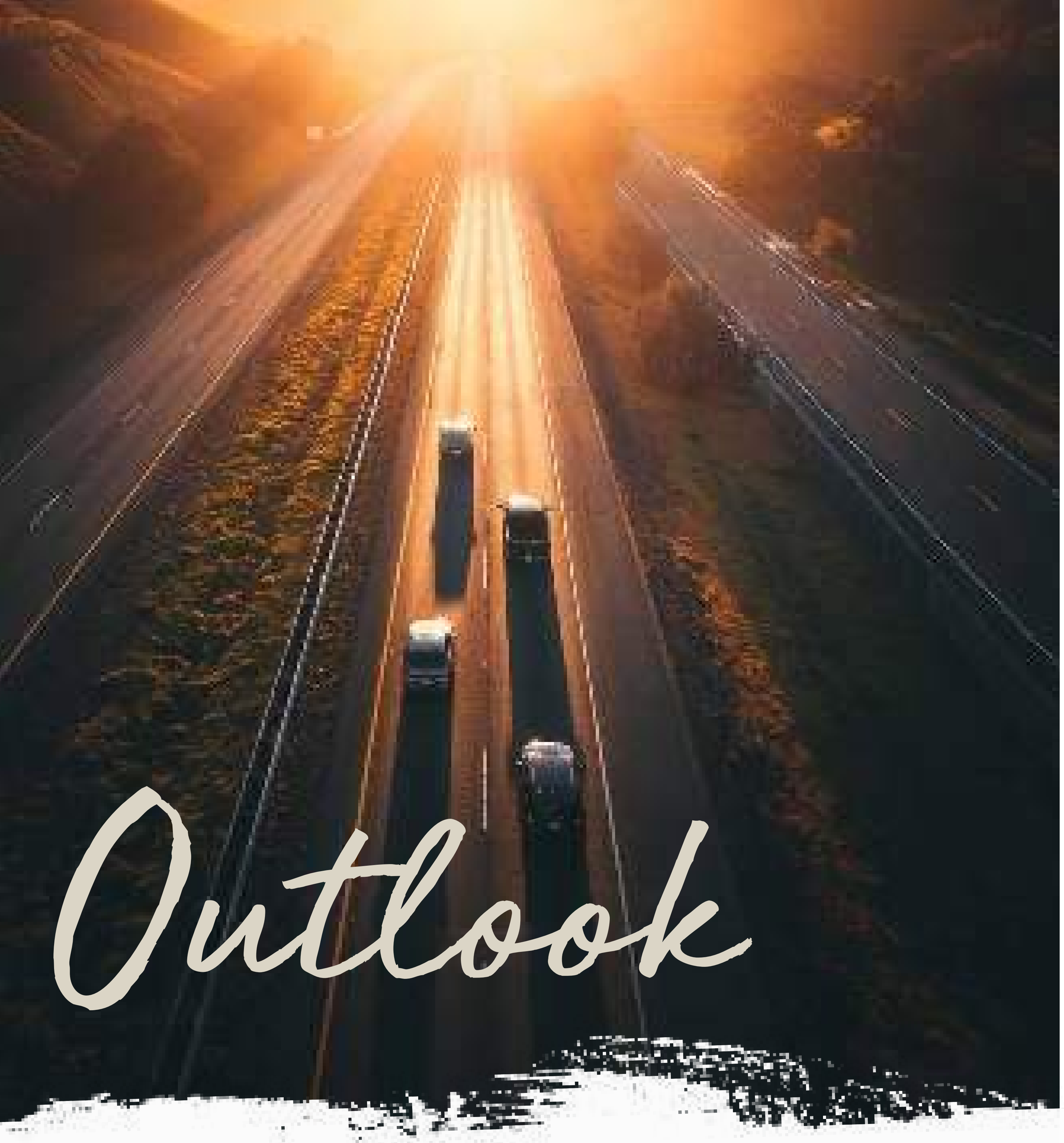
Investment Review

South Africa 2019/2020



Outlook

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 has been sourced from publicly available announced media reports, research by Real Capital Analytics (RCA), and Lightstone Property Toolkit, among other sources. This report provides an update to the 2018 Investment Review report published by JLL and analysis of significant transactions in South Africa's commercial property market over the period 2016 to 2020. Sectors of analysis include office, industrial and retail. While the analysis is focused on shifts in transactional trends in 2019, deals concluded from 2020 to date (May) have been included.

The total transactions reported do not reflect all activity in the market, but present the majority of transactions in the listed and unlisted space over this period, with smaller sales excluded.

Real estate capital markets respond to Covid-19

Over the short term, investment activity is expected to slow as valuation challenges, and broader uncertainty create barriers to investors' ability to price risk appropriately.

Defensive sectors such as healthcare and logistics continue to garner interest as active investors consider income stability, operational ability and occupational density to be critical factors in mitigating asset-level risk.

Despite some liquidity across debt and equity, lenders and investors alike remain in a phase of 'price discovery' and asset management.

Regardless of fluctuations in sentiment and activity, the overall trend has been for higher allocations to real estate, and we see no reason for this trend to reverse over the medium to long term given the advantages of real estate investments.

SA retail outlook

Retail has been one of the most adversely impacted sectors in the wake of the Covid-19 pandemic. Trade restrictions that compromise business operations, has seen landlords collect as little as 40%-50% of their rentals in April and May. This trend is set to continue until markets normalise.

Business shutdowns have caused Net Operating Income (NOI) instability, compromising investment sentiment. Without determinable NOI or substantial discounts, it is very unlikely that any sales will take place for the next six months, if not longer. In line with this outlook, prime retail yields remain uncertain over the short term.

