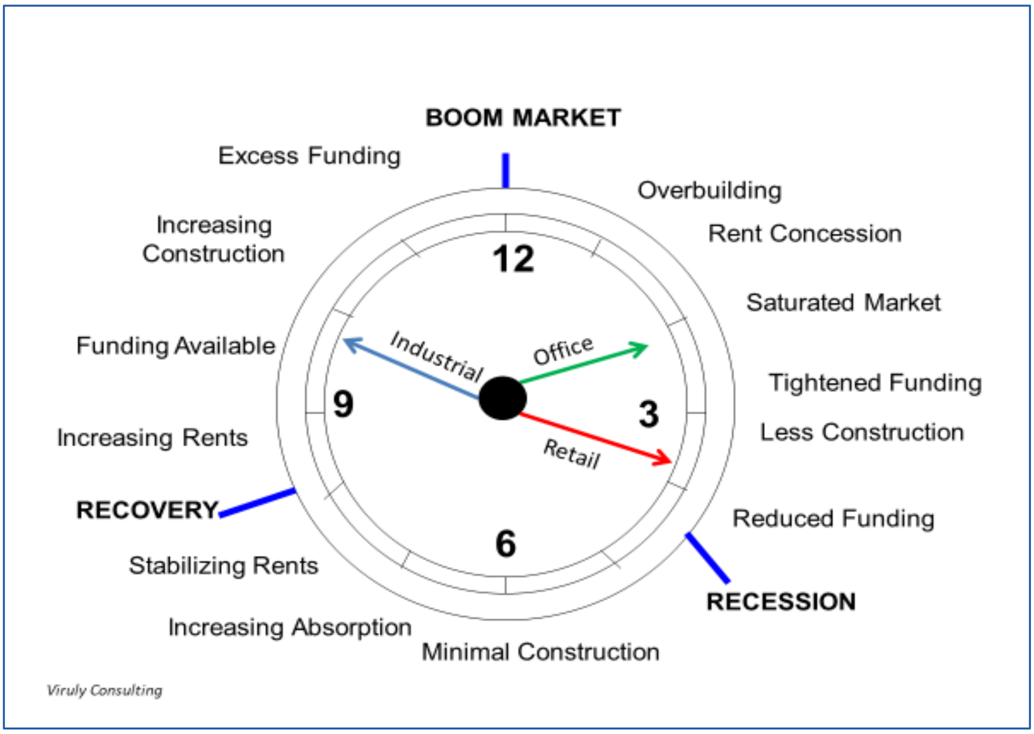
URBAN REAL ESTATE RESEARCH UNIT

Indicator Watch for the South African Investment Real Estate Market
March 2019

Cycle Position



The South African commercial property market continues to trade in a weak macro-economic environment with low investor confidence. The office market is experiencing high vacancy rates which is placing downward pressure on escalations and these are trending close to the inflation rate. Super regional shopping centres are outperforming the market, with mid-tier malls lagging.

In the industrial sector vacancy rates are presently close to the long-term average. While economic growth is impacting negatively on the sector, demand is being underpinned by the logistics sector and the demand for e-retailing related space.

Industry Quote

"Certain specialist warehousing can benefit from online retail development, but warehousing performance depends on the overall economic performance. While online retail can grab a larger slice of the overall retail pie in 2019, weak economic growth is expected to mean weak overall consumer spend and retail sales growth"

- John Loos, FNB Property Economist.

