

Property Still Strong

Growth in flat rentals, in areas such as Johannesburg, Pretoria and Cape Town, has for the past three years remained roughly in line with consumer price inflation (+9% p.a.) while in Durban (+12% p.a.) and Port Elizabeth (+11% p.a.) rentals even managed to marginally outperform inflation.

According to the latest Rode's Report, Durban continued to perform on the industrial front, and is the only city whose rentals (+21%) outperformed the growth in building-cost inflation (+12%). Growth in rentals in the other major industrial centres has cooled somewhat, with the Central Witwatersrand, the Cape Peninsula and Port Elizabeth showing rental growth of 12%, 10% and 9% respectively.

The building industry is experiencing its own slow-down in the form of 'stagflation' in that building-input-cost inflation in recent quarters has been accelerating while building-contract inflation has been decelerating. According to Erwin Rode of Rode & Associates: 'In the third quarter of 2008, for example, building-input-cost inflation (according to the Haylett index) is expected to have grown by about 16%, while building-contract-cost inflation (according to the BER Building Cost Index) is expected to have recorded growth of roughly 12%.

'Keener tendering competition, on the back of waning building activity, is currently forcing contractors to trim their profit margins, which in turn is leading to lower building-cost inflation. What's more, a quarter-on-quarter annualized growth rate of -9% in the BER BCI, does serve to reveal the current weakness in the building-construction industry, implying a tumbling in building contract prices compared with the previous quarter. This figure, although provisional, is supported by anecdotal evidence.'

The tide appears to have turned on capitalization rates across all non-residential property sectors, which – according to the latest Report – are now pointing sharply north in the third quarter of 2008. Capitalization rates are the property market's equivalent of the forward earnings yield of equity, and rising capitalization rates erode market values. According to Rode: 'This is most probably as a result of a deterioration in investment demand triggered by increased political and economic uncertainty and crashing equity markets, combined with the now higher cost of financial gearing.

All of this, without a concomitant reduction in investment supply, has lead to a deteriorating market sentiment.'

However, on a more positive note, says Rode: 'Market rentals for prime office space in most of the country's top decentralized areas have, in spite of the challenges facing our economy both locally and from abroad, continued to show robust growth in the third quarter, with Pretoria, Durban, Johannesburg and Cape Town all achieving double-digit growth in excess of the expected building-cost rate of 12%. The consequence is that market values couldn't have dropped – notwithstanding rising capitalization rates.'