From an operator perspective, line shops have been the most vulnerable, with many being forced to close because of limited capital resilience. As a result, it is anticipated that retail centres which are primarily line shop weighted will suffer the most.

The e-commerce "boom" will reduce foot traffic and trade densities in conventional retail malls, as consumers opt for online purchases. This will have an adverse effect on larger entertainment and leisure based retail centres.

In contrast, grocery anchored retail should be better suited to weather the storm. Specifically, we foresee smaller convenience centres (7,000-8,000 sqm) and rural-based retail centres (30,000-35,000 sqm) recovering the quickest, as the market recovers.

SA office outlook

In the short to medium term, it is anticipated that office vacancies will continue to rise, whilst rentals will decrease. In order to minimise risks associated with constrained cash-flows, tenants will most likely advocate shorter lease lengths.

As new developments come to market and attract tenants away from existing stock, the risk of rising vacancies and reduced rentals remains imminent. Rosebank, Waterfall and Sandton are particularly at risk, with the highest development activity. Subsequently, it is expected that speculative office development will dampen, whilst tenant-driven, pre-let developments will become more common.

Banks are starting to move away from expanding their office portfolios, opting to rather scale down and consolidate. With the exception of discounted P-grade spaces with long-lease deals and highly opportunistic deals, we anticipate that very few office transactions will take place over the short term. B and sub-grade office spaces are expected to suffer the most.

Whilst the demand for office space is expected to decline in response to business consolidations and a contracting economy, the use of traditional office space may vary as corporates consider their re-entry into the working environment. Social distancing measures will mean that current office spaces may not be able to accommodate employee head-count volumes as done previously. Where the business environment will invariably experience a contraction from an operational perspective, the subsequent demand for office space may not be influenced to the same degree. Whilst many staff may be required to work from home, the reduced headcount demand may be partially offset by the increase in personal space requirements.

Accordingly, the flexible space sector is likely to undergo significant consolidation, although, in the long run, it will remain a key feature of office markets. Despite the current switch to remote mass working, the physical office will maintain its importance for facilitating interaction and collaboration and, ultimately, for employee health, well-being and productivity.

SA industrial outlook

The Industrial sector in South Africa has shown resilience, with segment leading year-on-year capital growth backed by low vacancy rates. The sector has been supported by a growing demand for warehouse and distribution space due to the significant growth in online retail sales, albeit from a relatively low base.

E-commerce is expected to strengthen as consumer preference and behaviours change, with increased market penetration as a result of more accessible and affordable technologies.

Although logistics is expected to perform well, we do not forsee the sector side stepping the downturn entirely. Smaller, speculative spaces will see rises in vacancies, whilst larger boxes may seek to consolidate and improve operational efficiency.

2019 / 20 Market Overview

Asset classes slide into downturn phase

The economic shock caused by Covid-19 will invariably place downward pressure on rental levels and capital values across all market segments. This trend is expected to persist over the short to medium term, as markets remain in a downturn phase. The Industrial sector however, is expected to show some resilience, with e-commerce driving demand for warehousing and distribution space. From a nodal perspective, Johannesburg is expected to outperform due to strong supply and demand fundamentals.

Investment slows across all commercial real estate sectors

South Africa's total transaction values decreased by 20.5% year-on-year, reaching R16.7 billion by the end of 2019. Investment value into the office, industrial and retail sectors all experienced the same trend, contracting by 23%, 15% and 21% respectively.

While the value of transactions in 2020 has slowed considerably when compared to the equivalent 2019 January-to-April period, investment sentiment in the industrial space has shown the most resilience, constituting 46% of 2020's R1.8 billion spend to date.

It is important to note that although there was marginal increase (2%) in transaction volumes from 2018 to 2019, the average capital value per sqm across asset classes, declined sharply. This is congruent with the fact that 2019 saw a significant rise in transaction GLA, while investment value fell across the board.

Gauteng remains top investment destination for 2020

Gauteng remained the top investment destination for 2020, albeit at substantially lower (56%) transactional values than the previous 2019 equivelant period. To date, the province holds 62% of transactional value and takes up 74% of GLA sold.

Although the Western Cape dominated retail transactional activity (63%), Gauteng was home to the majority of industrial (74%) and office (100%) transactions. This trend is likely to persist over the medium term, as Gauteng continues to attract interest as the largest investment hub of South Africa.

Whilst businesses scale down and consolidate to preserve cash reserves, strategically locating operations will become pertinent as businesses gradually return to previous trading levels.

Industrials edge ahead in 2020

While office remained the best performing asset class in terms of transactional value, GLA and volumes during 2019, industrial space leads the pack in 2020. This comes off the back of an emerging e-commerce "boom" in South Africa, driving the demand for warehousing and distribution facililties.

Additionally, movement restrictions and new social distancing norms implemented in response to the Covid-19 pandemic, will see more people persuing online shopping alternatives. Accordingly, we anticipate retail driven warehousing and distribution space demand to expand over the short-to-medium term.

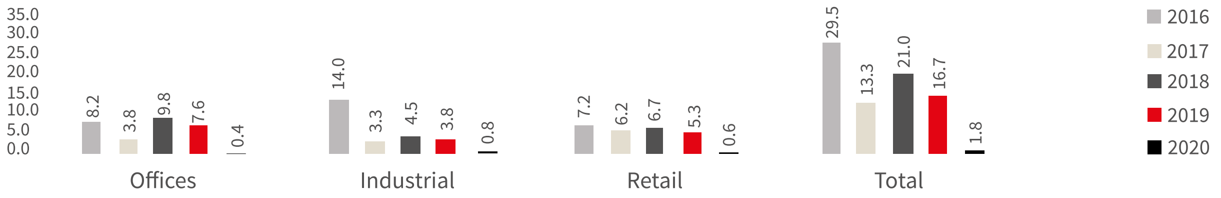
Prime yields expected to move outwards in reponse to market conditions

In reponse to prolonged economic contraction and perceptions of increased risk, prime yields are anticipated to move outwards over the short to medium term.

