SA property resilient despite challenging economic conditions - here's why

By Mahir Hamdulay

29 Apr 2024

Despite the challenging economic backdrop, high interest-rate environments and elevated cost pressures associated with load shedding, the domestic property sector delivered a resilient performance in 2023 according to data from the annual *MSCI South Africa Property Index*.

Source: Pexels

The South African Property Index achieved a total return of 8.7% in 2023 (vs 9.3% in 2022), with the income return improving to 8.3% and capital return slowing to 0.4%.

The net operating income (NOI) growth of 4.5% achieved in 2023 lagged inflation - which given the elevated cost pressures associated with load shedding and above inflationary increases in property taxes - is not surprising.

Key operating metrics - specifically vacancies and reversions - continue to show a sustained improvement, which is encouraging in view of a tough operating environment.

Across the globe, 2023 was characterised by swings in market sentiment due to the fluctuating views on inflation, interest-rate expectations and concerns that major economies could fall into a recession.

Ongoing geopolitical tensions have disrupted supply chains adding additional upside risk to inflation which further dampened consumer and business confidence.

During the last quarter of 2023 inflation started to ease and widespread expectations of global interest-rate cuts supported a welcomed change in sentiment.

Late-year rally and retail strength

Given its interest-rate sensitive nature, the South African listed property sector was a laggard for much of the calendar year 2023 (CY) - however the sector rallied in the last quarter of 2023 largely driven by the pivot in expectations towards likely interest-rate cuts.

This resulted in the FTSE/JSE All Property Index (ALPI) and the FTSE/JSE SA Listed Property Index (SAPY) achieving a total return of 10.7% and 10.1% respectively for CY23, ahead of SA Equities (9.3%), SA Bonds (9.7%), and SA cash (7.8%).

The retail sector (comprising 59% of the MSCI index, by value) delivered a strong performance off a high base, achieving a total return of 9.7% (vs 9.4% in 2022). According to the South African Property Owners Association (Sapoa) the fourth quarter 2023 Retail Trends Report, year-on-year (yoy) annualised trading density growth (ATD) continued to moderate, slowing to 5.7% for the fourth quarter from 7.6% in the previous quarter.

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This deceleration comes as little surprise given the subdued consumer environment with higher debt-service costs and muted wage growth weighing on disposable incomes.

ATD growth continues to be driven primarily by growth in foot count as opposed to increasing spend per head. Foot count, however, remains approximately 10% below its pre-pandemic base, according to Sapoa.

Retailers' cost of occupancy further improved in 4Q23 to 6.8% according to Sapoa, reaching its healthiest level in almost 10 years.

The sustained improvement in recent periods has been driven by tenant sales growth running ahead of rental growth.

Healthier occupancy cost ratios and low average vacancies have increased the bargaining power of landlords in leasing negotiations. As a result, there has been a sustained improvement in rental reversions on average with an increasing number of landlords reporting positive reversions within their retail portfolios in recent updates.

Industrial sector thrives, offices lag

The industrial sector (12% of MSCI index) has maintained its relative out-performance, achieving a return of 11.2%.

The sector continues to benefit from low vacancies and tenant-driven developments. The logistics sub-segment in particular has benefited from the increased focus on supply-chain optimisation, onshoring as well as a sustained appetite for secure modern facilities.

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The outlook for the industrial sector remains positive - given the low vacancies, high construction costs placing upward pressure on rentals, and ongoing geopolitical tensions - that supports the need to hold more stock.

Office sector slow, vacancies high

The office sector (20% of the MSCI index) continued to be slow relative to other property sub-sectors, achieving a total return of 4.8%.

Constrained office-development activity and increased demand for space - in part due to load shedding and a push for ‘return-to-office’ from some employers - has led to an improvement in office occupancies with Sapoa reporting a vacancy rate of 15.2% in 4Q23, down 30 bps from the previous quarter and the sixth consecutive quarter of improvement.

This remains well above its pre-pandemic level and is likely to remain elevated in the absence of meaningful economic growth required to drive new demand.

A flight to quality continues to play out - supported by a relatively small rental gap between prime and A-grade offices and a greater demand for backup power and water supply. There is a growing divergence between nodal occupancies with Sapoa reporting a vacancy rate of 7.5% for Cape Town, significantly better than the 18% recorded for Johannesburg as at 4Q23.

The improvement in occupancy continued to come at the expense of rental growth, with real-asking-rentals back at levels seen 21 years ago, according to Sapoa.

While the key operating metrics and performance published by MSCI suggests that the sector is well placed at this point in the cycle, a sustained positive performance for the South African property industry is contingent on the outcome of elections, timing, and the extent of interest-rate cuts and how the sector will weather the macroeconomic headwinds.

ABOUT THE AUTHOR

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