URBAN REAL ESTATE RESEARCH UNIT

Indicator Watch for the South African Commercial Property Market Cycle

March 2018

Cycle Position

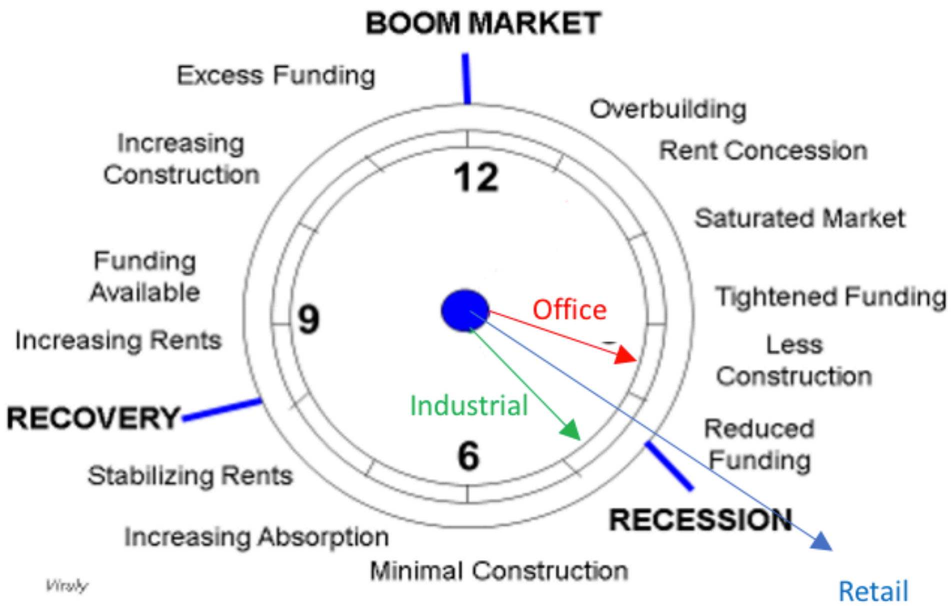
Real estate markets, with a few exceptional niche segments, are in the doldrums and squarely in the recessionary phase of the cycle, with only the industrial sector possibly beginning to emerge from the downturn (see the Property Clock below). House prices are declining and building costs are increasing at close to 3 times the rates of inflation. Key drivers are a low-growth economy, relatively high interest rates, lower planned building activity, high vacancies, and signs of oversupply and saturation in many areas. The 'new dawn' of Cyril Ramaphosa's presidency held promise for consumer and business confidence to improve, but this is faltering as fierce rivalry between personalities and parties grab headlines, and there is a resumption of populist rhetoric which fuels uncertainty. The listed property sector is trailing other asset classes, reflecting the influence of international monetary trends and the upheaval in local stock prices. However, there is growing attention being paid to Environmental, Social and Governance (ESG) factors and regulation throughout the economy. The 'industry quote' below is perhaps indicative of this. Most analysts are predicting a slow but steady return to normality through 2018, as markets adjust to the political climate and investor jitters subside.

Industry Quote

We must invest in our own future … while many white-run businesses had created wealth for shareholders and developed the country, they had not been charitable enough. Having a narrow view about business's role in SA had destroyed value in some parts of the country. I remember in the 1980s, [property investor] Gerald Leissner tried to save the Johannesburg CBD, but so much investment left it and a lot of capital was lost. We can't repeat a mistake like this.

Marc Wainer — Executive Chairman, Redefine Properties.

Property Clock



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INDICATORS	% CHANGE YTD	MOVEMENT	IMPACT ON THE PROPERTY MARKET
GDP GROWTH	1.5 % Q4 2017 YOY ∆		This has been the best year on year change this year. Forecasts differ but the World Bank predict only 1.1 % growth in GDP for 2018.
INTEREST RATE	10.25% Prime Rate March 2018		There has been no change to interest rates and there is no major pressure to increase rates. The 1% increase in VAT seems not to have had much affect.
INFLATION RATE (CPI)	4.0% February 2018 YOY ∆		Presently the CPI is within the required 3-6% range but is widely expected to increase to 5-6% over 2018.
RETAIL TRADE SALES – RETAIL SECTOR	5.3% QTR December 2018 YOY ∆		Retail Sales improved in the latest quarter. Nontraditional Retail segments (Other) performed better than the main categories. The impact on property will be evident down the line but first requires an improvement in occupancy and trading levels.
HOUSE PRICES	2.3% February 2018 YOY (FNB)		The rate of house price growth slowed in the first part of this year. However, it is forecast that there will be stronger growth through 2018 due to an expected return of confidence and better mid to lower end market prices.
BUILDING PLANS PASSED (RESIDENTIAL) REAL TERMS	-7.9% January - December 2017 YOY ∆		Building plans were almost 8% lower in 2017 than in 2016 in real terms. This is a picture of a distressed market not planning to expand.
BUILDING PLANS PASSED (NON-RESIDENTIAL) REAL TERMS	--14.8% January - December 2018 YOY ∆		The decline in the value of Non-Residential plans continued and was a severe -14.8% for the full 2017. This has accelerated in January 2018.
MFA/BER BUILDING COST INDEX	11% Q4 2017 YOY ∆		11% higher building costs indicate major pressure on builders. Coupled with flat economic conditions, building activity will drop off and declining plans passed are showing this.
OFFICE VACANCY RATES	11.2% Q4 2017		The Office vacancy rate is stable and unlikely to change overall, while much excess space remains available.
RETAIL VACANCY RATES	4.2% September 2017		Retail vacancies are on the rise, reflecting excess supply and spending constraints. Currently, neighborhood shopping centers have the highest vacancy in the sector (6.7%), followed by super regionals (4.7), community (4.2), small regional (2.9) and regional (2.5).
INDUSTRIAL VACANCY RATE	3.5% June 2017		Industrial property is performing relatively better than the other sectors with plans passed increasing and vacancies possibly peaking. Most of the strength is in the Logistics and Warehousing segments.
RETAIL TRADING DENSITY GROWTH	-1.0 % September 2017 YOY ∆		Retail density up to September last year was down only 1% but as economic pressure increases this may fall further. In the September quarter there was an increase in spend per head but a decrease in aggregate foot count per sqm.

Sources

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

** 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*