JLL | Achieve Ambitions

2017

Investment Review

South Africa

March 2018

Market Overview

The real estate market was not immune to low levels of investor confidence going into 2017, made worse by the declaration of a technical recession in Q1 2017 as GDP contracted for the second consecutive quarter. This set the tone for benign investment activity in the remainder of the year and it is not surprising that overall capital invested (excluding new developments) declined to R13.3 billion from R28.7 billion in 2016, the lowest level of investment in the seven years that JLL has undertaken this review.

Be that as it may, there are three crucial elements that explain this contraction in 2017 which should not go without mention:

1. Decline in portfolio transactions in 2017

Compared to 2016 and 2015 this exaggerates the slowdown in investment activity in 2017. Large portfolio sales saw investment growth increasing by over 53% y/y in 2015 and a further 35% y/y in 2016. This has somewhat reversed with investment value declining by 53.9% y/y in 2017.

2. Ongoing confidence in developer activity

This continues to bring into question the long-term value of existing assets in the current economic climate. In addition to the completions made in 2017, the national office development pipeline is estimated at a notable 690,000m^2 (SAPOA). Similar trends are visible in the retail and industrial sector. Hence the options for capital within the real estate market remain broad, increasing competition for the secondary market.

3. A growing interest in both non-traditional and/or foreign assets

REITs that traditionally play in the office, industrial and/or retail space showed greater interest in student housing, residential accommodation and hotels in 2017. However, in some instances, purchases have been made to secure redevelopment opportunities or land value. Such is the case with the joint venture between Ingenuity and the Rabie Property Group, who have purchased City Park Hospital in Cape Town and will explore its redevelopment potential.

In addition, it is worth noting that several local REITs invested in or looked at opportunities in Europe, Australia, America and other parts of Africa. Hyprop added an iconic Bulgarian shopping mall to its portfolio through its international partner Hystead, while Redefine acquired student accommodation in Australia, diversifying both in geography and asset type. Capital outflow related to real estate investment grew substantially in the past year suggesting that this may be a growing trend. However, this is by no means a sign of a lack of investor confidence in the local market, as developer confidence remains firm.

Scope of analysis

This report reviews investment activity in the South African commercial real estate market and analyses key trends observed from investment sales data. Data was sourced from publicly available media reports, research by Real Capital Analytics (RCA) and the annual reports of the listed sector, among other sources. This report covers the years 2013 to 2017, with reference to commercial property, including the office, industrial and retail sectors, focusing primarily on major transactions. The total transactions reported do not reflect market activity completely, but present a majority of activity in which listed and unlisted major funds have either acquired or disposed of commercial real estate assets, with the section of smaller sales excluded due to lack of data.

Outlook

We cannot avoid a slight turn towards the political climate in painting the investment outlook. The election of Cyril Ramaphosa as the new President of the ANC has renewed investor confidence in South Africa, resulting in a sharp recovery of the Rand following his appointment. Nevertheless, it is incorrect to assume that the change in investor sentiment would be enough to swing sentiment in the local real estate market and we look at the same three drivers mentioned earlier to explain this.

Portfolio deals for companies with distressed balance sheets likely to reduce as economic outlook improves

Firstly, much of the recent portfolio deals have been a result of distressed balance sheets on the seller's side, often involving companies in the manufacturing sector. The window for similar deals in the future is likely to be limited, especially as economic prospects improve in key sectors of the economy.

Waiting for completion of new developments may delay investor decisions

Secondly, the option to invest in development sites or newly completed assets may see investors delaying capital expenditure until these options have reached completion. The market remains starved of high quality assets. Therefore, the option to invest in newly developed Grade P space over existing Grade A or Grade B stock that needs some work is something that could slow market activity in terms of existing assets.

Asset type and geographical diversification could reduce demand for 'traditional' investments

Lastly, the fundamental argument for seeking alternative geographies and assets remains. Investors are looking at ways to diversify. It is one way of avoiding an oversupply in the fast growing industrial and office markets and potentially a good way to protect the assets investors already hold in these sectors.

In conclusion, although not evident in the numbers, commercial real estate remains a solid option for investors. Though 2018 is expected to show improvement in investment activity from 2017, growth may not be as dramatic as we have seen in the past few years for reasons already mentioned. This could be read as a positive sign of moving into a more stable investment climate in comparison to the volatility seen in recent years, which in itself is discouraging to potential investors. It is important to note that this doesn't mean investors are not investing. It must be clear that these are not discouraging factors for the real estate sector, but may be for secondary or older assets. Finally, with the 'distressed sales' phase coming to a close, we are likely to see an improvement in initial yields during 2018. More so as new completions come into the market.

Snapshot of key portfolio transactions

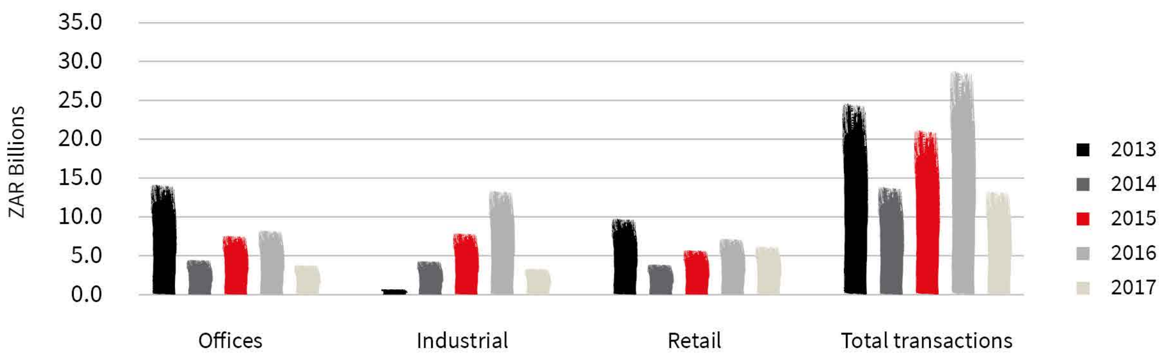
Trematon Capital and Redefine

The Trematon (buyer) and Redefine (seller) portfolio deal consisted of seven properties in total which amounted to R446.89 million worth of investment. The investments were spread out in three different provinces with one office property in Gauteng, one office property in KwaZulu-Natal and five properties in the Western Cape (three retail and two industrial).

