State of the property market

State of the property market in quarter 3 of 2012

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

- Manufacturing woes a hurdle to industrial rentals
- Building industry still pessimistic but hanging in there
- Cons outweigh pros in the housing market
- Office rentals are stalling

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 2012:3) with that collected a year earlier.

Table 1
The property market at a glance at quarter 2012:3*
% growth on four quarters earlier (on smoothed data)

	Nominal	Real**
A-grade CBD office rentals		
Johannesburg	5,7	-4,8
Pretoria	6,9	-3,6
Durban	-7,9	-16,9
Cape Town	-2,9	-12,4
A-grade decentralized office rentals		
Sandton CBD	5,4	-5,0
Randburg Ferndale	-0,3	-10,1
Brooklyn/Waterkloof (Pta)	4,8	-5,4
Hatfield	-4,5	-13,9
Berea (Durban)	-5,8	-15
La Lucia Ridge	-4,9	-14,1
Claremont (CT)	0,2	-9,6
Tyger Valley	-1,3	-10,8

* 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 2012:3* % growth on four quarters earlier (on smoothed data)		
	Nominal	Real**
Prime industrial rentals (500 m² units)		
Central Witwatersrand	4,5	-5,7
East Rand	4,2	-5,9
Durban metro	4,2	-6,0
Cape Peninsula	4,2	-6,0
Flat rentals (standard quality, all sizes)		
Johannesburg metro	6,9	1,5
Pretoria metro	0,6	-4,5
Durban metro	4,3	-0,9
Cape Town metro	0,8	-4,3

* Unless otherwise specified

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

Capitalization rates

Capitalization rates for all non-residential property types continued to move sideways in the third quarter of 2012.

Although capitalization rates have strengthened (declined) since 2008, changes over the past year have been very marginal. Capitalization rates are the property equivalent of the forward earnings yield of equity. When they drop — holding constant market rentals and operating costs — market values tend to rise, and vice versa. Their steadiness over the past year is, naturally, good news for landlords in spite of the pressure on cash flows owing to stubborn vacancy rates, poorly performing market rentals and rising operating costs.

Office rentals

Hindered by soft labour market conditions — and general economic uncertainty — growth in the demand for office space has not been forthcoming. The result of this has been vacancy rates that are refusing to drop and market rentals that are showing a slight decline or at best feeble growth.

In the third quarter of 2012, rentals in the Pretoria suburbs showed the best annual growth of 2%. Nominal rentals in Johannesburg decentralized grew by 1%, while rentals in Cape Town (-1%) and Durban (-4%) decentralized shrank. Assuming building-cost growth of roughly 10% during the year in question, this implies that in all of these regions *real* rentals declined by between 7% and 14%.

Industrial market

Woes in the manufacturing sector are at the moment the biggest hurdle to industrial rentals.

Barring the adverse impact that the mining sector strikes have had on manufacturing output, the current weakness displayed in the manufacturing sector is, naturally, not surprising. Consider here the impact that the current moderation and in some cases absence of economic growth in many of South Africa's main trading partners is having on export demand. What's more, besides being an indication of weakened domestic demand for manufactured goods, the recent moderation in the growth of retail sales is also a bad omen for the demand for industrial (in particular warehouse) space. The manufacturing and retail sectors are the two support pillars of the industrial property market.

A look at rentals across the major industrial conurbations shows that nominal rentals have in recent years at least been able to move sideways. Growth wise, in the third quarter of 2012, nominal rentals on the East Rand, Central Witwatersrand, Durban and the Cape Peninsula were modestly up by between 4% and 4,5%.

Flat rentals

In recent quarters, the growth in flat rentals has started to accelerate to such as extent that in the third quarter of 2012 flat rentals were — on a national basis — up by a yearly rate of 6%.

Rentals on houses could only achieve growth of about 4% while those on townhouses remained at roughly the same level they were a year ago. Over the same period, consumer prices (excluding owners' equivalent rent) showed growth of roughly 5%, implying that flat rentals were at least able to show real growth. Considering the heavy weight of residential rentals in the calculation of headline CPI (the sum of actual rentals and owners' equivalent rent), residential rental growth is quite important. However, the moderate to poor growth at present has an almost negligible effect on the overall metric of consumer prices.

The house market

After starting 2012 off in contraction mode, nominal house prices have in recent months been able to show growth — albeit in the low single digits. In October 2012, national house prices were, according to both the Absa and FNB indices, up by about 3%.

Nevertheless, as things currently stand, the pros likely to support house prices continue to be outweighed by the cons. Factors that support growth are the return of growth in the value of new mortgage loans granted, the robust growth in disposable incomes recorded during the second quarter of 2012 and the surprise July 2012 interest-rate cut. But on the flip side, the unexpectedly high CPI reading for September (dampening the hope of another interest-rate cut for the year), broad-based weaker economic growth and its resultant scuppering of employment prospects, still-high household debt levels and tighter credit standards to households might all possibly place a damper on house prices.■