by roughly 8% over the same period.

Flat rentals

Flats rentals are at the moment trending sideways, and as a result showed dull growth, especially when compared to consumer inflation.

In the second quarter of 2009, rental growth in Durban was the best, growing by approximately 7% over the past year. Durban was followed by Johannesburg (+5%), Cape Town (+3%) and Pretoria (0%). Given that consumer prices grew by roughly 8% over the same period, contracting *real* flat rental growth occurred in all of these metropolises.

The house market

In August 2009, house prices were still roughly 3% lower than they were a year ago. More interesting, however, is that on a month-on-month basis, house prices were 0,2% up, which translates into an annualized rate of about +2,3%.

Interestingly, when one looks at house prices across the different value bands, growth in house prices on an annualized-monthly basis also seems to have turned the corner. Notwithstanding these tentative signs of a possible recovery in nominal prices, in *real* terms, house prices are still sky-high compared with previous levels. This, together with falling disposable incomes, lower wealth levels, high indebtedness and feeble consumer confidence will continue to depress prices in *real* terms for many years. This is despite higher LTVs granted by some banks and lower interest rates.

The building industry

Building activity, especially in the residential sector, remained in the doldrums in the second quarter of 2009.

In the reporting quarter, *real* gross fixed capital formation in residential buildings contracted by 8%, which comes as no surprise considering the tough time the house market has been going through. In the non-residential building sector − despite not being as hard-pressed as the residential sector − the growth in building activity decelerated to 7%, its lowest yearly growth rate in almost four years.

It follows that weak building activity will lead to reductions in demand for building-inputs and increased tendering competition amongst building contractors for the fewer new projects available. As a consequence, both the Haylett Index (which measures building-input costs) and the BER BCI (which measures both building-input costs and contractors' profit margins) are decelerating at an alarming pace.■