Octodec Investments

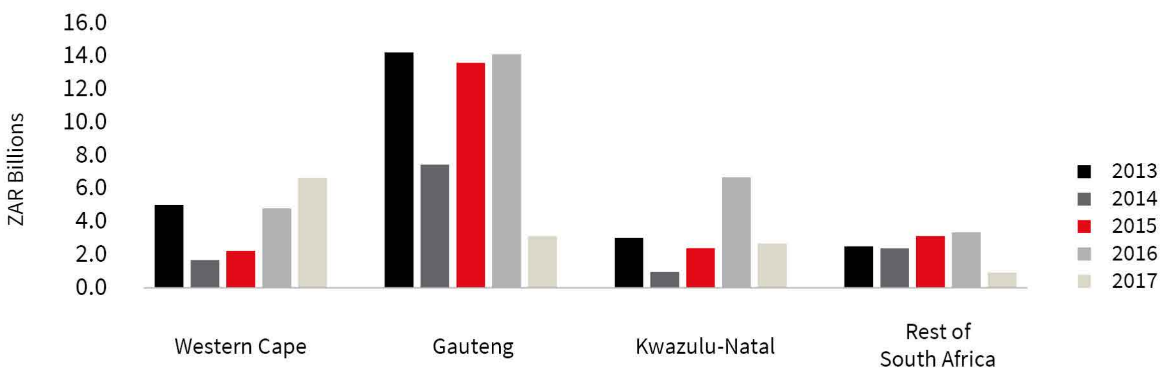
Octodec Investments disposed seven properties, four office and three industrial, worth R67.1 million. All transactions were in Gauteng, although in different sub-markets within the province.