Constrained business cash-flows will continue to place pressure on the tenant's ability to meet their rental obligations, whilst landlords will face new challenges in restructuring lease renewals and filling vacancies. Whilst interest rate cuts provide temporary relief to the borrower, general market conditions driving these changes often overshadow the benefit of lower lending rates.

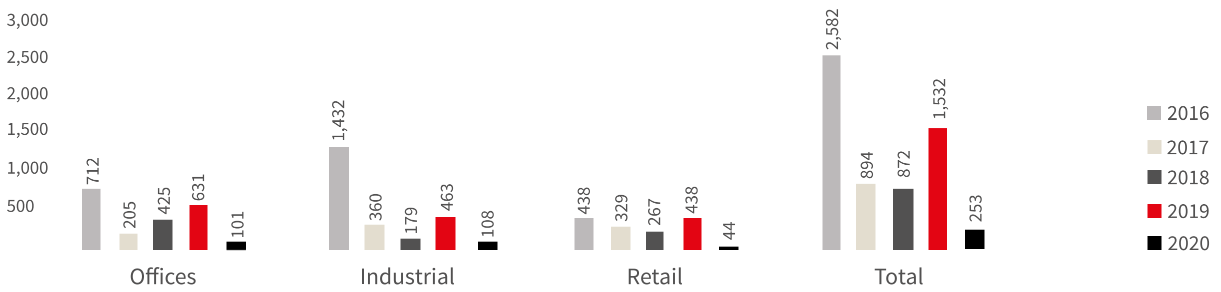
These factors all place increased risk premium on commercial real estate as an investment option. Accordingly, it is anticipated that yields will rise.

Total transaction value by asset class, 2016-2020, rand billion



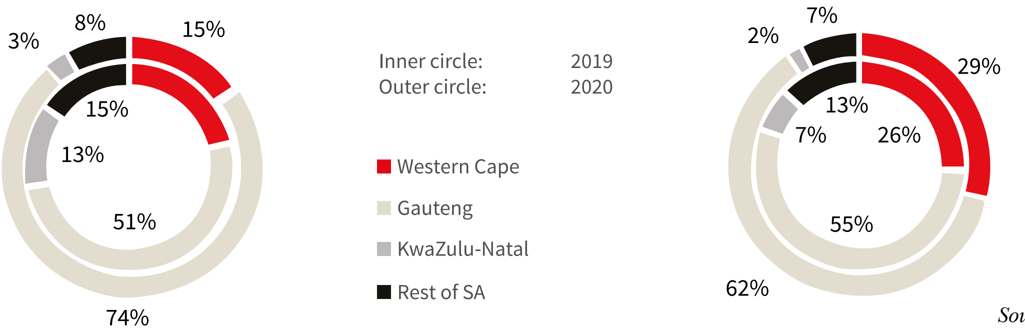
Source: RCA, JLL

Total transaction GLA by asset class, 2016-2020, sqm thousand



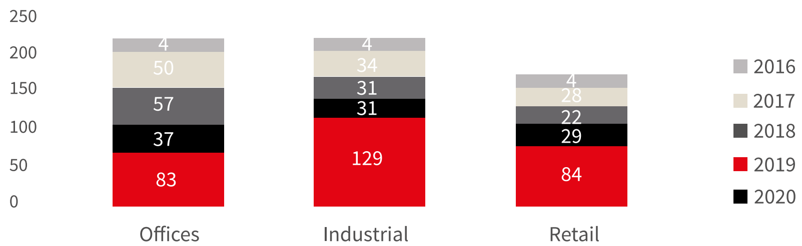
Source: RCA, JLL

Total transaction GLA & value distribution split by market 2016 - 2020, percent



Source: RCA, JLL

Total transactions volumes by asset class, 2016-2020, number



Source: RCA, JLL

Retail

Nation-wide retail investment transactions for 2019 amounted to R5.3 billion, a 20.5% decrease from 2018's R6.7 billion spend. This negative slide continues into 2020, with R557.9 million spent to date. This equates to a 68.4% decline in retail transactions when comparing accumulated investment for the equivalent period in 2019 (i.e. January-to-April 2019).

The 2018/19 decline in total retail transactional value coincides with a 27.3% increase in the total number of transactions. This suggests that 2019's transaction values were considerably lower than those recorded in 2018.

This downward trend is also reflected by a 34.6% decline in average capital value per square metre, sliding from R20,392 in 2018 to R13,340 in 2019. While the number and total value of transactions in 2020 have declined when compared to the equivalent 2019 period, the average capital value per square metre has increased by 19.6% to R15,960.

At a provincial level, 2019 data reveals that Gauteng accounted for the majority share of total transactions by value (36.2%), boosted by the sale of Hobart Grove Mall (Johannesburg) and Alberton Mall (Ekurhuleni). These two deals collectively sold for R624.8 million.

Moving into 2020, however, the majority share of retail transactions shifts to the Western Cape (63%). This share is supported by the sale of the Fairbridge and Nonkqubela malls, valued collectively at R384.6 million.

