New report: SA property bears brunt of Covid-19 economic fallout

According to JLL's *South African Real Estate Investment Review and Outlook 2021/22*, the property market struggled through the Covid-19 pandemic with virtually all sectors registering a decline in performance. Reporting is focused on deal flow registered in the 2021 calendar year and compares investment volumes in 2021 to deal flow over the previous four years.

Source: Gallo/Getty

“Deal flow value across the office and industrial declined compared to 2020, with reprieve in 2021 attributed to the retail and alternative and living property sectors. Student accommodation and filling stations emerged as a growing asset class in 2021, and demand remained rife for prime logistics and retail assets,” said Mieke Purnell, research manager, JLL.

Office sector remained under pressure

According to the report, investment in office property has continued to decline since 2018 as the local economy weakened and the sector battled an oversupply scenario. Despite the major drop-off that occurred in 2020, the office sector remained under pressure in 2021 as several of the adverse drivers from the previous year remained prevalent. The investment appeal of this sector was especially limited by weakened rentals, high vacancy rates, and a slump in demand during the pandemic with limited scope for improvement. This sector’s aggregate investment value reached roughly R2.6bn in 2021, down by 18% from the R3.1bn reported in 2020.

Major office deals in 2021 were generally sale and lease-back transactions linked to large corporates, such as the Telesure Campus transaction in Dainfern, or associated with redevelopment and refurbishment, such as the disposal and acquisition of 1 Thibault Square. According to Pepler Sandri, director: capital markets, JLL, average sales rate data reflects a bifurcation in the market, with prime stock achieving relatively favourable rates. In contrast, lower grade stock in weaker nodes realised significantly lower prices, particularly in comparison to replacement cost.

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Retail property proved resilient

Like other sectors, the retail property sector suffered under the initial lockdown restrictions but proved resilient in 2021. The staggered nature of lease expiry profiles at shopping centres, together with negative rental reversions, lower escalation rates, and shorter lease terms (none of which were unique to the retail sector), continue to hamper the performance of the sector, which is seen to be underperforming. The aggregate transactional value within the retail sector rose by ±17.6% in 2021, effectively exceeding values reported over the historical five-year period.

Transaction counts declined, but the aggregate lettable area transacted also improved through 2021. Retail transactions are estimated to account for around 34% of total deal flow activity, remaining level in terms of investment values reported for 2020. This is according to Sandri who continues that income performance of retail property is on the rise as vacancies are filled, and landlords seek alternative revenue streams through the installation of signage or solar PV systems, for example. Regardless of the headwinds faced, investment into the retail sector showed strong growth in 2021, increasing by 18% to peak at just over R7.0bn.

The retail sector saw several landmark deals in 2021, including the finalisation of the sale of Atterbury Value Mart for over R1bn, and the Nicolway Shopping Centre transactions at a record yield, breaching R1bn as well. Looking ahead, JLL is involved in and aware of several significant shopping centre transactions currently being negotiated, although it remains to be seen whether investment in 2022 will reach R7bn or higher.

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Industrial demand fundamentals remain strong

Following the outlier transaction volume experienced by the industrial property sector in 2020, investment volumes dropped significantly in 2021. When comparing investment in 2021 to before the pandemic, it is evident that demand fundamentals remain strong. As a case in point, JLL advised on the recent sale of the 145,000m^2 DSV Campus in Plumbago that transacted for R2.05bn in 2021, accounting for almost half of all deal flow within the sector for the year. Further investment into industrial property is presently limited by the lack of corestock available, rather than a lack of demand.

The alternatives and living sectors recorded a record year. This sector was dominated by student accommodation, senior housing, and mid-market rental accommodation. Data centres were added to the pool of non-traditional property investment in 2020, and in 2021 filling stations emerged as with strong investment volume. The outstanding performance of the alternative and living sector is primarily the result of two of the largest student accommodation portfolios changing hands, and unless a similar extraordinary deal is finalised this year, investment volume will likely not reach the record R6.6bn achieved last year.

Heavy impact on hotels, hospitality properties

Of all property sectors, hotels and hospitality properties possibly bore the heaviest brunt of the pandemic. Harsh operating conditions resulting in lower capital values created an opportunity for investors with a longer-term outlook to purchase hotels at well below replacement cost. Additionally, the pandemic-induced slump in hotel development activity (as well as offices and retail centres) should help with recovery as the stock situation is rectified. Investment into the hospitality sector in 2021 was not only limited to direct property sales, but rather included the restructuring of operational and letting agreements as well. A significant hotel sale recorded in 2021 is the Zimbali Resort in KwaZulu-Natal.

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'Green shoots emerging'

“Despite the adverse effects occasioned by the Covid-19 pandemic, investment activity is supported by debt capital becoming more affordable than ever through the lowering of lending rates. Along with discounted asset prices, this has led to an ideal investment climate for investors who predict a medium to long-term recovery,” added Purnell.

The report concludes that annual economic growth trends are forecast to stabilise (drop) to pre-pandemic levels as extraordinary stimulus winds down. Interest rates locally and globally are increasing, however, the expectation remains that lending rates will linger below levels seen before the global financial crisis.

Looking forward, Sandri suggests that “the green shoots of growing investor appetite are emerging, and 2022 is set to be a strong year from a commercial property investment sales perspective, with several preeminent deals already underway.”