Chapter 1: State of the property market

State of the property market in quarter 4 of 2023

In this issue, we report that operating conditions are still tough for property companies in South Africa due to the impact of load shedding, fast-rising operating costs, subdued economic growth and elevated interest rates. No wonder dividends are not back at pre-Covid levels, while debt levels are worryingly on the rise for some property companies. In such as environment, asset sales continue to occur, which has the effect of pushing up capitalization rates of directly-held properties – holding all other factors constant.

Above-average vacancies and subdued rental growth are still prevalent in the office and retail segments, which implies that it will take a few years for the property sector to recover fully and dividends to reach pre-Covid levels. The industrial property market is still performing comparatively better.

Encouragingly, share prices of many listed property funds bounced back in November and December as the market is hopeful that one of the challenges of the sector, namely high interest rates, will be less of a factor in the coming years. Thus, the ratings of REITs are still poor, but somewhat better than a quarter ago.

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 2023:4) with data collected a year earlier.

Office market

The office market had a better 2023 but remains in the worst position of the three major non-residential property types. Encouragingly, vacancies improved in 2023, while the nominal market rental data surveyed by Rode indicates a continued recovery from the low Covid levels. Rentals in *real* terms continue to look bleak.

Rode found that the average vacancy rate of grades A^+, A and B space combined in decentralized nodes in South Africa was 14,4% in the fourth quarter of 2023, better than the 15,2% average in the fourth quarter of 2022. Decentralized means all nodes in a metro lumped together, excluding the (old) central business district (CBD). Looking at the bigger picture, the current national vacancy rate is still well above the pre-Covid level of 10,5% in 2019 and the long-term average of 9,3%, as per SAPOA data.

In the fourth quarter of 2023, weighted gross market rentals for decentralized grade-A space increased nationally by a measly 1,5% in nominal terms compared to the fourth quarter of 2022, slowing from 2,8% in the third quarter of 2023. For the calendar year 2023, rental growth averaged 2,4%, which was faster than the 1,2% growth in 2022. All in all, rentals have improved from the big Covid declines, but are still not yet at 2019 levels (that is, before the pandemic).

Since 2022, Cape Town has been the clear standout of the four major cities. Here nominal decentralized grade-A gross rentals rose by 6% year on year in the fourth quarter of 2023, ending the year 5% higher than pre-Covid levels. For the full 2023, market rentals rose by 10%, thereby outpacing building-cost inflation (BER BCI) – the only major city to do so. Nominal rental growth in the decentralized nodes of Johannesburg, Durban and Pretoria averaged between 0% and 2% in the fourth quarter of 2023 − all below building-cost inflation.

Table 1.1
Office and industrial rentals: Performance as at quarter 2023:4
% change from four quarters earlier (on smoothed data)

	Nominal	Real*
A-grade decentralized office rentals		
Sandton CBD	-0,2	-9,6
Rosebank	-1,7	-10,9
Randburg Ferndale	0,6	-8,9
Centurion	-0,1	-9,4
Hatfield	8,5	-1,7
Menlyn	2,4	-7,2
La Lucia/Umhlanga Ridge	3,6	-6,1
Berea	-1,5	-10,6
Tyger Valley	1,7	-7,8
Century City	8,0	-2,1
South Africa	**1,5**	**-8,0**
Prime industrial rentals (500 m² units)		
Central Witwatersrand	4,6	-5,2
East Rand	6,1	-3,8
Durban	5,8	-4,1
Cape Town	5,8	-4,1
South Africa	**4,0**	**-5,7**

*Nominal values deflated by BER Building Cost Index

Industrial market

Results of Rode's fourth-quarter 2023 survey show that of the three major non-residential property types the industrial property market is still best placed. This is thanks to its low vacancy rates, resulting in satisfactory rental growth.

Nominal gross market rentals for space of 500 m^2 grew by 4% in the fourth quarter of 2023 compared to the fourth quarter of 2022, in line with the growth recorded in the third quarter. Rentals at the end of 2023 were up about 15% compared to the pre-pandemic levels of 2019. Overall, rentals grew by 4,1% in 2023, slightly slower than in 2022. Interestingly, rentals of industrial space of 1 000 m^2, which one can argue is probably more representative of the industrial market, grew at a slightly faster rate of 5% in 2023.

Regionally, growth was the strongest in Cape Town. However, in *real* terms, rentals in all major conurbations are still declining due to elevated building-cost inflation. This was to be expected, given weaker economic growth and in particular the pressure on the manufacturing and retail sectors.

The resilience of the industrial property market is particularly evident in its low vacancy rate. However, there is a risk of higher vacancies and lower rental growth in the short term, given the sustained level of low business confidence.

Residential market

The housing market continues to slow down due to lower effective demand for property as a result of the weak economy, the high cost of living and elevated interest rates. Nominal **house prices** grew by only 0,5% in November 2023 compared to November 2022, based on FNB data. This took house-price growth to 1,6% in the first 11 months of 2023, well below the 3,5% growth achieved in calendar year 2022. In *real* terms, house prices fell by about 4% in the first 11 months of 2023, after deducting the consumer inflation (CPI) rate of 6%.

Turning to our forecast, we expect nominal house prices to stagnate in 2024. Therefore, do not expect *real* price growth soon. It is all about affordability. Rode has noted that the market's interest rate expectations for 2024 have turned more favourable since the previous *Rode Report* and if the market is correct, this could boost house prices, starting later in 2024 and during 2025. But as we have warned often before, interest rate forecasts can change quickly.

Turning to **flats**, vacancy rates on a national level lifted to 8,1% in the fourth quarter of 2023 from 6,9% in the third quarter of 2023, according to Rode's residential survey data. Overall, vacancy rates averaged 7,2% in 2023, down from 8,3% in 2022. Regionally, the Western Cape continues to stand out with its low flat vacancy rate of 2,8% in the fourth quarter of 2023, well below the national average.

The decline in national vacancy rates since its Covid peak has supported rental growth. Official data from Stats SA shows that in the third quarter of 2023 nominal flat rentals in South Africa increased by 2,5% compared to a year earlier. PayProp data shows that the nominal rental growth rate for *housing* lifted to an even higher 4,6% in the same quarter – the fastest growth rate since the fourth quarter of 2017. Overall, house prices and rentals are still declining in *real* terms in most parts of the country. ■