State of the property market

State of the property market in quarter 4 of 2017

The South African property market ended 2017 on a better footing, with industrial property and flat rentals managing to outpace inflation. The vacancy rates for these two property types are considered fairly low. However, the same can't be said about office and retail property.

It was a good year for listed property, which was the best-performing traditional asset class after stocks. Listed property, however, started 2018 on a very low note as you will read in **Chapter 4**.

Economic growth and economic prospects have lifted since late last year, with President Cyril Ramaphosa's election definitely playing a role in raising confidence levels. Our new President has certainly hit the ground running, but the question remains how steadfast he will be in the face of the populists in his party. We agree with most economists that 2018 will be a better year for economic growth, but don't see a significant improvement as several structural issues (such as the quality of education) and cyclical problems (notably the fiscal crisis) remain. The proposed land expropriation without compensation naturally also poses a risk. A summary of the main findings per property type follows.

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 2017:4) with that collected a year earlier.

Office rentals

The office market continues to struggle under a significant oversupply. In the fourth quarter of 2017, nominal market rentals in Johannesburg decentralized performed the best of the major cities, growing by 5% compared to the fourth quarter of 2016. Rental growth in Cape Town (+2%) and Durban (+1%) continued to be slow, while Pretoria recorded its first decline since 2011.

In comparison, in the reporting quarter, building-cost inflation (as measured by the BER BCI) is expected to have shown yearly growth of about 6%. This implies that in all of the major office regions nominal market office rentals declined in *real* terms. This is another way of saying that new developments are becoming ever less viable.

Table 1
The property market at a glance in quarter 2017:4*
% growth on four quarters ago (on smoothed data)

	Nominal	Real**
A-grade decentralized office rentals		
Sandton CBD	3,3	-2,4
Randburg Ferndale	-3,1	-8,5
Brooklyn / Waterkloof (Pta)	1,5	-4,1
Hatfield	3,2	-2,5
Berea (Durban)	6,7	0,7
La Lucia / Umhlanga Ridge	-2,1	-7,5
Claremont	9,7	3,6
Tyger Valley	-3,9	-9,2
Century City	7,3	1,4
Prime industrial rentals (500m² units)		
Central Witwatersrand	6,2	0,3
East Rand	3,7	-2,0
Durban metro	7,7	1,7
Cape Peninsula	14,2	7,8
Flat rentals (standard quality, all sizes)		
Johannesburg metro	4,4	-0,3
Pretoria metro	7,5	2,6
Durban metro	12,1	7,1
Cape Town metro	3,9	-0,8

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

Industrial market

Industrial property rentals, unlike office property rentals, managed to beat building-cost inflation in the fourth quarter of 2017, with a solid performance from most major industrial areas, where vacancy rates generally are low. Vacancy rates in other industrial areas, such as Pretoria, Port Elizabeth and Nelspruit, averaged comparatively higher between 10% and 20%.

In the fourth quarter of 2017, nominal market rentals for prime industrial space (500m²) in the Cape Peninsula again performed the best of the four major industrial regions in South Africa, with growth of 14% year on year. Rentals in Durban, Central Witwatersrand and the East Rand grew by 7%, 6% and 4% respectively.

The changes in rentals and vacancy rates are strongly linked to the performance of the manufacturing and retail sectors, as well as business confidence levels. All of these drivers have performed better since late 2017, with the February 2018 Barclays Manufacturing PMI above the 50-point neutral mark for the first time since May 2017. The RMB/BER Business Confidence Index also jumped by 11 points to 45 in the first quarter of 2018. Improved confidence, if it can be sustained, bodes well for prospects for industrial property rentals and vacancy rates. However, we have our doubts due to structural and cyclical issues, most notably the fiscal crisis, facing the economy.

Flat rentals

Flat rentals across South Africa grew by a yearly rate of 6,4% in the fourth quarter of 2017, just outpacing building-cost inflation of about 6% and comfortably beating consumer inflation of just under 5%. It is difficult to read much into one quarter's figure, but the fourth quarter was the first time that rental growth accelerated from the previous quarter since the start of 2016.

Many South Africans are left with no option but to rent as the current economic climate has made owning a house unaffordable. During the survey quarter, nominal flat rentals in Durban grew at double digits, the best performance of all major cities for the third consecutive quarter. This was followed by Pretoria and Cape Town, where rentals were up by about 8% and 6% respectively. Johannesburg's rental rate grew only slowly, while at the same time its vacancy rate moved into double digits. This implies that all cities, barring Johannesburg, managed to beat inflation (consumer price increases excluding owners' equivalent rent) of about 5%.

The house market

Nationally, house prices gradually accelerated throughout 2017, with nominal growth peaking at 4,9% in the fourth quarter, before slowing again in early 2018 (source: FNB). For now, Cape Town remains the only major city, and KwaZulu-Natal the only province, where house prices are beating inflation. The drought appears not to have had much impact on Cape Town's house prices yet, but it remains a threat should winter rains disappoint again and the much-talked-about "Day Zero" arrives. ■