Total investment transactions value by sector



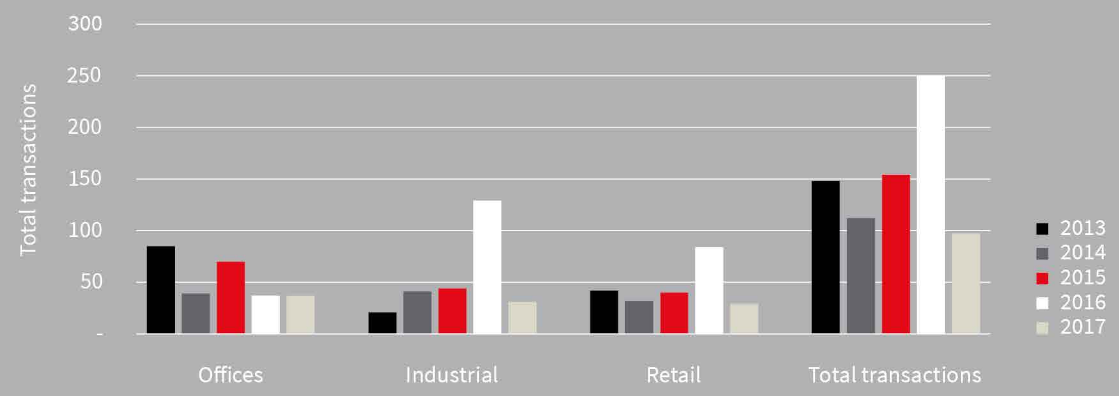
Source: RCA, JLL

Total investment transaction by province



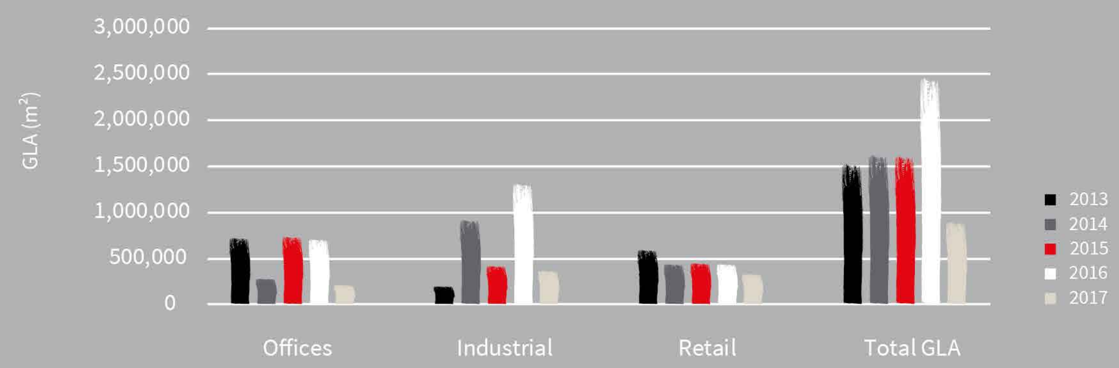
Source: RCA, JLL

Total number of transactions



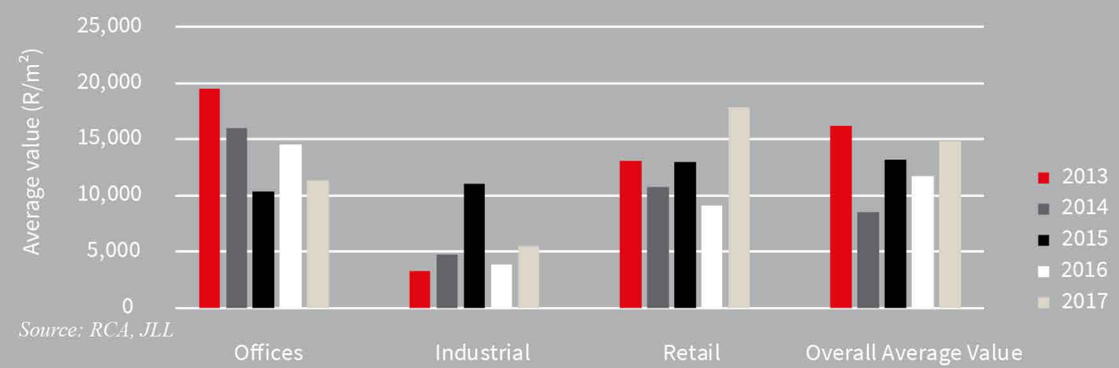
Source: RCA, JLL

Total transactions by GLA

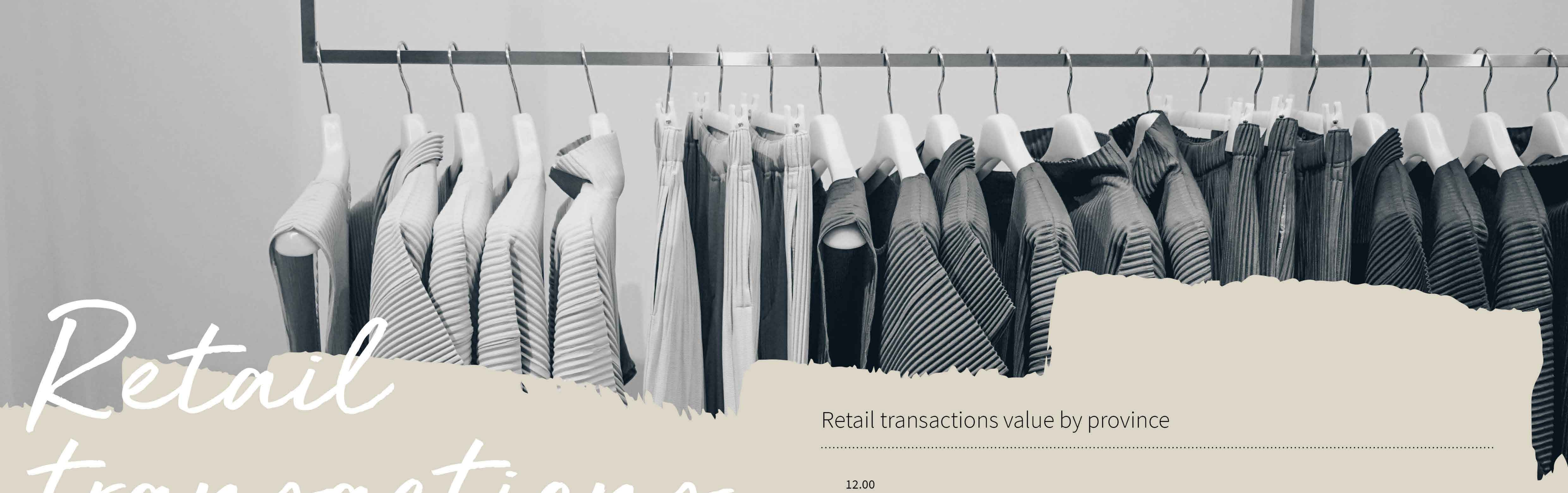


Source: RCA, JLL

Average value per square metre by sector



Source: RCA, JLL



Retail transactions

It is evident that 2017 was a difficult year with retail transactions amounting to just over R6.1 billion, a 14% decline in value compared to 2016.

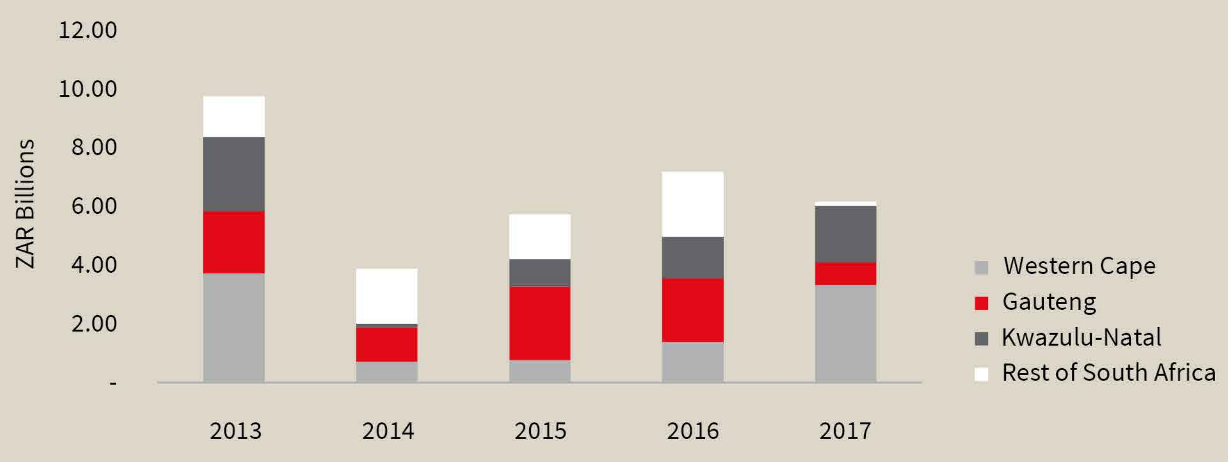
Interestingly, the transaction volume recorded a 65% decline compared to 2016. This indicates that transactions that took place were of high value despite fewer properties exchanging hands, further proof that property owners on the sell-side are driving for higher value transactions rather than focusing on the number of transactions. This is highlighted by the improvement in value per square metre. Average value per square metre came in at R17,811/m² in 2017 compared to R9,054/m² in 2016. The drive for higher value transactions has created a mismatch between buyers and sellers which has been a contributing factor to the decline in transaction volumes across all types of real estate assets. It is however important to acknowledge that the large portfolio sales may have greatly boosted the 2016 figures.

On a provincial level, Western Cape and KwaZulu-Natal recorded an increase in both volume and value, compared to the previous period's figures, with the five highest value transactions spread between the two provinces. The two provinces jointly accounted for 85.2% (WC – 53.9% & KZN – 31.3%) of the total transactions value for 2017.

In 2017, 29 retail properties were transacted, the lowest number of recorded transactions in the five-year period from 2012. The Western Cape saw an 8% increase in transaction volume compared to 2016. While on the other hand, all other provinces recorded a decline with KwaZulu-Natal recording the highest decline from 38 transactions in 2016 to a meagre seven transactions in 2017.

