

Chapter 1: State of the property market

State of the property market in quarter 4 of 2020

After a very tough 2020, the property market ended the year better, with listed property prices recovering strongly in November and into December, boosted by greater optimism regarding global economic growth following the expectations of the widespread use of vaccines against Covid-19, and better than expected company financials (see **Chapter 4**). But, by 14 December prices were still down 38% compared to end-2019 levels, which implies the recovery still has a long way to go.

However, even though company results were not as dire as anticipated, most companies did not declare a distribution and where funds did pay a distribution to shareholders, the pay-out was much lower than in the previous comparable period. This is illustrative of a still tough operating environment and uncertainty about Covid-19, especially as the virus will still be around for about a year before First-World countries reach herd immunity. In Third-World countries such as South Africa, herd immunity will probably lag by another six months. So, the Covid-19 effect is far from over, not to mention South Africa's other growth constraints.

Our fourth-quarter report shows that the office market has weakened further, with rentals heading south and capitalization rates rising (see **Chapter 2**). The flats market is also feeling the heat. The good news is that house prices and industrial properties, the

latter boosted by logistics, are proving resilient. The retail market is also recovering, but the second Covid-19 wave is a big threat to the sector's prospects. Shopping centres in communities/neighbourhoods and low-income areas still seem to be in favour.

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 2020:4) with data collected a year earlier.

Office market

The South African office market remains in serious trouble due to a swelling oversupply, with vacancy rates at levels last seen in 2003 amid weak demand (see **Chapter 6**). The large and growing amount of available space is giving tenants the upper hand in lease negotiations, leading to concessions such as longer rent-free periods and lower rentals on renewal.

National rentals for decentralized grade-A space decreased by 4% year on year in the fourth quarter of 2020, thus declining for the second consecutive quarter (see **Chapter 5**). Rentals fell by 1,2% in 2020. Of course declining market rentals as opposed to escalating contractual rentals help tenants

only at the time of reverting to market rentals – unless the tenant can negotiate a rental remission before the renewal date.

The sharp downturn in construction activity is a boon for the office market, which, together with the conversion of older office space, could put the market on a better footing in a few years' time if there is a demand recovery in the medium term. Sadly, this is an unrealistic scenario at this stage.

Industrial market

The industrial market is showing its mettle, with rentals staying reasonably stable in the second half of 2020 amid low, albeit rising, vacancies. Its main drivers, the manufacturing and retail sectors, rebounded in the third quarter after the second-quarter collapse, which has helped but probably won't be sustained in the near term given the global economic setback created by the resurgence of Covid-19 in key export regions such as Europe.

No doubt, the strong and growing demand for logistics boosted by the growing popularity of online retail is also supporting this sector. The market appears to be on a much better footing than the office and retail property markets, where the oversupply is substantial. The secret of the industrial property market's resilience is of course that few speculative developments are taking place.

Nominal rentals for prime industrial space remained relatively stable on a regional level compared to the third quarter, which is positive in the sense that rentals have not fallen deeper into negative territory as has been the case with office property. Rentals for prime space of 500 m² grew by 2% and 1% in Durban and the East Rand respectively.

In contrast, nominal rentals fell by 1% in both the Central Witwatersrand and Cape Town, while falling sharply in Port Elizabeth, which has some of the highest vacancies in the country. Cape Town has seen rising vacancies since the third quarter, which no doubt has put downward pressure on rentals.

Residential market

The positive momentum in the housing market, which some even describe as a "mini-boom", continued into the early parts of the fourth quarter, with residential agents reporting a record number of sales in many cities and towns. We assume this 'boom' is largely pent-up demand that is now being released, boosted by the 300 bps drop in interest rates.

However, this recovery in the number of transactions is not matched by sharp upward price movements. Nationally, nominal house prices grew by only 2,6% in October 2020 compared to October 2019 as the market recovered after the lows of the second quarter, as discussed in **Chapter 10**. No doubt the record-low interest rates have attracted buyers, especially in the hot middle segment of the market. Lower interest rates have also lured many tenants into purchasing property, which has negatively affected the rental market. However, considering the trend for the year, the story is not as bright. Prices grew by 1,8% in the first 10 months of 2020 compared to the same period in 2019, implying that full-year price growth will slow for the sixth consecutive year in nominal terms. This implies that the rate of growth has continued to decline in real terms after having taken out inflation, which has averaged 3,3% so far in 2020.

The preference for buying instead of renting, together with the dire state of consumers' finances, has contributed to flat vacancy rates rising further to 13% in the fourth quarter, according to Rode's survey data shown in

Chapter 9. High and rising flat vacancy rates have led to weaker rentals. The oversupply of flats is also linked to huge increases in new rental stock in 2018 and especially 2019. ■

Table 1.1
Rental performance as at quarter 2020:4
 % change from four quarters ago (on smoothed data)

	Nominal	Real*
A-grade decentralized office rentals		
Sandton CBD	-5,8	-7,0
Rosebank	-1,9	-3,1
Randburg Ferndale	-4,7	-5,8
Centurion	7,6	6,3
Menlyn	-7,0	-8,2
Brooklyn/Waterkloof	-4,0	-5,2
Berea (Durban)	-3,4	-4,4
La Lucia/Umhlanga Ridge	-1,0	-2,2
Claremont Upper	3,2	1,9
Century City	-2,8	-4,0
Prime industrial rentals (500-m² units)		
Central Witwatersrand	-1,5	-2,7
East Rand	1,1	-0,1
Durban	2,3	1,1
Cape Town	-0,6	-1,8

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