State of the property market

State of the property market in quarter 2 of 2011

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

- Poor office demand a damper on rental growth
- Indicators flash health warning about health of industrial property
- Weak mortgage lending restrains house-price movements

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 2011:2) with that collected a year earlier.

Table 1
The property market at a glance at quarter 2011:2*
% growth on four quarters earlier (on smoothed data)

	Nominal	Real**
A-grade CBD office rents		
Johannesburg	-16,1	-15,8
Pretoria	9,2	9,8
Durban	7,2	7,7
Cape Town	4,7	5,2
A-grade decentralized office rents		
Sandton CBD	10,7	11,2
Randburg Ferndale	-6,4	-5,9
Brooklyn/Waterkloof (Pta)	-5,1	-4,6
Hatfield	-3,2	-2,8
Berea (Durban)	-9,0	-8,7
La Lucia Ridge	-1,0	-0,2
Claremont (CT)	-1,0	-0,5
Tyger Valley	1,0	1,1

* Unless otherwise specified
** Nominal values deflated by BER Building Cost Index; however, flat rentals are deflated using the Consumer Price Index.

Table 1 (continued) The property market at a glance at quarter 2011:2* % growth on four quarters earlier (on smoothed data)		
	Nominal	Real**
Prime industrial rentals (500 m² units)		
Central Witwatersrand	1,5	2,0
Port Elizabeth	2,5	3,0
Durban metro	2,9	3,4
Cape Peninsula	8,2	8,7
Flat rentals (standard quality, all sizes)		
Johannesburg metro	2,0	-0,5
Pretoria metro	6,3	0,3
Durban metro	1,7	-0,5
Cape Town metro	4,2	-0,1
Port Elizabeth	3,0	-0,3
Bloemfontein	3,1	-0,3

* Unless otherwise specified
** Nominal values deflated by BER Building Cost Index; however, flat rentals are deflated using the Consumer Price Index.

Capitalization rates

Despite rising inflationary pressures, long-bond yields have over the past few months been able to head marginally south (thus pushing up bond prices), seemingly supported by a revival in demand from foreign investors. But, global unease over the deepening European debt crisis remains — the outcome of which could be capital flight from emerging markets and a reversal of the current trend observed in long-bond yields. Rising bond yields will depress listed property prices (holding all other factors constant) and might also tend to push up directly-held property's capitalization rates.

Further unwelcome news for the capitalization-rate outlook must be the slowdown in economic activity in the second quarter of 2011, as this could mean a further postponement in the hoped-for recovery of properties' fundamentals. The effect of the delayed upturn might, naturally, be hesitancy by property investors to buy property at higher prices (that is, lower expected income returns (capitalization rates)).

Nonetheless, in the second quarter of 2011, capitalization rates for retail, prime office and industrial property still managed to move marginally south or sideways.

Office rentals

After starting the year off with vigour, the growth in office rentals waned in the second quarter of 2011.

On a national basis, office rentals mustered growth of 5%. This comes after having recorded robust growth of 9% in the first quarter of 2011. The weaker economic activity in the reporting quarter must be affecting business confidence and must be making firms think twice about expanding their premises or hiring new employees. The implications of this might naturally be continued lacklustre demand for office space to rent. Thus, for now, moderate growth in rentals remains the most likely outcome.

Industrial market

Just as the first signs of recovery in the industrial property market became discernible, signs also emerged that prospects for one of its support pillars are not all that rosy.

The recent sharp slide in the Kagiso Purchasing Managers' Index (PMI) — a reliable harbinger of manufacturing production — is the reason for concern. Still, in the second quarter of 2011, robust rental growth of 8% was still observed in the Cape Peninsula. This was followed by Durban, the Central Witwatersrand and Port Elizabeth, where rental growth rates of 3%, 2% and 1% respectively were recorded.

Flat rentals

At the moment, there is still not much for buy-to-let residential-property investors to be chuffed about, as rentals continue to show lacklustre growth.

On a national basis, in the second quarter of 2011, house rentals mustered yearly growth of about 1%, while rentals of townhouses remained at roughly the same levels they were a year ago. Flat rentals performed the best with growth of only 3%. Some pleasant news for investors in the buy-to-let market is that, after peaking at the end of 2009, flat vacancies have since been edging southwards. Having said this, they might still feel hard done by owing to the adverse impact of sharp rises in property taxes and electricity tariffs; this amidst weak growth in cash inflows (rentals). For now they can at least breathe a sigh of relief, considering the Bank's decision to keep interest rates steady for the time being.

The house market

For the moment, prospects for the struggling housing market remain dreary; this as weaknesses in the residential mortgage market are likely to persist.

After peaking in the first half of 2010, the yearly growth in the value of new mortgage loans granted for residential property has been heading strikingly south. In fact, the deceleration in growth has been so sharp that in June 2011 the value of new loans granted was actually lower than what it was a year earlier. Naturally, contractions in mortgage loans granted act as a restraining factor on price movements. Even so, in August 2011 nominal house prices were — on a national basis — still up by 5%. Despite what seems to look like a mild recovery in price growth, given the weakness in the mortgage market, continued weak growth in prices remains the likely outcome.■