The Western Cape has recorded the highest volume of retail transactions for both 2019 and 2020 to date. During 2019, the Western Cape experienced more than double the volume of transactions from 2018, reaching 11 deals by the end of the year. In 2020 so far, the Western Cape accounts for 50% (2 of 4) of all retail transactions, inclusive of Bothasig's Shoprite Centre (R161.5 million) and Cape Town's Tokai Junction (R190 million).

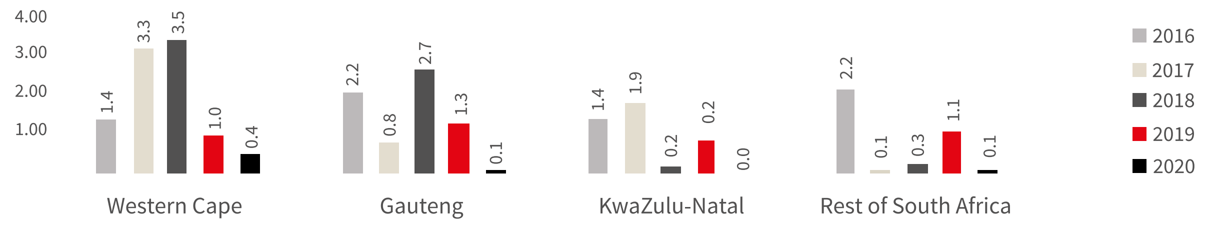
Gauteng and the Western Cape have the highest capital values per square metre. In 2019, these averaged R16,049 and R14,514, respectively. There is a significant swing moving into 2020, however, with the Western Cape topping the charts, at R20,614 per square metre. Gauteng experienced a 29.6% decline, averaging R11,307 per square metre by April 2020.

Three notable retail portfolio transactions were recorded in 2019, detailed as follows:

1 One Property Holdings and Emira Property Fund. Purchased a portion of Redefine REITs R441.6 million portfolio, with a transaction value of R260.3 million;
2 Fairvest Buyer Property Holdings. Purchased a portfolio from Investec Property Fund, valued at R169.2 million; and
3 The third portfolio sale included the Khula Sizwe Retail Portfolio. Valued at R1.7 billion, the sale was part of a larger R2.7 billion deal between Khula Sizwe Property Holdings (buyer) and Barloworld Limited (seller), comprised of 68 properties falling into both commercial, retail, industrial and residential sectors. The retail portion of the portfolio sale amounted to 128,913 sqm of GLA, with an average capital value per sqm of R13,032. The retail portfolio achieved a blended acquisition yield of 8.8%.

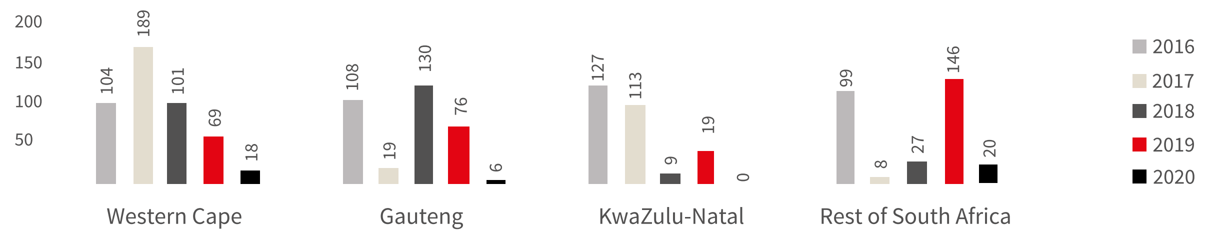
The largest individual retail transaction by value was the Mdantsane City Mall, valued at R511.4 million. The Eastern Cape based deal involved Rebosis (seller) and Vukile Property Fund (buyer), with a reported transactional yield of 9.0%.

Retail transaction values by province, 2016-2020, rand billion



Source: RCA, JLL

Retail transaction GLA by province, 2016-2020, sqm thousand



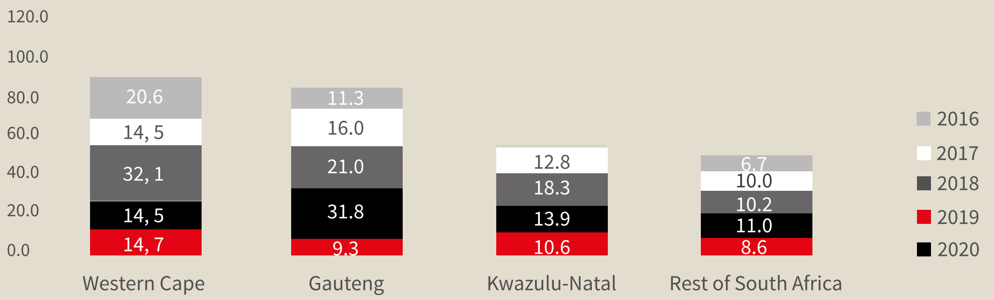
Source: RCA, JLL

[1] Portfolio has not been disaggregated by province. Data has been aggregated by sector only, with locations undisclosed. The portfolio has therefore not been disaggregated into the provincial analysis. This must be kept in mind when reading this document, as discrepencies in totals will occur.