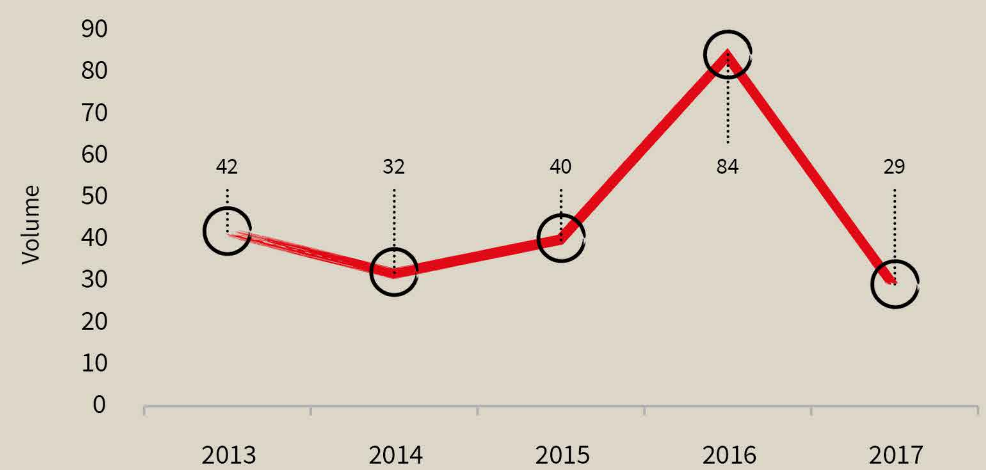
While none of the transactions from Gauteng made the top five transactions by value, they had the highest average for value per square metre which was recorded at R31,825/m². The province had three transactions that had the highest value per square metre; Woolworths on 45 Kerk Street (R40,000/m²), Grayston Shopping Centre (R41,530/m²) and 55 Pritchard Street (R35,000/m²). Transactions with such high values per square metre have been rare since 2012 (East Rand Mall).

Retail transactions value by province



Source: RCA, JLL

Retail transactions volume



Source: RCA, JLL

Retail average value /sqm

R13,032/m²	R10,757/m²	R12,989/m²	R9,054/m²	R17,811/m²
2013	2014	2015	2016	2017

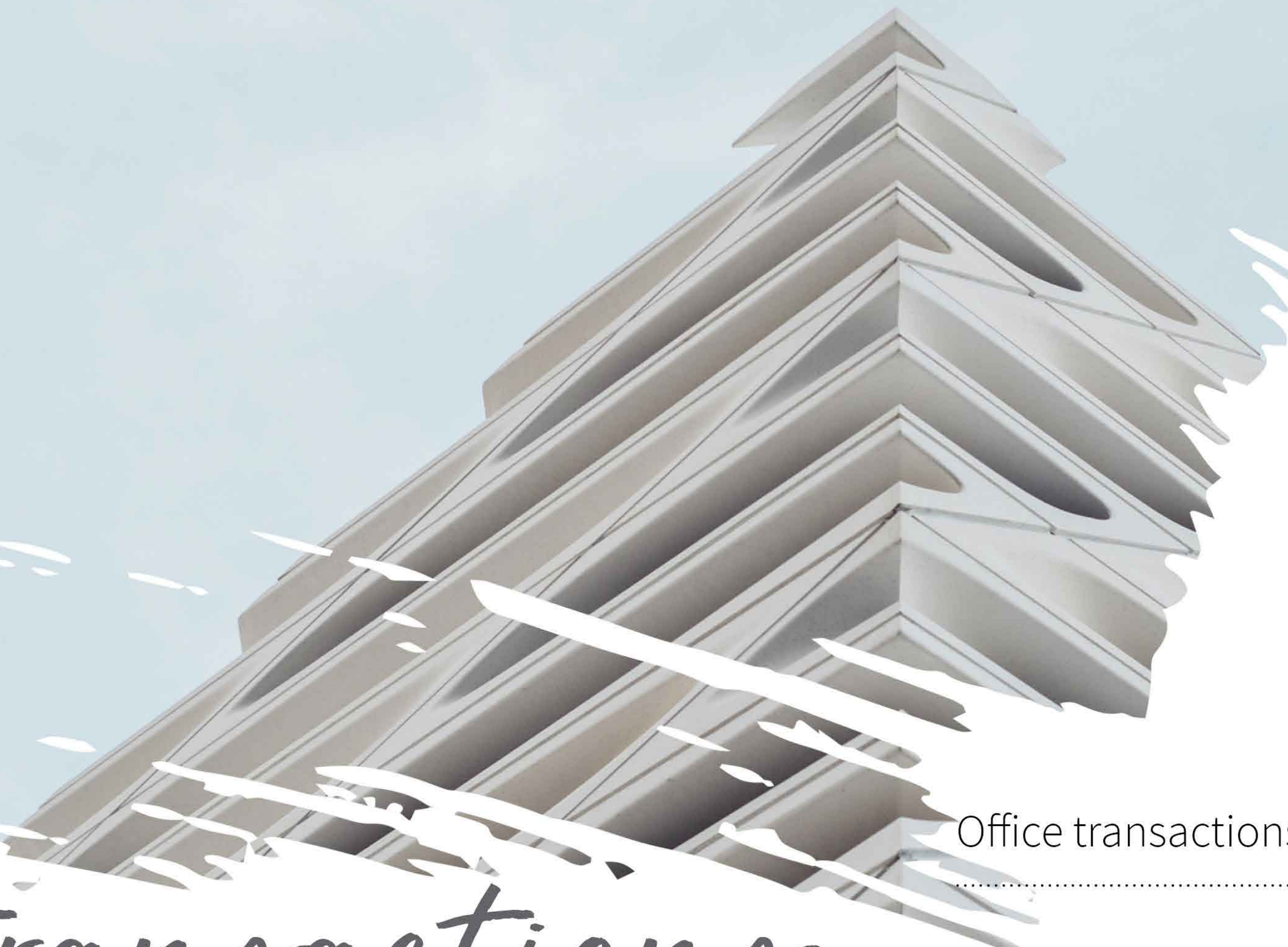
Source: RCA, JLL

Top five retail transactions by value

Market	Property	Price (ZAR)	Size (m²)	Buyer	Seller
KwaZulu-Natal	Pinecrest Shopping Centre	R813,000,000	40,111	Vukile Property Fund	SA Corporate
KwaZulu-Natal	The Crescent	R550,000,000	26,329	Vresthena	Fortress Income Fund
Cape Town	Willowbridge South	R460,000,000	29,899	Amrichprop Group	Hyprop
Cape Town	Maynard Mall	R245,830,673	24,270	Trematon Capital	Redefine REIT
Cape Town	Laguna Mall	R237,500,000	17,000	FPG Group	Milprops Group

Source: RCA, JLL

"2017 was a difficult year with retail transactions amounting to just over R6.1 billion, a 14% decline in value compared to 2016."



