State of the property market in quarter 3 of 2015

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

- Modest growth in office rentals continues
- Manufacturing output grows, but sector still far from being out of the woods
- More heavy blows expected on the housing market front.

As we are writing this, the news broke that the President has axed the Minister of Finance, Mr Nhlanhla Nene. Economists seem to agree that the implications for South Africa could be severe, including a greater chance of an early degrading to junk status

of RSA sovereign bonds (long-bond yields rose by about 140 bps within 36 hours), a greater possibility of a recession in 2016, faster rising interest rates, and so on. The reason for the negative reception of the announcement is that Mr Nene was regarded as the gatekeeper to fiscal prudence, and his successor is an unknown quantity. In fact, the suspicion is that Mr Nene was fired because of his attempt to reign in spendthrift SAA.

This development could make any forecasts done before the axing announcement seem optimistic. However, *Rode's Report* is mainly about the past; for forecasts see our sister publication *Rode's SA Property Trends*, which will be updated before the end of December 2015.

Table 1
The property market at a glance at quarter 2015:3*
% growth on four quarters earlier (on smoothed data)

	Nominal	Real**
A-grade decentralized office rentals		
National decentralized	3,9	-5,2
Sandton CBD	-1,1	-9,7
Randburg Ferndale	8,3	-1,1
Brooklyn/Waterkloof (Pta)	-5,8	-14,0
Hatfield	-2,7	-11,1
Berea (Durban)	10,8	1,2
La Lucia Ridge	0,1	-8,6
Tyger Valley	4,9	-4,2
Claremont	14,6	4,6
Century City	6,5	-2,8

* 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 2015:3* % growth on four quarters earlier (on smoothed data)		
	Nominal	**Real****
A-grade CBD office rentals		
Johannesburg	8,2	-1,3
Pretoria	-7,8	-15,8
Durban	1,0	-7,7
Cape Town	8,9	-0,6
Prime industrial rentals (500-m² units)		
Central Witwatersrand	6,4	-2,9
East Rand	4,7	-4,4
Durban metro	3,7	-5,3
Cape Peninsula	5,9	-3,2
Flat rentals (standard quality, all sizes)		
National	6,4	1,7
Johannesburg metro	1,3	-3,2
Pretoria metro	6,6	1,9
Durban metro	2,9	-1,6
Cape Town metro	13,2	8,2

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

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 2015:3) with that collected a year earlier.

Office rentals

For now, weak levels of business confidence will most likely continue to undermine the demand for office space to rent. This, naturally, will not augur well for vacancy rates and consequently for the growth in market rentals.

In the third quarter of 2015, market office rentals were on a national-decentralized basis up by only 4%. A look at growth at the regional level shows the strongest growth in Johannesburg decentralized (+5%), followed by Cape Town (+3%) and Pretoria (+2%). In Durban decentralized market office rentals remained at roughly their previous year levels.

Industrial market

Good news for the industrial property market comes from the manufacturing sector. Possibly thanks to a weak exchange rate, output produced by the manufacturing sector was again able to show growth. After contracting (-0,6%; y-o-y) in the second quarter of 2015, output produced by the manufacturing sector was again able to show growth (+1,4%; y-o-y) in the third quarter of 2015.

Bad news for the industrial property market was the October 2015 slump in the Barclays Purchasing Managers' Index (PMI). This suggests that the manufacturing sector is not yet out of the woods and will most likely continue to place a damper on rental growth.

Nonetheless, in the third quarter of 2015, industrial rentals in the Cape Peninsula and on the Central Witwatersrand were up by 6%. This was followed by the East Rand and Durban where rentals grew by 5% and 4% respectively. In the quarter under review, building-cost inflation — as measured by the BER BCI — is expected to have shown growth of 9%, implying that over the last year industrial rentals in all of major industrial conurbations were unable to grow in real terms. This is another way of saying that new speculative developments have become less viable.

The house market

In November 2015, national house prices in the middle segment of the market were only 4% higher than a year earlier. More revealing, however, is the fact that the average middle-segment house price (according to Absa) was up by only 0,1% when compared to the month before. This implies – assuming house prices continue to grow at this rate – growth of roughly only 1% over the next twelve months.

But considering the fact that it can take up to three quarters for interest rates to have a significant impact on house prices, the full blow of the November interest-rate hike still has to filter through the economic system. Thus, more downward pressure on house prices should be expected. Another reason to be cynical about the prospects for house prices is the firing of the Minister of Finance on 9 December. The prospects for steeper and swifter interest-rate rises in 2016 by the Reserve Bank, have consequently got stronger. And so has the possibility of a recession in 2016.

Flat rentals

For now, there are some signs of life as seen in the decent growth in flat rentals in some of the country's major cities. However, whether this will be sustained is debatable, given households that remain financially stretched, and are about to become even more so.

Nonetheless, despite decelerating slightly in the third quarter of 2015, national nominal flat rentals were still up by 6%. A look across the major cities again shows the strongest growth in flat rentals in Cape Town (+13%). There is anecdotal evidence aplenty that well-educated South Africans are semi-grating in large numbers to the Western Cape. This might in part explain the strong growth in flat rentals. Cape Town was followed by Pretoria (+7%), the East Rand (+6%), Durban (+3%) and Johannesburg (+1%). Anecdotal evidence is that the migrants come from the latter two cities.

In the same quarter, consumer inflation (excluding owners' equivalent rent for flats) showed yearly growth of 5%, implying that rentals in Cape Town, Pretoria and on the East Rand were able to grow in real terms.■