Retail average value /sqm, rand thousand

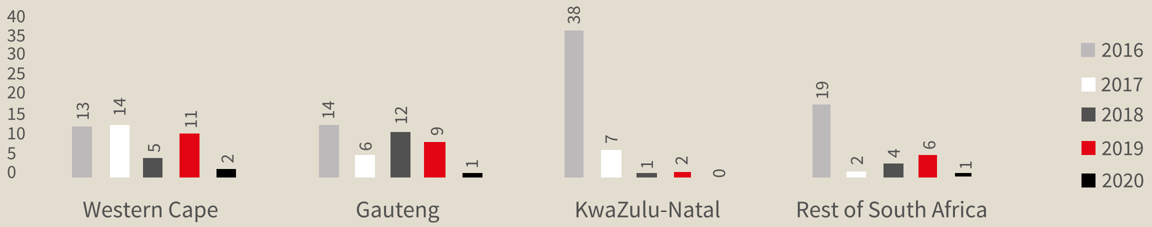
Source: RCA, JLL

Average retail value per sqm by province, 2016-2020, rand thousand



Source: RCA, JLL

Retail transaction volume by province, 2016-2020, Number



Source: RCA, JLL

Top five retail transactions by value

Property	Market	Price (R)	Size (sqm)	Buyer	Seller	R/sqm
Khula Sizwe Retail Portfolio	Non-disclosed	1,680,000,000	128,913	Khula Sizwe Property Holdings (RF) Ltd	Barloworld Ltd	13,032
Mdantsane City	Mdantsane (EC)	511,372,000	35,999	Vukile Property Fund	Rebosis REIT	14,205
Hobart Grove	Johannesburg	364,500,000	11,556	SIFOROX (Pty) Ltd	Sable Holdings	31,543
Fairbridge Mall	Cape Town	260,360,000	23,924	Shoprite Ltd	Fairbridge Mall (Pty) Ltd	10,883
Alberton Mall	Ekurhuleni	260,317,606	17,006	One Property Holdings, Emira Property Fund	Redefine REIT	15,308

Source: RCA, JLL

“Nation-wide retail investment transactions for 2019 amounted to R5.3 billion, a 20.5% decrease from 2018’s R6.7 billion spend.”

Office

Office transaction activity in 2019 experienced a notable decline in total office investment value and volumes, with year-on-year contractions of 23% and 12.3% respectively. Total value in office transactions was recorded at R7.6 billion for 2019, with 50 deals having taken place (nine fewer than 2018).

This is in part due to multiple new developments coming to market simultaneously, placing pressure on an already over-supplied office market. This is supported by the GLA growth results, showing increases from 425.3 thousand sqm in 2018 to 631.1 thousand sqm in 2019. This indicates that although the average transaction involved larger properties, deal values were notably lower. This can be seen in the depression of average office capital value per sqm, which declined by 10.2% in 2019, averaging R10,988.

While Gauteng continues to dominate the office sector from a value and volumes perspective, the Western Cape leads the charts when it comes to average capital value per sqm, albeit marginally, due to a 30.2% year-on-year decline in Gauteng's capital value per square metre. For 2019, the Western Cape has an average office capital value per sqm of R13,040.

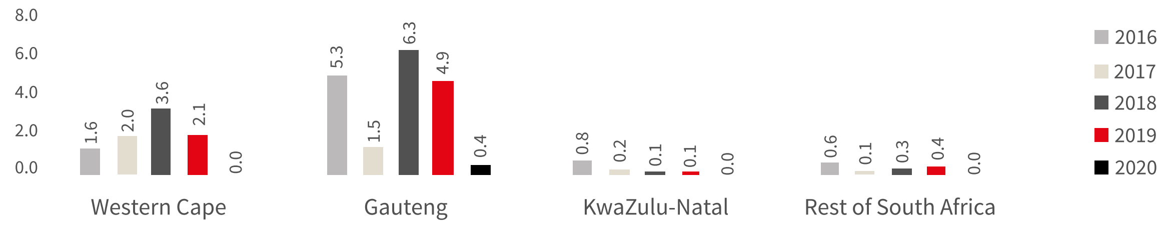
The same downward trend continues into 2020, with dampened transaction values and fewer concluded deals when compared to the equivalent 2019 January-to-April period. During the first four months of 2020, four office transactions collectively valued at R441.6 million took place.

It is worth noting that 2019 saw fewer portfolio sales than in 2018. With that said, one notable portfolio sale occurred in 2019, involving Inani Property Holdings (buyer) and Emira Property Fund (seller). The portfolio included two office assets, Lincoln Wood Office Park (Johannesburg) and Menlyn Square Office Park (Pretoria). The portfolio was sold for R692.9 million, with an average capital value per sqm of R33,375. This is almost triple the average sqm value for Gauteng, indicating higher building quality finishes within prime locations longer term leases and strong covenants.

The largest recorded individual office transaction for 2019 was Identity Property's purchase of The Campus from Dimension Data. The deal was valued at R1.3 billion, while the average capital value per square metre for the asset amounted to R20,745.

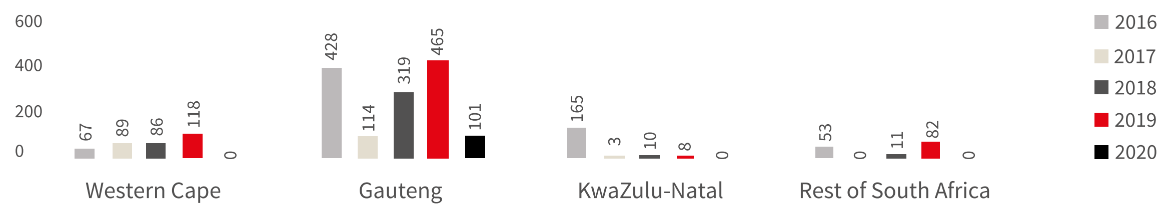
Other notable transactions for the 2019 FY included Cape Town's Grand Central, Liberty Centre and Metlife Centre. Spear REIT's purchase of Liberty Centre from Liberty Properties Ltd and Liberty Two Degree REIT, sold for R370 million, with an average capital value per sqm of R20,281 and a quoted yield of 9.30%. The top five office transactions by asset value are highlighted in the adjacent table.

