Chapter 1: State of the property market

State of the property market in quarter 3 of 2021

The property market continued to recover in the third quarter of 2021 as indicated by the further increase in listed property prices, boosted by higher global economic growth and better-than-expected company results. Listed property prices at the end of September were 20% higher than at the end of 2020. However, looking at the bigger picture, prices were still 10% below those as at the end of February 2020, just before Covid-19 emerged in South Africa. This implies that the sector is recovering, but still has a long way to go to reach pre-pandemic levels.

The move to Covid lockdown level 1 at the end of September is a welcome boost for the economy and property market, which will no doubt support the recovery. However, we are not out of the woods yet due to a possible fourth wave closer to the end of 2021, given that only about 21% of the population had received a first vaccine dose by the end of September, while worryingly only 15% had been fully vaccinated. This implies that it will be a bumpy road ahead.

Fundamentally, industrial property remains in the best position compared to the other non-residential property types. The retail market has recovered well, while the office market remains significantly oversupplied and as a result the riskiest.

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 2021:3) with data collected a year earlier.

Office market

Just when it looked as if more workers would return to the office, the third Covid-19 wave came along in June. Another wave closer to the end of 2021 means office property owners are bracing themselves for even tougher times over the short term as many workers will continue to stay away from the office. That said, the impact of the work-from-home trend over the long term is probably overstated as working completely from home won't work for many companies, especially large corporates, as humans need face-to-face interaction to build a company culture and morale. This means a flexible or hybrid approach would likely become the norm, for example working 3 days a week at an office if required.

The results of Rode's second office vacancy survey continue to point to a high and rising amount of empty office space. We found that the national decentralized vacancy factor (for grades A and B combined) stood at 4,2 points in the third quarter of 2021. This equates to an average vacancy rate of about 14%, the highest this century. Several REITs, like Growthpoint (20%), have reported even higher vacancy rates this year, suggesting that the national figure could rise even more.

The large and growing amount of available space means tenants are spoilt for choice and clinching eye-popping deals. Rode's latest office market survey shows that national gross market rentals for decentralized grade-A space decreased by 6% year on year in nominal terms in the third quarter of 2021, declining for the fifth consecutive quarter. Rentals are down even more if some of the steep concessions are considered

In the third quarter of 2021, grade-A nominal market rentals decreased by 11% in Cape Town decentralized and 6% in Johannesburg compared to the third quarter of 2020 – the worst declines of the major cities. Rentals declined by 5% in Pretoria. This implies that no major city managed to record above-inflation rental growth.

Industrial market

The industrial property market is continuing to recover, with gross market rentals in the third quarter of 2021 growing by 2,6% year on year amid continued low vacancies, according to Rode's industrial survey data. This means growth has picked up from the roughly 1% achieved in the first half of 2021. However, rental growth is still well below the 5% of 2019.

The industrial sector is now comfortably the best placed of the major non-residential sectors. One of the key reasons for the outperformance of industrial property is the largely non-speculative nature of developments.

Table 1.1
Rental performance as at quarter 2021:3
% change from four quarters ago (on smoothed data)

	Nominal	Real*
A-grade decentralized office rentals		
Sandton CBD	-3,7	-7,1
Rosebank	-6,0	-9,3
Randburg Ferndale	-1,5	-5,0
Brooklyn/Waterkloof	4,2	0,5
Menlyn	-6,6	-9,9
La Lucia/Umhlanga Ridge	0,1	-3,5
Westville	-4,0	-7,3
Claremont Upper	-8,3	-11,4
Century City	-15,8	-18,8
South Africa	**-5,8**	**-9,2**
Prime industrial rentals (500 m² units)		
Central Witwatersrand	2,3	-1,4
East Rand	1,7	-1,9
Durban	2,4	-1,3
Cape Town	3,7	0,0
South Africa	**2,6**	**-1,1**

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

Rentals for prime industrial space of 500 m^2 grew by about 2% in Durban, Central Witwatersrand and the East Rand. In these conurbations, vacancies declined in the first nine months of 2021 compared to 2020 and are generally still quite low (less than 5%).

The story of the quarter is Cape Town, where nominal rentals rebounded to grow by 3,7% compared to the third quarter of 2020, after falling for four consecutive quarters. This is surprising as the Mother City's vacancy factor has stayed above level 3 on the Rode scale of 1-9 (that is, higher than about 5%) since the third quarter of 2020. Capitalization rates in Cape Town also declined in the third quarter, which means brokers are perceiving this sector in a more positive light than before.

Residential market

The housing market, which defied the odds during the Covid-19 pandemic, continues to cool. Nationally, nominal house prices increased by 3% year on year in September 2021, slowing gradually from the pandemic peak of 5,1% in April 2021, according to FNB data. Looking at the trend for 2021 so far, prices grew by 4,3% over the nine months compared to the same period in 2020 – on par with consumer inflation.

The cooling house prices do not come as a surprise to us given the record-high unemployment and that the economy, albeit recovering, has not reached pre-pandemic levels yet and will probably only do so in 2022 or 2023 due to the extent of the damage caused by the virus and government policies over many years. The impact of the third-wave restrictions and severe riots in July has been a further setback.

The prospects of higher local interest rates are looming large as several countries, like South Korea and Brazil, have started to increase rates due to higher inflation. Faster increases in inflation are becoming a global problem in the wake of accommodative monetary policies and shortages of several products and commodities due to supply-chain disruptions caused by the pandemic. Hikes in global interest rates will force South Africa to follow suit. The worldwide normalization of interest rates will have serious implications for inflated asset prices – globally.

Flat vacancy rates in South Africa declined further to 10,2% in the third quarter of 2021, after hitting a peak of 13,1% in the fourth quarter of 2020, according to Rode's residential survey data. However, vacancy rates are well above the 5,3% average recorded in the three years (2017 to 2019) that preceded the pandemic, implying that they are high compared to historical levels. No wonder rentals are under enormous pressure. ■