Chapter 1: State of the property market

State of the property market in quarter 3 of 2010

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

- Office rentals show some growth amidst headwinds
- Weakness in manufacturing not good news for industrial property
- House prices doing a double dip

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 2010:3) with that collected a year earlier.

Table 1
The property market at a glance at quarter 2010:3*
% growth on four quarters earlier (on smoothed data)

	Nominal	Real**
Prime CBD office rentals		
Johannesburg	-9,3	-9,2
Pretoria	1,2	1,1
Durban	4,0	4,0
Cape Town	-10,0	-9,7
Prime decentralized office rentals		
Sandton CBD	11,9	12,1
Randburg Ferndale	10,2	10,1
Brooklyn / Waterkloof (Pta)	2,7	2,8
Hatfield	11,3	11,5
Berea (Durban)	1,4	1,4
La Lucia Ridge	4,3	4,4
Claremont (CT)	-1,2	-1,7
Tyger Valley	-16,8	-16,8

* 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.

Table 1 (continued) The property market at a glance at quarter 2010:3* % growth on four quarters earlier (on smoothed data)		
	Nominal	Real**
Prime industrial rentals (500 m² units)		
Central Witwatersrand	-3,6	-3,5
Port Elizabeth	1,3	1,4
Durban metro	-5,5	-5,4
Cape Peninsula	0,1	0,3
Flat rentals (standard quality, all sizes)		
Johannesburg metro	1,3	-2,1
Pretoria metro	1,1	-2,2
Durban metro	3,1	-0,3
Cape Town metro	3,3	-0,2
Port Elizabeth	-0,8	-4,2
Bloemfontein	3,2	-0,3

* 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

At present, downward pressure on capitalization rates comes from benign inflation expectations, inflows of foreign portfolio capital, its positive impact on bond yields and, hence, required minimum income returns on substitute investments. However, doubts about the sustainability of rises in market-rental growth, as well as rising municipal charges, are probably exerting a counter-balancing influence.

These forces seem to be in equilibrium, hence capitalization rates were – generally speaking – in the third quarter of 2010, either marginally up or down compared to the previous quarter.

Office rentals

Even amidst the headwinds of a slowing economy and rising unemployment, office rentals in many of the country's nodes managed to put together some growth.

Although not vigorous, the growth in market rentals in Johannesburg (+5%), Durban (+4%) and Pretoria (+3%) decentralized, managed — in the third quarter of 2010 — to outperform building-cost inflation (0%). The disappointment came from Cape Town decentralized (-4%), where market rentals continued to contract.

Industrial market

In the third quarter of 2010, the fickle and uncertain nature of the economic recovery was exposed by the moderation in economic activity.

More disappointing, from an industrial property point of view, was that the slowdown was in large part attributable to a contraction in manufacturing production. This, given industrial property's reliance on a strong manufacturing sector, could mean more downward pressure on market rentals. Indeed, in the third quarter of 2010, growth in nominal rentals remained poor. The best rental performance came from Port Elizabeth (+1%), followed by the Cape Peninsula, where market rentals showed no growth. On the Central Witwatersrand (-4%) and in Durban (-5%) contractions in market rentals were still observed.

Flat rentals

Flat rentals have started to show signs of an acceleration in yearly growth, albeit modestly. In fact, in some regions growth has stepped up to rates that are now at least on a par with consumer inflation.

In the third quarter of 2010, nominal rentals in Durban, Cape Town and Bloemfontein were up by 3%, in line with the growth rate of consumer inflation (excl. housing). However, in Johannesburg (+1%), Pretoria (+1%) and Port Elizabeth (-1%) growth in nominal rentals was unable to keep up with inflation. This, of course, means that in these cities flat landlords continued to suffer the indignity of having flat rentals contracting in *real* terms.

The house market

Now that the base effects on the yearly growth in house prices have worn off, the weakness still inherent in the market has been exposed.

In November 2010, the growth in nominal house prices continued to lose momentum; so much so, that they were down by about 1% compared with a year earlier. However, more interesting is the fact that house prices have been contracting on a month-on-month basis since May 2010. Thus, in November, house prices were roughly 0,7% lower than the month before. Assuming prices continue to contract at this rate would result in values being as much as 8% lower in twelve months' time!■