Office transactions

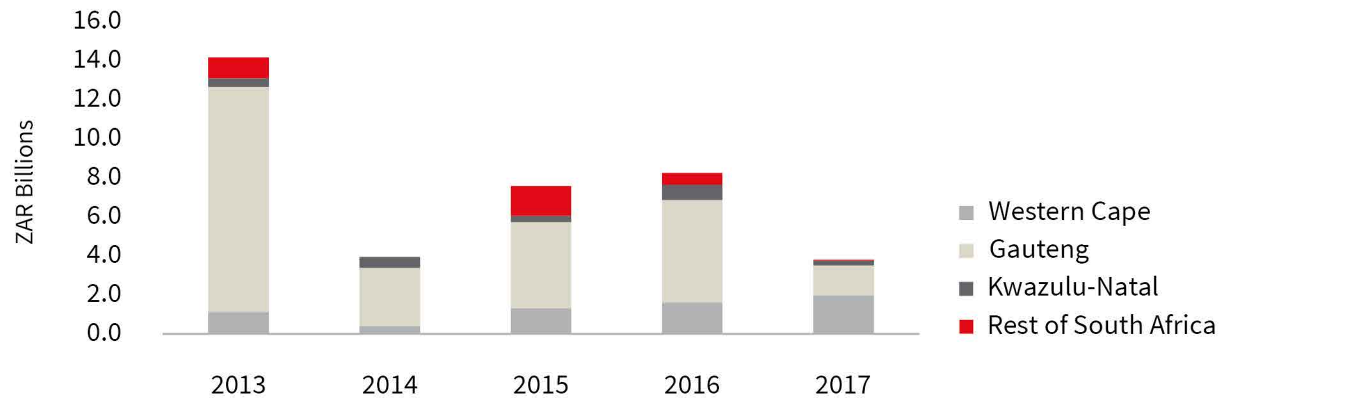
The total investment value for office transactions came to R3.81 billion for 2017, a 53.8% decline compared to 2016. One may easily point to the poor economic climate as the cause for the low transactions performance. While that may be true, there is another explanation. According to Statistics South Africa, the total value for new office buildings completed in South Africa summed up to R5.8 billion. This highlights the increased demand for higher quality office accommodation which is environmentally friendly, efficient and of modern design, leading to an increase in office developments.

In total, 37 office properties were transferred to new owners in 2017 compared to 82 properties in 2016, a notable 62% decline in transactions volume. The Western Cape was the only province that recorded an increase in number of transactions going from four properties transacted in 2016 to 13 properties in 2017. Nevertheless, Gauteng accounted for 54% of the number of transactions recorded for 2017. Office activity has been concentrated around Gauteng with the province accounting for more than half the country's ongoing office developments.

While Gauteng accounted for most of the office transactions in volume, this was not the case in terms of value. The Western Cape accounted for 40% of the investment transaction value for 2017, proving to be the best performing market despite weak economic conditions.

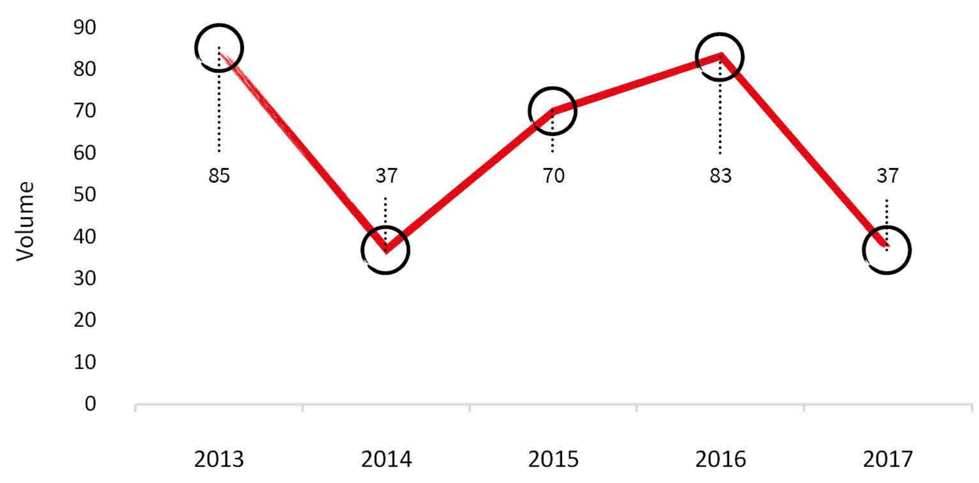
On a value per square metre basis, there was a 22% decline in value compared to 2016 which was driven by the significant drop in the estimated value per square metre for the Western Cape. It is worth noting that the average value per square metre recorded for most provinces (R9,000/m^2) was not far from the value per square metre for new builds which was recorded at R9,200/m^2.

