State of the property market

State of the property market in quarter 4 of 2011

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

- Sandton office market booming
- Guarantee Fund a boon for prices in the affordable market segment
- Building-construction industry experiences stagflation

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 2011:4) with that collected a year earlier.

Table 1
The property market at a glance at quarter 2011:4*
% growth on four quarters earlier (on smoothed data)

	Nominal	Real**
A-grade CBD office rents		
Johannesburg	15,0	2,7
Pretoria	10,0	-1,4
Durban	-2,0	-12,0
Cape Town	11,0	-0,4
A-grade decentralized office rents		
Sandton CBD	15,7	3,7
Randburg Ferndale	-5,1	-14,7
Brooklyn/Waterkloof (Pta)	0,2	-10,1
Hatfield	0,0	-10,4
Berea (Durban)	-3,2	-13,0
La Lucia Ridge	2,7	-7,8
Claremont (CT)	0,8	-9,5
Tyger Valley	6,3	-4,0

Table 1 (continued) The property market at a glance at quarter 2011:4* % growth on four quarters earlier (on smoothed data)		
	Nominal	Real**
Prime industrial rentals (500 m^2 units)		
Central Witwatersrand	3,0	-7,7
Port Elizabeth	-1,1	-11,4
Durban metro	1,8	-8,8
Cape Peninsula	1,9	-8,8
Flat rentals (standard quality, all sizes)		
Johannesburg metro	7,4	1,3
Pretoria metro	0,3	-5,4
Durban metro	4,4	-1,5
Cape Town metro	3,6	-2,3
Port Elizabeth	4,1	-1,8

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

Capitalization rates

Signs of a possible improvement in investment demand for industrial and office properties became visible in the fourth quarter of 2011. This as capitalization rates on these property types strengthened (decreased) marginally.

For now, however, one should not read too much into this, considering that office and industrial vacancy rates are still stubbornly refusing to drop, while rentals are finding it difficult to beat inflation. This, naturally, does not augur well for capital-growth prospects.

Office rentals

There are early indications that the grade-A office market might be staging a recovery. The rally is being led by bellwether Sandton CBD, which showed a phenomenal grade-A rental growth of 16%.

Digging behind the scenes of Sandton's rental performance, reveals declining vacancy rates on the back of improving demand for A-grade space — but possibly at the cost of grade B space. Thus, in the latter half of 2010, the growth in demand for grade-A office space started to improve, eventually reaching growth of 2% in the fourth quarter of 2011. As is to be expected, vacancy rates moved south over the same period. In other top office nodes, however, the rental performance was not as impressive with nominal rental-growth unable to beat building-cost inflation.

Industrial market

For the time being, no improvement in the demand for industrial space is discernible, as vacancy rates continue to move sideways. In fact, if anything, there is a slight upward trend in vacancies. This explains the mediocre performance of industrial rentals.

Pretoria finished off 2011 the best, with rentals showing the strongest growth of 8% in the fourth quarter. The picture was, however, more dreary in the other conurbations, with nominal rental growth ranging between 2% and 3% for the Central Witwatersrand, the Cape Peninsula and Durban. In the windy city of Port Elizabeth, the climate is stormy indeed, with nominal rentals now having contracted by 1% year-on-year for the reporting and previous quarter.

Over the same period, building-cost inflation — as measured by the BER BCI — is expected to have accelerated to a whopping 14%. This, of course, implies that in *real* terms industrial rentals in all of these industrial areas are actually lower than they were a year ago. However, it must be said that the 14% reflects a rebound following years of building-cost decline. The current underlying growth in building costs is probably well below the double-digit mark.

Flat rentals

Flat and house rentals were able to show growth of 4% in the final quarter of 2011. Townhouse rentals, however, showed no growth when compared to a year ago. From this finding it is evident that townhouses are still oversupplied – a hangover from the boom period.

As if dealing with mediocre growth in rentals was not enough, landlords who do not meter electricity separately will soon face another severe hike in operating costs in the form of seriously higher power costs – this on top of ever-rising assessment rates.

On the positive side, however, landlords who still have to service mortgage debt can for now breathe a sigh of relief in light of the Reserve Bank's decision to keep interest rates steady for the time being.

The house market

A look at the housing market shows that prices in the middle-class segment remain stuck in a rut.

In February 2012, Absa's national house-price index showed no growth, with prices remaining roughly at the same level they were a year ago. At the start of 2012, the outlook for the economy remains modest, with the general consensus being slower growth in 2012 compared to 2011. This does not bode well for demand for housing. What's more, despite record low interest rates — for more than a year now — households or mortgage providers are seemingly not taking the bait of low borrowing costs. Consider here the contractions in value of new mortgage loans granted over residential property. For now, banks will continue to be constrained by the still frustratingly high ratios of debt to disposable income, which have not come down by much since the peak of the boom. A further factor that has entered the equation quite recently is the explosive growth in unsecured loans. These factors form an important brake on granting mortgage bonds – and one can add to this concoction the expected sharp increase in utility charges, expected more modest salary increases, and the fact that house prices are still very high in real terms. ■