State of the property market

State of the property market in quarter 1 of 2012

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

- Sentiment of property investors improves ever so slightly
- Drivers of office demand losing their oomph
- Office rentals contract

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 2012:1) with that collected a year earlier.

Table 1
The property market at a glance at quarter 2012:1*
% growth on four quarters earlier (on smoothed data)

	Nominal	Real**
A-grade CBD office rentals		
Johannesburg	+18,0	+4,8
Pretoria	+8,0	-4,2
Durban	-5,0	-15,5
Cape Town	+12,0	-0,4
A-grade decentralized office rentals		
Sandton CBD	+8,6	-3,4
Randburg Ferndale	-4,8	-15,4
Brooklyn/Waterkloof (Pta)	+7,3	-4,7
Hatfield	-2,5	-13,3
Berea (Durban)	+0,2	-10,9
La Lucia Ridge	+0,6	-10,6
Claremont (CT)	+0,1	-11,1
Tyger Valley	+5,6	-6,1

* 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 2012:1* % growth on four quarters earlier (on smoothed data)		
	Nominal	Real**
Prime industrial rentals (500 m² units)		
Central Witwatersrand	+10,3	-2,0
Port Elizabeth	-1,7	-12,7
Durban metro	+0,5	-10,7
Cape Peninsula	-1,1	-12,2
Flat rentals (standard quality, all sizes)		
Johannesburg metro	+7,2	+1,1
Pretoria metro	+0,0	-5,7
Durban metro	+4,8	-1,2
Cape Town metro	+3,3	-2,7
Port Elizabeth	+3,8	-2,2

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

Capitalization rates

While it's been a bumpy ride for capitalization rates, their direction over the past three years has been marginally south. This means that there was no major panic among direct investors and that, if anything, the investment mood remained buoyant.

Despite an upward trend since 2008, non-residential vacancy rates were in 2011 still below their early 21st century highs (see corresponding graph). This might, in part, explain property investors' refusal to panic, even amid the uncertain economic times. Of course, a property's vacancy rate has a direct impact on the perceived risk to its potential income. This will in turn affect the required income return (capitalization rate) at which investors will be willing to trade property.

Office rentals

Moderate economic activity is keeping the demand for office space at bay. As a consequence, vacancies are, in general, stagnant and flatly refuse to drop. This is in turn leading to an uninspiring rental performance. In fact, such has the impact of the lull in business activity been that the trend in real (BER BCI-deflated) rentals has been south over the past year.

In the first quarter of 2012, nominal market rentals in only Pretoria decentralized (+0,5%) could muster any growth at all. Nominal market rentals in Johannesburg decentralized remained at the same level as a year ago, whereas nominal market rentals in Cape Town (-1%) and Durban decentralized (-2%) contracted. Given that building-cost inflation — as measured by the BER BCI — is expected to show growth of roughly 13% during the year in question, the implication is that in all of these regions *real* rentals declined by between 11% and 13%.

Industrial market

The strong growth in output produced by the manufacturing sector must have been welcoming news for the industrial property market.

In the first quarter of 2012, manufacturing output accelerated to 8% (quarter-on-quarter, annualized). Disappointing, however, is that despite the impressive quarterly increase, growth decelerated on a yearly basis to 1% from slightly above 2% in the previous quarter.

The weakness in the manufacturing sector is likely to persist, considering the continued economic woes of the Eurozone, as Europe is a major destination for SA goods. However, there is another side to this story, namely the current weakness of the rand (as in mid-June 2012), not to mention its potential to weaken even further. Evidently, rand weakness makes SA goods more competitive, but what the outcome of this tug-of-war will be, is anyone's guess. This is especially so because of SA's vulnerability to fickle portfolio inflows, which prop up the rand exchange rate. Imagine a situation where portfolio inflows become outflows. Uncertainty is, therefore, high.

Needless to say, a poorly performing manufacturing sector does not bode well for the demand for industrial property and industrial rentals. In fact, in the first quarter of 2012 only on the Central Witwatersrand (+10%) were rentals able to buck the trend of generally poor yearly growth. In other major industrial conurbations, such as the East Rand (+3%), Durban (+0,5%),

the Cape Peninsula (-1%) and Port Elizabeth (-2%) rentals either showed poor growth or contracted when compared to a year ago.

Flat rentals

Nationally, in the first quarter of 2012, market rentals of flats and houses grew by 5% and 4% respectively. Townhouses lagged behind with rentals for this segment of the residential rental market, posting growth of only of 1%. Rentals for townhouses, therefore, continued on their sideways movement observed since 2009.

The house market

The most recent Absa House Price Index indicates that nominal house prices have now been contracting for four months year on year.

The latest figure shows a contraction of just below 6% since May 2011. This is the largest contraction recorded since the late 1980s. House prices last significantly deflated during the first half of 2009, after which they rebounded.

As a result, house prices are now, in *real* terms, moving closer to their long-run trend line, aided by high building-cost inflation (which is now much higher than consumer inflation). ■