Office transactions value by province



Source: RCA, JLL

Office transactions volume



Source: RCA, JLL

Office average value /sqm

R19,488/m²	R15,981/m²	R10,331/m²	R14,491/m²	R11,360/m²
2013	2014	2015	2016	2017

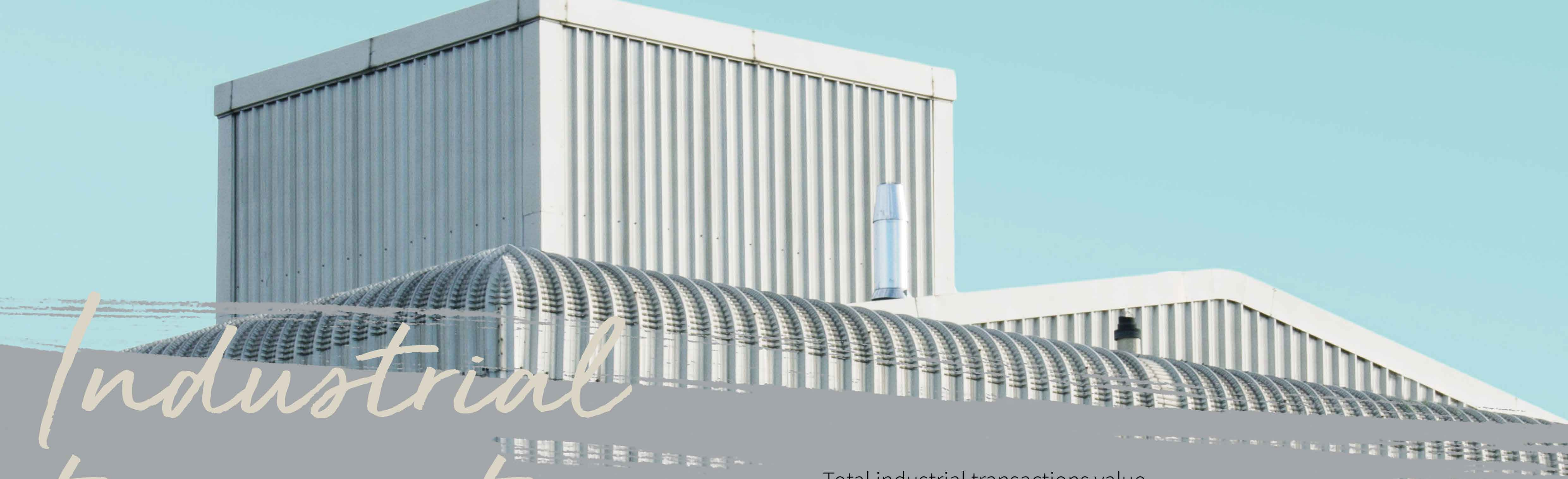
Source: RCA, JLL

Top five office transactions by value

Market	Property	Price (ZAR)	Size (m²)	Buyer	Seller
Johannesburg	ABSA Contact Centre	399,000,000	12,000	ABSA Bank	Royalyard Traders 19 PTY LTD
Cape Town	2 Long Street	389,000,000	23,294	Spear REIT	Fortress Income Fund
Cape Town	Pier Place	167,206,496	14,613	Trematon Capital Investments	Redefine REIT
Cape Town	The Park	149,000,000	unknown	Life Healthcare Group	Newshelf 922 Pty Ltd
Cape Town	47 Somerset Road	145,000,000	unknown	Folkes Holding	Cape Trans Property Investments

Source: RCA, JLL

“The total investment value for office transactions came to R3.81 billion for 2017, a 53.8% decline compared to 2016.”



Industrial transactions

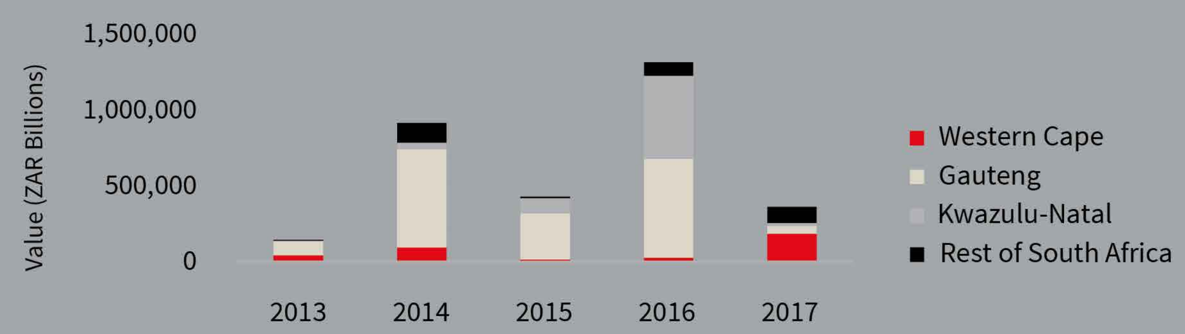
Compared to the number of portfolio deals concluded in 2016, the industrial market recorded a notable decline in total investment value, by 75.0%, from R13.3 billion in 2016 to just R3.3 billion in 2017. The year was a poor performance for the sale of existing assets in the industrial sector and is the lowest value since 2013.

Having noted the relative confidence in the industrial sector in comparison to other sectors, it might be surprising to see that the investment value has declined. However, it would be incorrect to see this decline as a lack of confidence on the side of investors. In contrast, what is evident is that investors are looking to initiate large scale greenfield developments such as the Aeroton Business Park in KwaZulu-Natal. Instead of acquiring existing assets which may be unable to incorporate new technological needs, investors are building from the ground up and in some cases are catering to special requirements of pre-let occupiers. According to Statistics South Africa, over 1 million square metres of accommodation was completed in the industrial, logistics and warehousing sector in 2017. The sector has 1.8 million square metres of plans passed in large municipalities. To compare this to investment sales, completed buildings in 2017 make a combined R6.6 billion, double the estimated value of secondary sales in the same year.

On the upside, when comparing the value of sales based on Rands per square metre where sufficient data is provided, there was a notable improvement in 2017 (R5,506/m^2) compared to 2016 (R3,818/m^2). This suggests that the market has shifted away from distressed assets and the 'discounts' from struggling manufacturers that contributed to portfolio transactions and lower asset revenues in 2016 and 2015.
If investor appetite is there, the completion of new, speculative buildings will introduce high quality assets which shouldn't struggle for occupiers or buyers.