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INDICATORS	% CHANGE YTD	MOVEMENT	IMPACT ON THE PROPERTY MARKET
GDP GROWTH	1.4 % Q4 2018 YOY Δ	↑	The SA economy performed poorly in 2018, with GDP growing by a mere 1.4% in Q4 (QOQ). In 2018 the economy grew by a mere 0,8%. In 2019 GDP growth is now expected to surpass 1.5%. This invariably will continue to constrain the demand for space in all sectors of the commercial property market.
INTEREST RATE	10.25 % Prime Rate Mar 2019	↔	South African interest rates have remained stable in 2019 at 10.25%. The last increase was in October 2018. The SA Reserve Bank is presently responding to a low economic growth scenario combined with an inflation rate that is well within the SARB 3-6% target. This has provided a level of funding cost stability in the sector.
INFLATION RATE (CPI)	4.1% Feb 2019 YOY Δ	↑	The inflation rate (CPI) in January was recorded at 4.1%. Rising fuel prices are expected to place upward pressure on the inflation rate in 2019. The property market is also experiencing an increase in operating costs well above inflation rate driven by escalations in electricity costs and municipal related costs.
RETAIL TRADE SALES – RETAIL SECTOR	1.2% QTR Jan 2019 YOY Δ	↑	Disposable income and related retail sales has remained under pressure. In January retail sales increased by 1.1% year-on-year. For the retail sector consideration should be given to the changing nature of retailing with a growing focus moving to e-retailing.
HOUSE PRICES	3,7% Feb 2019 YOY (FNB)	↓	Residential house prices have, in the past four years, increased by some 4% per annum (nominal terms). This implies that property prices continue to decline in real terms. From an investor's perspective returns in this sector are favourable compared to the office sector. This is also being reflected in the conversion of certain obsolete office blocks to residential use.
BUILDING PLANS PASSED (RESIDENTIAL) REAL TERMS	-2 % Jan'18-Jan'19 YOY Δ	↓	Building plans passed in the residential sector entered negative territory in December 2018 and January 2019. This reflects a general downward trend in the building activity across the economy.
BUILDING PLANS PASSED (NON-RESIDENTIAL) REAL TERMS	-17 % Jan'18 -Jan '19 YOY Δ	↑	Building plans passed (non-residential) continue to show a positive trend in the industrial and retail property markets. In the office market, which is presently oversupplied, building plans passed turned negative (-17%) in the period Jan 2018–Jan 2019. This reflects relatively high vacancy rates in the office sector.
MFA/BER BUILDING COST INDEX	0.8% Q4 2018 YOY Δ	↓	Building cost increases have continued a downward trajectory. This is being driven by the poor performance of the construction sector and reduced inflationary pressure. The BER building cost increase of 1.7% in Q4 2018 was well below the CPI.
OFFICE VACANCY RATES	11.1% Q4 2018	↓	Office vacancies have continued to rise in most markets. This is being driven by poor economic growth and a relatively strong increase in supply. The expected slowdown in building activity is expected to stabilize vacancy rates in 2019. The present vacancy rate scenario is facing negative pressure on rentals.
RETAIL VACANCY RATES	4.2% Q4 2018	↓	Retail vacancy rates are above the long-term average of 3%. While vacancy rate for regional shopping centers was 5.1% in December 2018, community shopping centres experienced stronger market conditions with vacancy rates of 3.5%. Changing retailing habits (including the rise in e-retailing) has placed renewed pressure on the sector.
INDUSTRIAL VACANCY RATE	3.3% Q2 2018	↔	Industrial vacancy rates have largely remained stable since late 2016. In many respects market fundamentals seem to be balanced in the sector of the market. The industrial sector is showing considerable strength compared to the office and retail sectors. It has also benefited from a high demand for modern logistics space.
RETAIL TRADING DENSITY GROWTH	2.5 % Q4 2018 YOY Δ	↑	Trading densities strengthened in 2018. Trading density growth (Dec 2017–Dec 2018) was 2.5% with a 5.3% increase in per head spending, while foot count declined by 2.7% in 2018. Community shopping centers showed a particularly strong performance with trading in densities rising by 4.29%.

Sources

ABSA, FNB, C&CI, BER, MFA, MSCI/IPD, SAPOA, Stats SA, SARB, URERU and Viruly Consulting.

** Note that some data where the movement is described as 'Lower' or 'Declining' could indicate an improvement in the situation (e.g. Interest rates, building costs, cap rates, vacancies) depending on the perspective i.e. if 'buyer' or 'seller' the converse also holds true*