Office transaction values by province, 2016-2020, rand billion



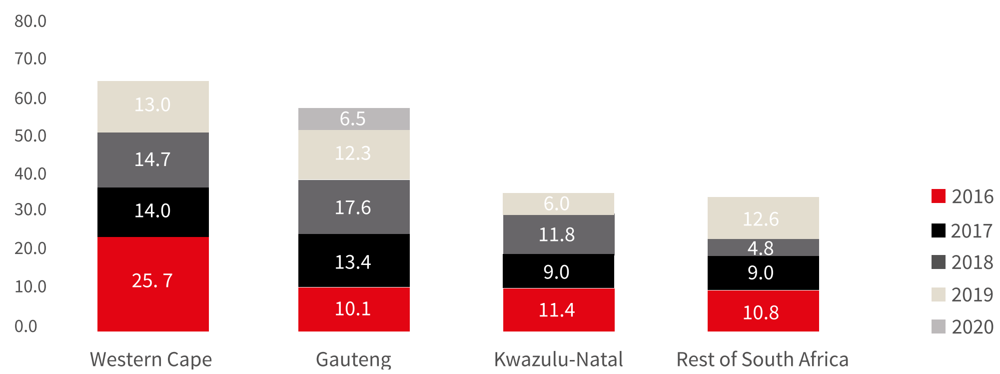
Source: RCA, JLL

Office transaction GLA by province, 2016-2020, sqm thousand



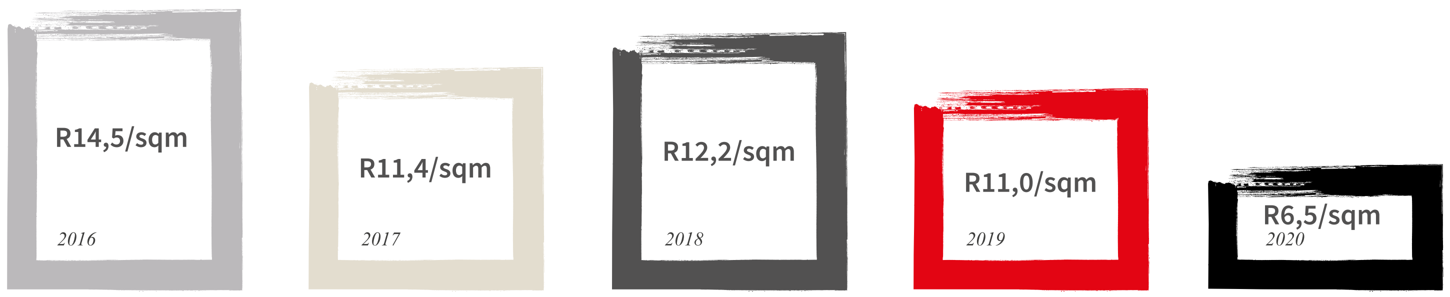
Source: RCA, JLL

Average office value per sqm by province, 2016-2020, rand thousand



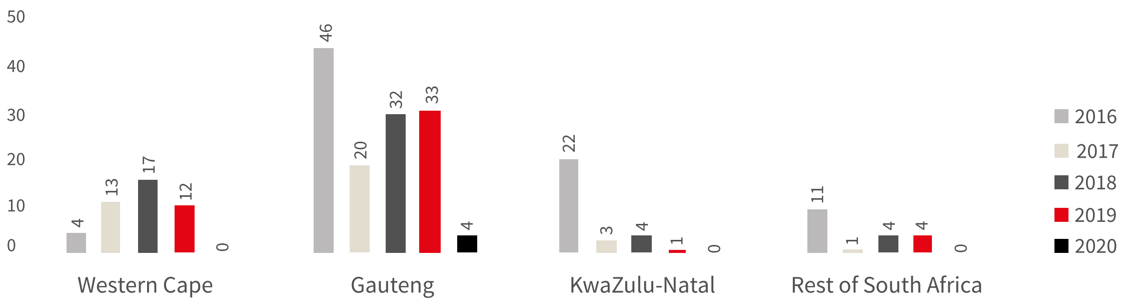
Source: RCA, JLL

Office average value /sqm, rand thousand



Source: RCA, JLL

Office transaction volumes by province, 2016-2020, number



Source: RCA, JLL

Top five office transactions by value

Property	Market	Price (R)	Size (sqm)	Buyer	Seller	R/sqm
The Campus	Johannesburg	1,300,000,000	62,665	Identity Property Fund	Dimension Data Facilities (Pty) Ltd	20,745
Lincoln Wood Office Park & Menlyn Square Office Park	Johannesburg & Pretoria	692,949,502	20,762	Inani Property Holdings	Emira Property Fund	33,375
Grand Central	Cape Town	510,000,000	33,615	Dalopix Pty Ltd (Mark Stillerman)	Rebosis REIT	15,172
Liberty Centre Cape Town	Cape Town	370,000,000	18,244	Spear REIT	Liberty Two Degree REIT	20,281
Metlife Centre	Cape Town	315,200,000	28,710	Sandton Treeway Centre (Pty) Ltd	MMI Holdings Ltd	10,979

Source: RCA, JLL

“2019 experienced a notable decline in total office investment value and volumes, with year-on-year contractions of 23% and 12.3% respectively.”

Industrial

The Industrial sector space remains strong, with sector-leading year-on-year capital growth backed by low vacancy rates. There is now a growing demand for warehouse and distribution space due to the significant growth in online retail sales from a relatively low base in South Africa.