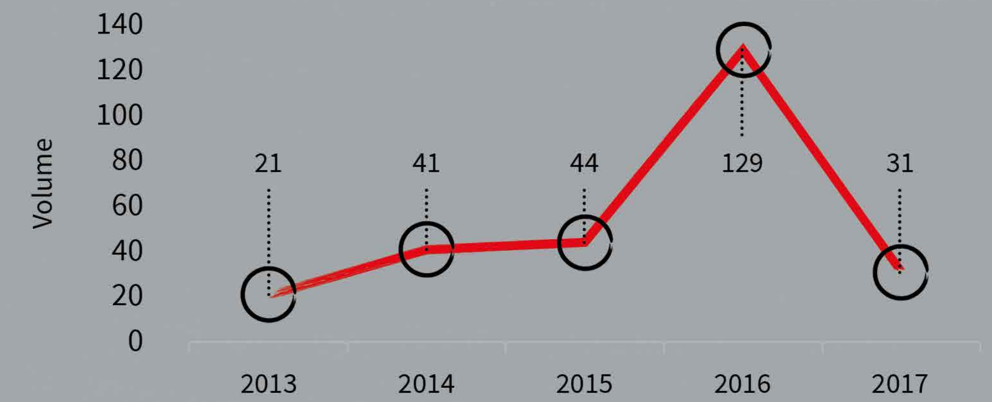
Going into 2018, there are several important factors which could swing investor sentiment. Firstly, the market has read Presidents Zuma's resignation as a positive move in the political situation of the country, which may encourage some investors to look at local assets. On the other hand, improving exports and a positive trade balance may be reversed as the Rand strengthens. This may reduce demand for logistics services and discourage or delay investment decisions. Lastly, there is a substantial amount of stock which will be introduced into the market over the next few years, most of which is strategically located, in addition to having the technology of the time. It solves the issue of a lack of investable accommodation at a time when economic prospects are improving.

Total industrial transactions value

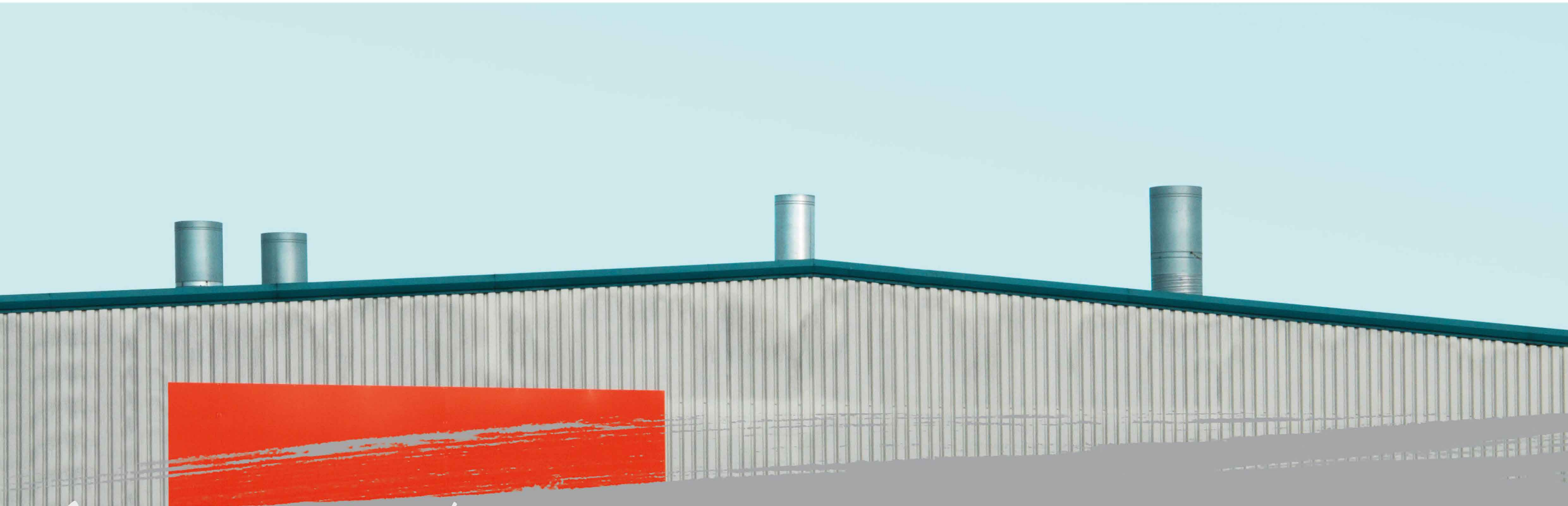


Source: RCA, JLL

Industrial transactions volume



Source: RCA, JLL



Average value /sqm

R4,885/m² 2013

R5,092/m² 2014

R10,992/m² 2015

R3,818/m² 2016

R5,506/m² 2017

Source: RCA, JLL

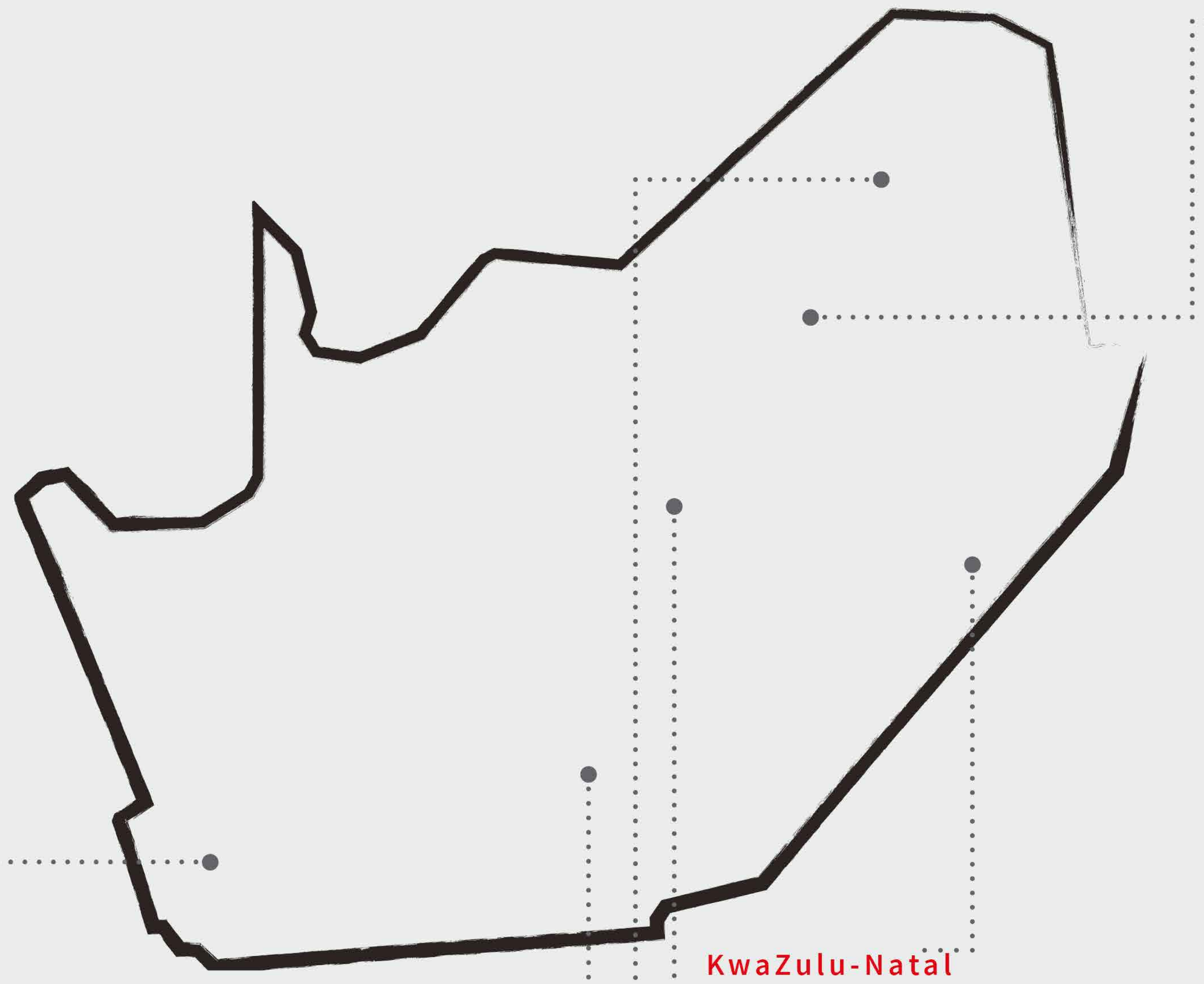
Top five industrial transactions by value

