State of the property market in quarter 1 of 2020

After another tough year for the South African property market in 2019, some of us were hopeful for a better 2020. This looks highly unlikely given the weaker first-quarter Rode survey data and the growing negative impact of Covid-19 on the global and SA economies.

Please note that Rode's surveys for the first quarter were completed before the spread of the coronavirus (Covid-19) became a major crisis in the public mind. Thus, property values and rentals could come under severe pressure in the near term – possibility not reflected in this issue.

A summary of the main findings by property type follows.

Quantitative overview of the property market

Table 1.1 on the next page provides a snapshot of how the property market has performed over the past four quarters by comparing the latest information (quarter 2020:1) with data collected a year ago.

Office market

Nationally, nominal market rentals for grade-A office space in the first quarter of 2020 were roughly the same as in the fourth quarter of 2019. Rentals increased by 3,7% compared to a year ago, in line with the 4% year-on-year growth recorded at the end of last year. However, rentals continue to be in negative territory when measured in *real* terms, after accounting for building-cost inflation (BER BCI) of about 5%.

Over the past year, grade-A Cape Town rentals were the best performer (+7%). Rentals grew by about 5% and 4% in Johannesburg and Durban respectively, while rentals failed to grow in Pretoria. This implies that only Cape Town managed to record above-inflation rental growth.

The office market remains worst placed of all the property types due to its significant oversupply. We expect 2020 to be a very tough year for the office market as demand will worsen, given the growing challenges facing the global and SA economies, now also related to Covid-19. In the short term, the virus will reduce office demand as some companies will be forced to close permanently due to financial losses, while "work-from-home" policies could also become common. Holding all other factors constant, the latter phenomenon will slow the demand for office space structurally, leading to even higher vacancy rates and weaker rentals.

Industrial market

Until 2019 the industrial market was the shining star of the South African property market but is now under increasing pressure as rental growth is slowing and vacancy rates rising.

Nominal industrial market rentals on a national level grew by 2% in the first quarter of 2020 – the second consecutive quarter of slower growth after rentals still expanded by 6% in the third quarter of 2019. Rentals have been significantly impacted by the weak economy, particularly the worsening performance of the manufacturing and retail sectors. This implies that rentals grew at a slower rate than building-cost inflation.

Nationally, nominal rental growth for prime industrial space of 500 m² was the fastest in Cape Town at about 4%, despite growth slowing from 5%. Rentals grew by 3% and 2% in Durban and the East Rand respectively, while rental levels stayed roughly the same in the Central Witwatersrand. Vacancy rates in most regions are showing an upward trend compared to last year.

Residential market

The housing market remains under pressure, with national house price growth continuing to slow in early 2020. National house prices, as measured by FNB, grew by 3,1% in nominal terms in February 2020 compared to February 2019. This implies that prices have continued to decline in real terms, after adjusting for building-cost inflation.

The interest rate cuts of 2020 will be slight support – but by far not enough – to cancel out the deleterious effect of the recession, which has been exacerbated by Covid-19.

In the flat market, vacancy rates have increased to 6,1% in the first quarter of 2020 from 5,5 in the fourth quarter of 2019. High flat vacancy rates have led to slower rental growth, which averaged 3,8% on a yearly basis in the fourth quarter of 2019. This implies that rentals rose at roughly the same rate as consumer inflation, but lower than building-cost inflation. Flat vacancy rates will likely rise more in the short term as the shrinking economy, now aggravated by Covid-19, puts significant financial pressure on many tenants. A positive for the oversupplied market is that new completions are slowing, while developers are also planning to build less. ■

Table 1
Rental performance as at quarter 2020:1
% change from four quarters ago (on smoothed data)

	Nominal	Real*
A-grade decentralized office rentals		
Sandton CBD	5,3	-0,1
Rosebank	4,1	-1,3
Randburg Ferndale	1,0	-4,2
Centurion	-2,5	-7,5
Menlyn	3,0	-2,3
Berea (Durban)	-6,9	-11,7
La Lucia/Umhlanga Ridge	4,1	-1,3
Claremont Upper	4,4	-1,0
Tyger Valley	10,6	4,9
Century City	10,4	4,7
Prime industrial rentals (500-m² units)		
Central Witwatersrand	-0,1	-5,3
East Rand	1,5	-3,7
Durban	2,7	-2,6
Cape Peninsula	4,1	-1,3

*Nominal values deflated by BER Building Cost Index (2016 = 100)