State of the property market in quarter 3 of 2014

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

- Office rental growth decelerates in tandem with rising vacancy rates
- House prices are buoyed by a softening in bank lending policies
- Declining flat vacancies should bode well for rentals

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 2014:3) with that collected a year earlier.

Table 1
The property market at a glance at quarter 2014:3*
% growth on four quarters earlier (on smoothed data)

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

Table 1 (continued) The property market at a glance at quarter 2014:3* % growth on four quarters earlier (on smoothed data)		
	Nominal	**Real****
Prime industrial rentals (500-m² units)		
National	3,0	-5,4
Central Witwatersrand	1,9	-6,3
East Rand	4,2	-4,3
Durban metro	1,8	-6,4
Cape Peninsula	8,8	0,0
Flat rentals (standard quality, all sizes)		
National	4,6	0,2
Johannesburg metro	3,0	-3,2
Pretoria metro	3,0	-3,2
Durban metro	4,5	-1,8
Cape Town metro	2,9	-3,3

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

Office rentals

On the back of upward trending office vacancy rates, the growth in national decentralized office rentals has been losing steam. In the third quarter of 2014, market rentals for grade-A multi-tenanted office space could — on a weighted national basis — only record growth of 3%. With in-contract escalation rates at about 8%, many a landlord is already experiencing downward rental reversions on the expiry of leases, and this is set to continue unabated.

A look at the regions, shows the strongest growth in market rentals in Cape Town decentralized (+6%). This is followed by Pretoria and Durban, where market rentals are on average up by 5% and 3% respectively. In Johannesburg decentralized, market rentals remained at roughly their previous-year levels. In the third quarter of 2014, building costs are expected to have accelerated to roughly 9%. This implies that across the regions it has become less viable to erect new office buildings in the absence of secure long-term leases well above market levels. This trend can be expected to continue for many quarters, if not years.

Industrial market

Prospects for the industrial property market remain daunting, especially when considering the continued struggles of the manufacturing sector.

Surprisingly, in the third quarter of 2014, market industrial rentals in the Cape Peninsula and Port Elizabeth were actually able to show growth of roughly 9%. On the East Rand, market-related industrial rentals for prime space were up by 4% while on the Central Witwatersrand

and in Pretoria, rentals showed moderate growth of only 2%. Over the same period, building costs are estimated to have grown at about 9%. This implies that on the East Rand, the Central Witwatersrand and in Pretoria, industrial rentals continued to contract in *real* terms. In the Cape Peninsula and Port Elizabeth, nominal rentals were at least able to show growth in line with building-construction inflation.

The house market

In general, nominal house prices continue to show decent — consumer-inflation beating — growth.

In November 2014, the yearly growth in nominal national house prices ranged between 7% and 8%, depending which index you use. Naturally, one of the only logical explanations for the resilience of house prices seems to be lenders that have softened their lending criteria as the worst of the panic post 2008 is receding. Allegedly, banks are in some instances again lending as much as 100% of the market value of existing housing stock. Evidence of lender generosity also comes in the form of the strong growth in the value of new residential mortgages granted. Since the second quarter of 2013, the yearly growth in the nominal value of new residential mortgages granted has increased at an average yearly rate of about 16%. Add to this the fact that little new residential construction has taken place over the past five years, and we come close to explaining this phenomenon.

Flat rentals

On a national basis, in the third quarter of 2014, flat and house rentals were up by about 5%, while rentals for townhouses could only muster growth of 3%. The differences in growth rates can be ascribed to differences in new supply being added to the stock. Clearly, townhouses (in gated communities) are where most new supply is being added. This trend reflects both a change in lifestyle and security concerns.

Some good news for investors in the buy-to-let flat market is the decline in flat vacancies in recent quarters, with a current vacancy factor of only 3% nationally. This improvement in demand naturally bodes well for market rentals of flats.

A 23-year analysis of flat vacancies shows that the vacancy risk for owners of flats is quite low compared to landlords of office buildings. This low-risk characteristic of residential properties does mean that a specialist apartment-owning fund would probably be well received on the JSE.■