E-commerce is expected to strengthen as consumer preferences and behaviours change, with increased market penetration as a result of more accessible and affordable technologies.

Additionally, movement restrictions and new social distancing norms implemented in response to the Covid-19 pandemic, will see more people persuing online shopping alternatives. Accordingly, we anticipate retail driven warehousing and distribution space demand to expand over the short-to-medium term.

This is supported by the investment trends recorded over the 2019/20 period. Total transactional value for industrial asset classes during 2019 amounted to R3.8 billion, R0.7 billion down from 2018. Total transaction GLA more than doubled (year-on-year) to 462.6 thousand sqm by the end of 2019.

This is mainly attributed to growth in the number of deals (9.7%) that took place during 2019, as well as the discount benefits associated with larger transactions. Average capital values per sqm for 2019 weakened by 10.8% to R8,736.

Over the first four months of 2020, 4 industrial transactions, collectively valued R557.9 million have taken place. Equivalent comparisons (i.e. January to April) reveal that transaction values for 2020 to date fall short of those recorded in 2019 by 68%.

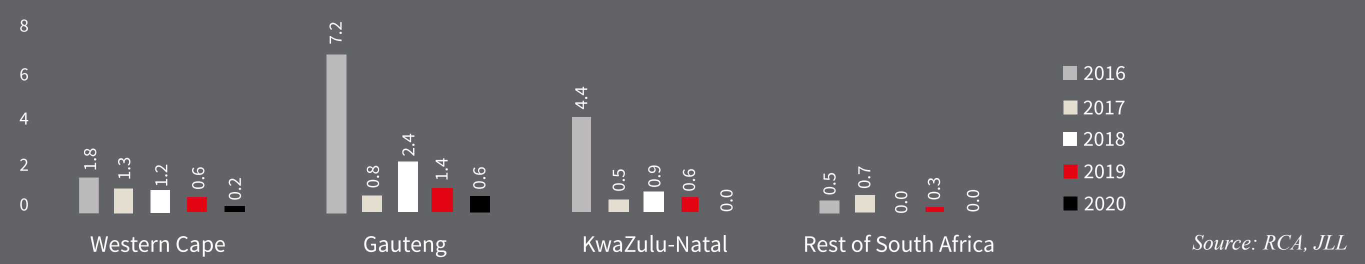
Similar to 2019, Gauteng remains the dominant destination for industrial transactions, holding 74% of the R841.9 million sold to date. Two mentionable portfolio sales took place over the 2019/20 period. The first sale included the Khula Sizwe Industrial Portfolio, valued at R914 million[2]. The transaction was part of a larger R2.7 billion deal between Khula Sizwe Property Holdings (buyer) and Barloworld Limited (seller). The industrial portion of the portfolio sale amounted to a GLA of 140,995 sqm, with relatively low average capital value per sqm of R6,483. The industrial portfolio achieved an acquisition yield of 9.30%.

The second sale included a Gauteng Industrial Portfolio sold to Mbako Property Fund by Vukile Property Fund for R621.4 million. The total portfolio GLA amounted to 80,658 sqm, with an average capital value of R7,705 per sqm. The portfolio comprised of seven industrial properties located in Johannesburg and Pretoria[3].

The largest deal for 2020 is still pending and is therefore not included in the table and charts. Equites Property Fund is set to invest R2.1bn for 50.1% stake in a JV with Shoprite Checkers. As part of the arrangement Shoprite will transfer the Shoprite Centurion Campus (170,000 sqm), Brackenfell Distribution Centre (102,000 sqm) and development bulk of 40,000 sqm in Brackenfell to the JV for a 49.9% sake in the JV. The JV will then acquire the Cilmor Distribution Centre (130,000 sqm) in Brackenfell for R1.2bn. All the deals are subject to Shoprite Checkers leases of 20 years (with three 10-year renewal options). The initial yield for the leased transactions is 7.5% and the leases will escalate at 5% p.a.

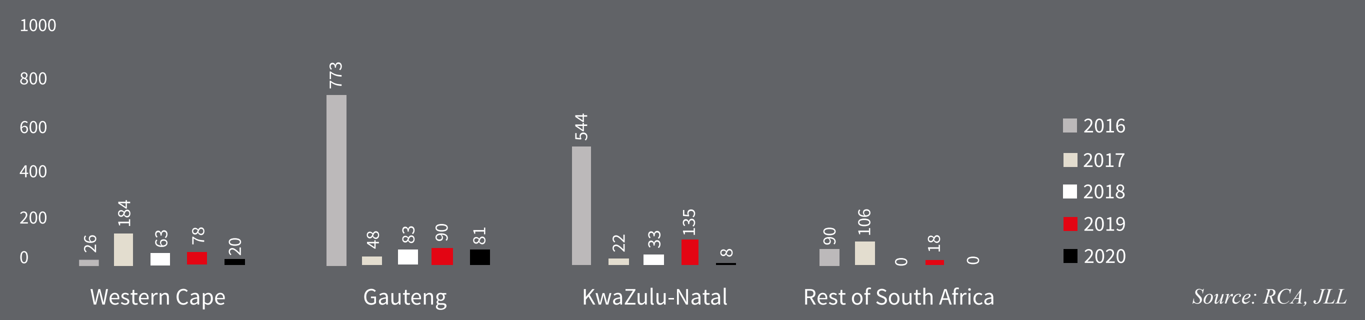
[2] Portfolio has not been disaggregated by province. Data has been aggregated by sector only, with locations undisclosed. The portfolio has therefore not been disaggregated into the provincial analysis. This must be kept in mind when reading this document, as discrepencies in totals will occur.
[3] Centurion Samrand N1; Houghton 1 West Street; Kempton Park Spartan Warehouse; Midrand Allandale Industrial Park; Midrand Ulwazi Building; Pretoria Rosslyn Warehouse; Sandton Linbro 7 on Mastiff Business Park

