Chapter 1: State of the property market

State of the property market in quarter 4 of 2009

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

- Opposing forces acting on capitalization rates
- Cape Town and Johannesburg decentralized office rentals in the red
- Demand prospects improving, but industrial rentals now contracting
- Flat rental growth remains flat

Quantitative overview of the property market

Table 1.1 provides a snapshot of how the property market has performed over the past four quarters by comparing the latest information (quarter 2009:4) with that collected a year earlier.

Table 1.1
The property market at a glance at quarter 2009:4*
% growth on four quarters earlier (on smoothed data)

	Nominal	Real**
Prime CBD office rentals		
Johannesburg	3,7	13,3
Pretoria	14,1	24,6
Durban	12,5	23,3
Cape Town	0,0	9,4
Prime decentralized office rentals		
Sandton CBD	-13,0	-4,9
Randburg Ferndale	-1,2	8,0
Brooklyn/Waterkloof (Pta)	10,0	19,7
Hatfield	16,4	27,2
Berea (Durban)	14,0	24,5
La Lucia Ridge	0,2	9,4
Claremont (CT)	-16,8	-8,9
Tyger Valley	3,0	12,9

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

Table 1.1 (continued) The property market at a glance at quarter 2009:4* % growth on four quarters earlier (on smoothed data)		
	Nominal	Real**
Prime industrial rentals (500 m² units)		
Central Witwatersrand	-3,0	6,2
Pretoria metro	-7,8	0,8
Durban metro	-0,9	8,4
Cape Peninsula	-7,0	1,6
Flat rentals (standard quality, all sizes)		
Johannesburg metro	0,7	-5,3
Pretoria metro	-0,4	-6,5
Durban metro	3,5	-2,7
Cape Town metro	1,1	-5,0
Port Elizabeth	-2,4	-8,3

* 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.

Capitalization rates

After weakening (increasing) marginally during 2008 — as a result of uncertain economic conditions both locally and abroad — capitalization rates turned the corner in the first quarter of 2009, and headed marginally south and sideways again.

At the moment, however, opposing forces are seemingly playing tug-of-war with the future direction of capitalization rates. On the one side, scaled-down expectations regarding the direction of *real* rentals and the possibility of rising long-bond yields (due to increased government debt issuance needed to fund the budget deficit) could now result in upward pressure on capitalization rates. On the other side, the fact that landlords in S.A. are generally not under huge duress to sell (compared to their Anglo-Saxon counterparts), could mean that the most likely direction of capitalization rates might be sideways.

Office rentals

Overall, the growth performance of market rentals was weak in the fourth quarter of 2009. This was especially evident in Cape Town (-6%) and Johannesburg (-4%) decentralized, where rentals were, on average, lower than what they were a year ago. But, this comes as no surprise in light of the faster northward march of prime-office vacancies in these two decentralized regions. In the reporting quarter, growth in Pretoria and Durban decentralized still averaged 9% and 10% respectively.

Industrial market

Despite the improvement in manufacturing output and capacity utilization during the fourth quarter of 2009, market rentals for industrial property still shrank.

In the Central Witwatersrand (-3%), Durban (-8%), Port Elizabeth (-7%) and the Cape Peninsula (-1%) market rentals were —in the fourth quarter of 2009 — all lower than they were a year ago. However, having said that, real rentals were at least still able to show positive growth only because building-cost inflation, as measured by the BER BCI, is expected to have fallen off a cliff and contracted by 9%.

Flat rentals

Barring Durban, flat rentals in all of the major metropolises remained rather flat in the fourth quarter of 2009.

In Durban, flat rentals mustered growth of about 4%, while in Johannesburg, Pretoria and Cape Town rentals were roughly at the same level they were a year ago. The most disappointing rental performance was in Port Elizabeth, where flat rentals *contracted* by 2%. Naturally, one can conclude that these disappointing growth rates are indicative of the financial distress of incumbent and prospective flat tenants. Usually, during tough economic times 'doubling up' (e.g. children moving back to their parents, and so on) happens on a large scale, keeping the demand for residential space to rent (or buy) in check.

The house market

Good news for the ailing house market has been the heating up of the yearly growth in nominal house prices over recent months. In January 2010, after having already been accelerating since the second half of 2009, nominal house prices were up by 5%.

Despite this, questions remain as to whether or not growth in nominal prices will soon be "hot" enough to, more importantly, lead to a change in the direction of *real* house prices. One only has to consider likely nominal-house-price growth coolants, such as high household debt levels, rising unemployment, waning disposable incomes and high *real* house prices to conclude that this might not soon be the case.■