

This year's challenges, opportunities in property

During 2011, although the gradual recovery of the economy was at a slower pace than anticipated, it had a positive effect on disposable income, which reflected in positive retail growth. However, it is increasingly evident that the massive increases in electricity tariffs coupled with increases in fuel, rates and taxes are beginning to affect marginal tenants' ability to meet monthly financial obligations, which in turn may lead to a rise in insolvencies, liquidations and unemployment.

By [Mama van der Walt](#) 20 Feb 2012



Gautrain. Image: www.gautrain.co.za

The IPD (Investment Property Databank) reported that in 2011, operating costs across all sectors were around 50% with electricity hikes of 29% and rates and taxes 21%. Since the introduction of the New Companies Act, a number of financially distressed companies are using business rescue to avoid liquidation, however, due to the requirements of the Act, these companies have to advise their creditors that they are under business rescue, thereby placing further pressure on their finances.

The uncertain economic environment - fuelled by a volatile global economic climate - is affecting business confidence. This influences the decision of companies to expand and employ more staff - which would contribute positively to economic growth, or in extreme cases to close their doors. This is directly influencing the demand for space and rental growth, with the office sector showing a decline in rental growth from 9% in the first quarter of 2011 to 5% in the second quarter.

While office vacancies are seemingly stable, high vacancies and limited demand is placing tenants in a good position to negotiate rentals down. In addition, rental escalations are not keeping pace with rising operating costs, with increasing utility costs far exceeding the inflation rate. This is placing downward pressure on the net operating income of buildings and affecting property values.

Transport issues

Transport issues are also affecting the commercial property market about choice of location, with the Gautrain stations a key positive factor. The opening of the majority of the Gautrain routes as well as the continued implementation of the BRT routes has increased demand for properties in close proximity to the stations and the BRT routes. The opening of the Sandton Gautrain station has opened up the Sandton retail precinct to a wider consumer market to the north, which now has easier access.

However, if implemented, the proposed tolling of the freeways around Johannesburg will have a negative influence on the property market, with companies taking into account the possible effect of tolls in their choice of location. Furthermore, the proposed tolling is coupled with reported additional taxes for properties situated along public infrastructure corridors such as the Gautrain - a factor that will place increased pressure

on consumers, directly influencing the retail market and indirectly the industrial market.

A new trend currently apparent in the marketplace is that due to the lack of new stock coming onto the market, older buildings are in demand and can be acquired at very competitive prices. In addition, property owners driven by the need to fill vacant space are prepared to accept lower initial rentals, however, in such instances escalations tend to be higher than in the last few years.

Industrial property affected by international crises

In industrial property sector, the performance of the manufacturing sector is currently reflecting a more positive outlook than last year, but its poor performance in 2011 has negatively affected the industrial sector which is further influenced by the poor performance of the mining sector and the agricultural sector. The continued economic crisis in the Euro-zone will influence the demand for South African products, which may result in further downward pressure on manufacturing, thereby negatively affecting the industrial sector.

We anticipate that interest rates will remain at the same low levels until the third quarter of 2012. However, sluggish economic growth and rising concerns regarding the global economic outlook are applying pressure on the Reserve Bank to reduce rates, which is offset by the fact that the inflation rate has reached the upper limits of the target range and as a result does not bode well for a cut in the interest rate. Having said that, there is a more positive sentiment in the market this year and we expect business confidence to increase. The JSE is currently at its highest level and the infrastructure projects announced by government will help grow South Africa's economy.

Legislative impacts

The Consumer Protection Act is changing the leasing landscape with property owners preferring to enter into a lease with companies rather than private individuals who can effectively exit lease agreements with a notice period of 20 working days.

In addition, the planned implementation of Carbon Tax will have a significant impact on the property sector with early indications that this will be set at R100 per ton of carbon dioxide, creating a carbon tax bill of around R45 billion a year, based on South Africa's current carbon emissions. It is estimated that the property sector will be responsible for approximately 23% of the carbon tax bill, which will affect all parties involved in this sector - from construction to investors, contractors, property owners and tenants.

On a positive note, listed properties continue to outperform other asset classes, despite the fact that growth is lower than previous years, making it an attractive investment which is underlined by the number of new listed property companies that entered the market during the past year. In order to retain existing tenants and attract new tenants and due to the continued rise in utilities costs and rates, property owners will need to give more attention to the greening of their buildings. In addition, the decision of some listed companies not to invest in areas where there are low-quality municipal services may open the door for smaller investors to acquire quality properties.

ABOUT THE AUTHOR

Marna van der Walt is the CEO of JHI Properties.

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