Industrial transaction values by province, 2016-2020, rand billion



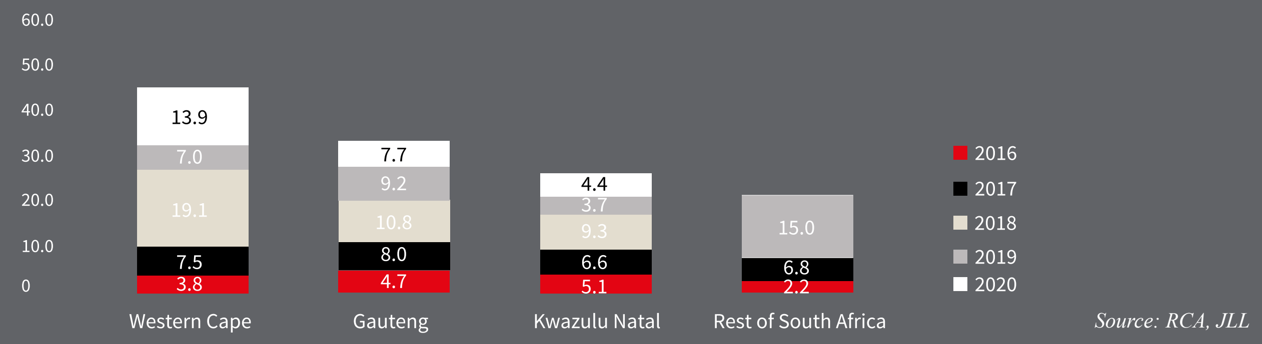
Source: RCA, JLL

Industrial transaction GLA by province, 2016-2020, sqm thousand



Source: RCA, JLL

Average industrial value per sqm, 2016-2020, rand thousand



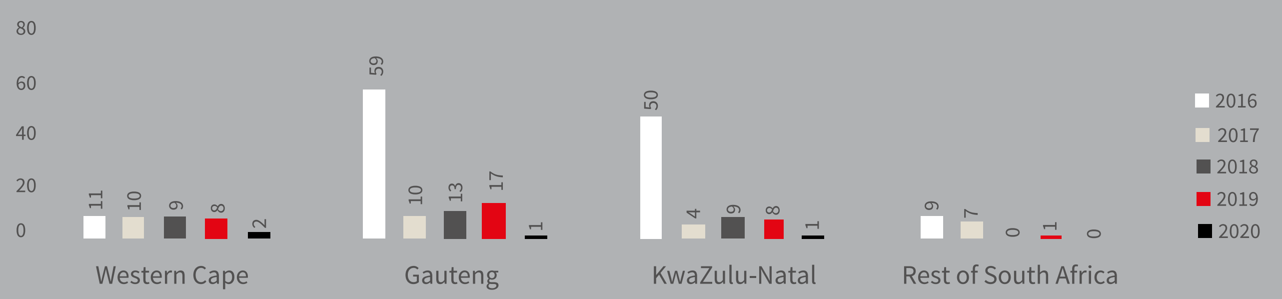
Source: RCA, JLL

Average value /sqm, rand thousand

R3,9/sqm	R5,5/sqm	R9,8/sqm	R5,0/sqm	R8,7/sqm
2016	2017	2018	2019	2020

Source: RCA, JLL

Industrial transaction volume by province, 2016-2020, number



Source: RCA, JLL

Top 5 Industrial transactions by value

Property	Market	Price (R)	Size (sqm)	Buyer	Seller	R/sqm
Khula Sizwe Industrial Portfolio	Non-disclosed	914,000,000	140,995	Khula Sizwe Property Holdings (RF) Ltd	Barloworld Ltd	6,482
Gauteng Industrial Portfolio	Johannesburg & Pretoria	621,445,805	80,658	Mbako Property Fund	Vukile Property Fund	7,705
20 Pendoring St	Brits	267,040,933	17,780	Bayer Property	Monsanto Co	15,019
Firewings Prop 21 Industrial Portfolio	Johannesburg (Wynberg)	207,000,000	11,154	Fire Wings Prop 21 (Pty) Ltd	Synergy Prop Inv (Pty) Ltd	18,558
Diageo Khangela Brewery	Durban	153,000,000	14,000	Shree Property Holdings (Pty) Ltd	United National Breweries (Pty) Ltd	10,929

Source: RCA, JLL

“The Industrial sector space remains strong, with sector-leading year-on-year capital growth backed by low vacancy rates.”

Contact us

JLL South Africa
Johannesburg

3rd Floor, The Firs
Cnr Biermann & Cradock Ave
Rosebank, South Africa, 2196
Phone: +27 11 507 2200

With other regional offices in Dubai, Abu Dhabi, Riyadh, Jeddah, Al Khobar, Cairo, and Casablanca

Michael Scott
Analyst: Research
JLL Sub-Saharan Africa
+27 11 507 2200
michaelc.scott@eu.jll.com

Henry Playne
Head: Capital Markets
JLL Sub-Saharan Africa
+27 72 763 4090
henry.playne@eu.jll.com

Pepler Sandri
Associate Director: Capital Markets
JLL Sub-Saharan Africa
+27 82 445 5496
pepler.sandri@eu.jll.com

www.jll.co.za