Market	Property	Price (ZAR)	Size (m²)	Buyer	Seller
Cape Town	Mega Park	379,157, 000	85, 746	Spear REIT	Sujean Property Investments
Cape Town	DC Dischem	240,992, 915	18, 000	Dischem Group	Investec Property Fund REIT, Annenberg Group
Gauteng	DC Spar Green-gate	156,733, 327	unknown	SPAR Osterreichische Warenhandels-AG	Afroprop
KwaZulu-Natal	35 Circuit Road	150,000, 000	unknown	unknown	SA Corp Real Estate
KwaZulu-Natal	Brackenhill	145,000, 000	22, 000	Stor-age	DanCor Properties

Source: RCA, JLL

“the market has shifted away from distressed assets and the ‘discounts’ from struggling manufacturers”

Mapping the deals of 2017



Western Cape

Property Name	Price (ZAR)
The Park	149,000,000
1 Thibault Square	527,911,550
Fountains Place	52,500,000
4 Liddle Street	58,140,000
Pier Place	167,206,496
2 Long Street	389,000,000
40 Sir Lowry Road	57,250,000
St Georges Mall (office condo)	66,500,000
70 Prestwich	124,600,000
Belvedere Place	85,560,764
47 Somerset Road	145,000,000
142 Edward Street	41,200,000
Estuaries No 1	100,000,000
Willowbridge North	225,000,000
Edgars Wynberg	26,241,170
Maynard Mall	245,830,673
Belhar Retail	103,000,000
Picbel Parkade	270,400,000
Willowbridge South	460,000,000
Laguna Mall	237,500,000
Standard Bank	7,526,644
Village Square	91,777,778
28 High Street	26,222,222
Former Nettex	85,000,000
Island Centre	115,000,000
Mega Park	379,157,000
26 Sacks Circle	130,000,000
12 Nourse Avenue	40,191,427
Berg River Park	103,112,361
Former Dairybelle	66,000,000
DC Booksite	117,420,000
DC Dischem	240,992,915
Ottery	R 42,000,000

Free State

Property Name	Price (ZAR)
Saint Andrews Sentrum	58,900,000

North West

Property Name	Price (ZAR)
Shoprite Brits	91,000,000

Mpumalanga

Property Name	Price (ZAR)
29 Walter Sisulu Street	55,000,000
Bertling	75,240,000
CHEP Jet Park	54,500,000

KwaZulu-Natal

Property Name	Price (ZAR)
Commercial City	90,000,000
Kingsfield Place	130,000,000
Glenashley Views	23,990,639
The Crescent	550,000,000
Shoprite Centre Empangeni	172,500,000
Capital Centre	90,000,000
Kingsburgh Centre	117,000,000
Taxi City Centre	114,000,000
Melmoth Shopping Centre	78,227,557
Pinecrest Shopping Centre	813,000,000
TFD Network Africa	140,485,651
35 Circuit Road	150,000,000
Brackenhill	145,000,000
36 Wankel Street	37,000,000

Gauteng

Property Name	Price (ZAR)
Dunkeld Office Park	100,000,000
Presidia	115,000,000
288 Kent Avenue	56,000,000
Melrose Place	62,000,000
Hyundai Training Centre	95,934,633
Thebe House	52,000,000
Absa Contact Centre	399,000,000
CSA	86,799,600
Metropolitan Office Park	75,000,000
16 Quality Street	8,872,405
25 Wellington Road	108,300,000
NBS Building	80,940,000
Brooklyn Forum	98,707,550
Waterkloof House	54,742,442
Brooklyn Gardens	78,750,000
Glenwood Office Park	42,000,000
Frederika Street Gezina	7,800,000
Karkap Gezina	5,500,000
Munt Street Waltloo	10,900,000
Albertina Sisulu Street	5,300,000
Woolworths	160,000,000
Pick 'n Pay Diepkloof	70,000,000
Grayston Shopping Centre	138,000,000
55 Pritchard Street	175,000,000
Ga-Rankuwa Shopping Centre	219,183,000
Cnr Rockey Street and Davies Street	5,500,000
Continental Brands	50,000,000
15-27 Springbok Road	70,000,000
Isando Industrial	143,640,000
84-86 Mimetes Road	88,000,000
TFD Network Africa	66,690,000
SpecPharm Holdings	96,500,000
DC Spar Greengate	156,733,327
Imperial Group	68,970,000
Pretwade Wadeville	10,500,000
Iskemp Isando	18,000,000
Swemvoor Gezina	9,100,000

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