

Hikes 'No Lid on Rentals'

Will the commercial property development boom be halted by the uncertain interest rate environment?

Property analysts do not think so, saying any additional costs from a rising interest rate environment will be passed on to prospective tenants by developers raising rentals.

Because there is a shortage of vacant space in the commercial property market, tenants will also be forced to accept increased rentals as they do not have many options when it comes to finding suitable unoccupied space .

The commercial property market has been experiencing boom conditions over the past few years, with property values increasing dramatically. Demand has mopped up most vacant space and sparked an increase in new property developments coming to market.

The turnaround in commercial property fortunes began in a declining interest rate environment. But economists are expecting the monetary policy committee to hike interest rates this month and some have not ruled out a further hike in rates later this year.

David Green, MD of commercial and industrial property brokers Pace Property Group, says interest rate hikes would “certainly affect the feasibility of new property developments”. The only way to mitigate this risk to new developments is for owners to raise rentals. “In that way the developers would try to pass on the increased development costs to prospective tenants.”

He says that because the interest rate increases are not that significant, the “ultimate effect” on the cost of new developments will not be significant. “The smaller the scale of the actual development, the more likely the impact of interest-rate increases will be felt.”

First National Bank property strategist John Loos says there is a possibility of further interest rate hikes but FNB believes the most likely scenario is one more rate increase. “ We believe we are near the peak of the interest rate cycle.”

He says the effects of higher rates will not be too significant because what militates against the negative interest rate environment is “very low vacancy rates in commercial property”. As a result, there are “very strong rental inflation prospects”.

“Especially in the area of industrial and office space, the prospects are for very strong net income growth on property and for that reason I don’t think the current mild interest rate hiking will have too much effect on the levels of development activity.”

Property economist Erwin Rode, of Rode & Associates, says the interest rate hike effect will be minimal. “The reason is that in order to make new developments feasible, developers will be forced to charge slightly higher rentals and tenants will gladly cough up the difference because they have no alternative.”

Rode says there is a shortage of commercial space in the market. Rising rentals are only possible where there is a shortage of space.