Conversion boom running out of steam

By Joan Muller

2 Sep 2013

The office-to-flat conversion boom in downtown Jo'burg is running out of steam because developers are finding it increasingly difficult to make a decent return on their investments.

Developers first began buying up mothballed commercial buildings in the mid-2000s, after the corporate exodus from Jo'burg's central business district (CBD) to Sandton and other suburbs.

The early pioneers, who turned derelict offices into well-managed rental blocks of flats being let at between R2,000 and R4,000 a month, may have made lots of money but it wasn't long before a rush of other developers followed suit and drove the prices of inner-city buildings up and yields down.

"Office-to-flat conversions are slowing because it is becoming expensive to make these projects work," says Anthony Stein, financial director of City Property, the property management arm of JSE-listed Premium Properties and Octodec Investments

City Property, founded by the Pretoria-based Wapnick family 20 years ago, is believed to be the biggest inner-city property developer in Gauteng. The company manages around 11,500 residential flats in Johannesburg and Pretoria.

Stein says in 2005 the group could easily pick up old office buildings in downtown Johannesburg for R800/m². But values have since increased tenfold, not only because more developers wanted to cash in on the office-to-flat conversion trend but also because listed property funds began entering the government-tenanted office space.

The upshot is that far more developers are now chasing a smaller pool of inner-city buildings. Stein says that has caused yields (rental income as a percentage of market value) of CBD buildings to drop to around 7% or 8% against 12% to 15% that was being achieved in the mid-2000s.

Huge demand

He says that despite a huge demand for inner-city rental flats - vacancies in City Property's portfolio are less than 0,5% - it is difficult for investors to make an acceptable profit if they have to buy buildings at these yields.

"It doesn't make financial sense to pay between R8,000 and R10,000/m² when you still have to spend another R6,000 to R7,000/m² on conversion costs," Stein says.

He says the group's focus is now shifting towards demolishing and rebuilding properties it already owns.

It seems the easy money has also already been made by buy-to-let investors who bought converted inner-city flats from developers.

Figures from Johannesburg-based property group Citiq show that sales prices of individual apartments in Johannesburg's inner city rose nearly fourfold from an average R1,200/m² in 2002 to R4,200/m² in 2007. But average values plunged to less than R3,000/m² in the three years leading up to 2010.

However, Citiq's chief executive Paul Lapham says there has been a recovery in sales values since 2011, a trend he expects to accelerate over the next few years, given the inner city's relative value proposition.

"Inner-city apartments are trading at an average R3,986/m² compared with an average R6,879/m² for sectional title units in Johannesburg's northern and north-western suburbs."

Andrew Schaefer, managing director of property management group Trafalgar, agrees that the investment case for inner-city buy-to-let is improving on the back of lower vacancies.

"Chances of finding a decent flat in the Johannesburg CBD to rent for less than R4,500 a month are less than 1%," he claims.

Schaefer says residential vacancies in the Johannesburg inner city have reached a historical low, which is paving the way for a new surge in investor interest.

He notes inner-city buy-to-let investors can now expect rental yields of between 11% and 15% against an average 6% to 8% in the northern suburbs of Johannesburg.

Two-bedroom units in the R3,000 to R4,500 a month bracket in areas such as Yeoville, Berea, parts of Hillbrow and the residential improvement districts tend to be most in demand.

Source: Financial Mail via I-Net Bridge