

Chapter 1: State of the property market

State of the property market in quarter 4 of 2021

This, the final report of 2021, indicates that the property market generally performed better in 2021 after a disastrous 2020. Not many would have forecast at the end of 2020 that listed property would be the top-performing traditional asset class in 2021, outshining equities, bonds and cash. Several REITs managed to deliver better financial results and reward shareholders with dividends, but a few still disappointed.

The property market is without a doubt not out of the woods yet, as the economy still has not reached 2019 levels, while Covid-19 remains a threat. Besides, property fundamentals, such as vacancy rates and rental levels, are still under significant pressure for office, and to a lesser extent, retail properties, which implies that it will take a few years for the sector to recover fully.

The industrial property market continues to look best placed at this stage due to its low vacancies and recovering rental growth. It ended 2021 quite well to edge ahead of house prices, which have slowed of late, to be the top-performing property market.

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 2021:4) with data collected a year earlier.

Office market

The office market continues to be plagued by a severe oversupply, with the national decentralized vacancy rate (for grades A and B combined) increasing further to 4,3 points in the fourth quarter of 2021, up from 4,1 points in the third quarter, according to Rode's office vacancy survey. This equates to an average vacancy rate of 14,2%. In cities such as Johannesburg and Cape Town decentralized, vacancy rates are averaging even higher at 19,8% and 16,7% respectively. The work-from-home trend has been a killer blow for the sector and its impact will still be felt over the next few years.

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 4,2% year on year in the fourth quarter of 2021, declining for the sixth consecutive quarter. This is somewhat better than the 5,8% year-on-year decline recorded in the third quarter.

In the fourth quarter of 2021, grade-A nominal rentals decreased by 12,6% in Cape Town decentralised compared to the fourth quarter of 2020 – by far the worst decline of the major cities. Nominal rentals declined by 3,6% and 2,7% in Johannesburg and Pretoria respectively, but are showing some form of

stabilisation at lower levels. This implies that no major city managed to record above-inflation rental growth.

Industrial market

The industrial property market is continuing to pick up, with nominal rentals in the fourth quarter of 2021 growing by 3,7% year on year amid continued low vacancies, according to Rode's industrial survey data. However, rentals still decreased in *real* terms after deducting building-cost inflation (BER BCI), which was about 5% in the fourth quarter. Turning to the full 2021, nominal rentals grew by about 2%, an improvement on the 0,5%

growth rate of 2020, but still well below the roughly 5% growth achieved in 2019.

This means the industrial sector is still comfortably the best placed of the major non-residential sectors, where vacancies are much higher, especially office properties. One of the key reasons for the outperformance of industrial property is the largely non-speculative nature of developments. Another driver has been the superior performance of logistics, especially since the pandemic started, due to the online sales boom. The same cannot be said about traditional manufacturing, which remains under pressure.

Table 1.1		
Rental performance as at quarter 2021:4		
% change from four quarters ago (on smoothed data)		
	Nominal	Real*
A-grade decentralized office rentals		
Sandton CBD	-1,4	-5,8
Rosebank	-7,2	-11,4
Randburg Ferndale	-3,7	-8,0
Brooklyn/Waterkloof	10,8	5,8
Hatfield	-6,5	-10,7
La Lucia/Umhlanga Ridge	1,4	-3,2
Westville	-5,9	-10,1
Tyger Valley	-10,2	-14,1
Century City	-16,5	-20,2
South Africa	-4,2	-8,5
Prime industrial rentals (500 m² units)		
Central Witwatersrand	4,2	-0,5
East Rand	1,1	-3,4
Durban	3,5	-1,2
Cape Town	5,8	1,0
South Africa	3,7	-1,0

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

Rentals for prime industrial space of 500 m² grew by 5,8% year on year in Cape Town to above pre-Covid levels, the strongest of the major industrial conurbations. Cape Town's vacancy factor improved to about 3,5 from 3,7 in the third quarter (on Rode's vacancy scale), which implies a vacancy percentage of just above 5%. Capitalization rates in Cape Town declined in the second half of 2021, which means brokers are viewing this sector in a more positive light than before.

Nominal rentals in the Central Witwatersrand and Durban also picked up, growing by 4,2% and 3,5% respectively, while growth was more subdued at 1,1% in the East Rand. All conurbations, apart from Cape Town, saw vacancies improve in 2021 versus 2020, with vacancies generally still seen to be quite low (less than 5%). Vacancies remain the highest in Gqeberha (PE) and Bloemfontein.

Residential market

Flat vacancy rates in South Africa averaged 10,1% in the fourth quarter of 2021, unchanged from the third quarter of 2021, according to Rode's residential survey data. Generally, vacancies improved in 2021 after hitting a peak of 13,1% in the fourth quarter of 2020, but remain at double pre-pandemic levels. There are no signs yet that the improvement has resulted in an upward move in rental growth. This suggests that vacancies will have to improve more to see upward momentum in rentals. Flat rentals in nominal

terms grew by only 0,7% in the first eleven months of 2021, slowing from the 2,4% growth recorded in 2020 and 4,4% in 2019.

A slowdown has also been observed in national house prices. Nominal prices rose by 3% year on year in October 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 4,2% year on year over the first ten months boosted by record-low interest rates – roughly on a par with consumer inflation of 4,3% over the same period. House prices will likely end the year in negative territory in real terms given the upward move in inflation to 5,5% in November. It is also noteworthy that in nominal terms the growth rate has consistently been decelerating since May 2021.

Slower house price growth was expected given the fading impact of lower interest rates amid record-high unemployment and an economy that is struggling to get back to pre-pandemic levels. So, what will 2022 have in store?

Next year will probably see continued decelerating growth in nominal house prices and growth may even be negative by the end of 2022. The reasons are the fundamental factors, such as the weak economy, maybe leading to even higher unemployment, and rising interest rates (pretty certain). The crucial question is by how much interest rates will be hiked and how swiftly. Nobody knows the answer to this one. ■