Chapter 1: State of the property market

State of the property market in quarter 4 of 2013

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

- Office rental growth not too shabby
- Industrial rentals in Durban showing strong growth
- An improvement in building activity, but still below recent historic highs

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 2013:4) with that collected a year earlier.

Table 1
The property market at a glance at quarter 2013:4*
% growth on four quarters earlier (on smoothed data)

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

* 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 2013:4* % growth on four quarters earlier (on smoothed data)		
	Nominal	Real**
Prime industrial rentals (500-m² units)		
National	4,2	-1,7
Central Witwatersrand	2,3	-3,5
East Rand	5,2	-0,8
Durban metro	9,1	2,9
Cape Peninsula	0,2	-5,4
Flat rentals (standard quality, all sizes)		
National	2,9	-2,9
Johannesburg metro	2,1	-3,7
Pretoria metro	2,5	-3,3
Durban metro	2,3	-3,5
Cape Town metro	8,2	2,1

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Office rentals

Despite office vacancy rates that stubbornly refuse to drop, the growth in market rentals in some of the country's top office nodes is not too shabby.

In the fourth quarter of 2013, nominal market rentals in Durban decentralized (+5%) showed the strongest growth. Cape Town and Pretoria decentralized recorded growth of 4% while in Johannesburg decentralized, rentals were up by about 3%. Over the same period, we estimate building-cost inflation — overall tender price inflation — to have shown growth of about 6%, which is roughly in line with the 7% growth in building-input prices. Nonetheless, the estimated 6% growth in building costs implies that, at the regional level, rentals were unable to show growth in *real* terms.

However, looking at decentralized averaged-rental growth often hides what's happening within the individual office nodes. A closer look within Johannesburg decentralized reveals nominal growth of 8% in the Sandton CBD. The strong rental growth in Sandton might, however, not be sustained in light of the node's high vacancy rate and the huge amount of additional office space that is in the pipeline. Other office nodes that showed decent inflation-beating growth in rentals were Menlyn (+12%), Century City (+10%), Brooklyn (+8%) and Illovo (+7%).

Industrial market

Growth in industrial rentals in Durban has been heating up, so much so that in recent quarters this city has been showing the strongest growth amongst the major industrial regions.

During the fourth quarter of 2013, prime industrial rentals in Durban were up by an impressive yearly rate of 9%. As for rental growth in the country's other major industrial conurbations, rentals on the East Rand were able to show growth of 5%. In the Central Witwatersrand and the Cape Peninsula, rental growth of 2% was recorded, while in Port Elizabeth rentals were unable to show any growth. We estimate building costs — overall tender prices — to have shown yearly growth of about 6% during the fourth quarter of 2013. This is roughly in line with the 7% growth in building-input prices. Thus, the estimated 6% growth in building costs implies that Durban was the only industrial conurbation which saw real growth in market rentals.

For now, conditions in the manufacturing sector remain challenging. This naturally places a lid on the demand for industrial space and might keep rentals growing at moderate rates. Naturally, the weak rand (not to mention its potential to weaken even further) will make S.A. goods internationally more competitive – but only for the time being, until inflation catches up.

Flat rentals

During the fourth quarter of 2013, rentals of townhouses were able to show the best yearly growth of roughly 5%, albeit from a low base. This was followed by flats and houses, whose rentals were up by about 3% on a national basis.

Regionally, flat rentals in Cape Town were the best performer as rentals here showed growth of 8%. However, the rental performances in Johannesburg, Pretoria and Durban were not as impressive, with modest flat rental growth of around the 2% mark. As a reference point, during the fourth quarter of 2013, consumer prices (excluding owners' equivalent rent) showed growth of just below 6%.

For now, lacklustre economic activity and the damper it places on the growth in employment will most likely continue to be unsupportive of households' financial position. The outcome of this will be continued modest growth in residential rentals.

The house market

Notwithstanding differences in growth trends, the main house price indices are for now at least in agreement on the rate at which house prices are appreciating.

According to the Absa index, the yearly growth in national house prices has in recent months been losing some of its momentum, while according to the FNB index it has heated up slightly. Both indices were, however, in agreement that in February 2014, national house prices were up by a yearly rate of roughly 8%.

Nonetheless, there remain headwinds that are likely to place a damper on the growth in house prices. Consider here:

- Still-high household debt-to-disposable income levels. Although credit-risk profiles did improve slightly during the fourth quarter of 2014, the debt-to-disposable income ratio remains uncomfortably high at 74%.
- Slumping consumer confidence levels, which might affect the willingness of households to make substantial financial commitments such as buying a house.
- The continued rise in property running costs such as property taxes and electricity, which naturally undermine the effective demand for housing ownership.
- Lacklustre economic growth and its damper on growth in employment and disposable income.■