JLL | Achieve Ambitions

The South Africa Q2 Real Estate Market

Cape Town

City overview

The City of Cape Town rests in the coastal province of the Western Cape and is home to 4.6[1] million residents. The local economy is predominantly services driven, making up 12% of the country's GDP. The city hosts national headquarters for multiple retail and financial listed companies, creating an attractive commercial environment for multinationals and global organizations. A resilient commercial environment coupled with a thriving tourism sector means that the city is home to the second largest airport in South Africa. The financial and business services sector contributes 30%[2] of the city's total GDP and has been supported by a resilient central business district along with thriving decentralized nodes. As a result, the metropolitan has seen some of the best quality office space come to market over the past 5 years.

[1] Source: Macro Trends, 2020 [2] Source: Oxford Economics, 2020

Office

2.6million[4]
Estimated stock

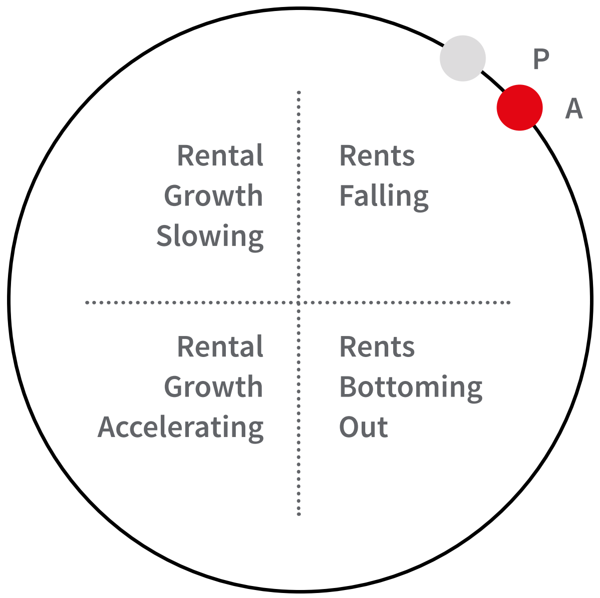
8%-8.5%[5]
Prime yields

8.9%[4]
Vacancy rate

P = 3.9% A = -3.7%[4]
B = 1.3% C = -5.6%
Annualised rental growth

R180-R230[(4)(5)]
Prime rent

Negative, cyclical downturn ▼
Rental outlook



The property clock is a graphical tool developed by JLL to illustrate where a market sits within its individual rental cycle at a point in time. These positions are not necessarily representative of investment or development market prospects. It is important to recognize that markets move at different speeds depending on their maturity, size and economic conditions. Markets will not always move in a clockwise direction, they might move backwards or remain at the same point in their cycle for extended periods.

[4] Source: SAPOA, 2020 [5] Baker Street Properties

Industrial

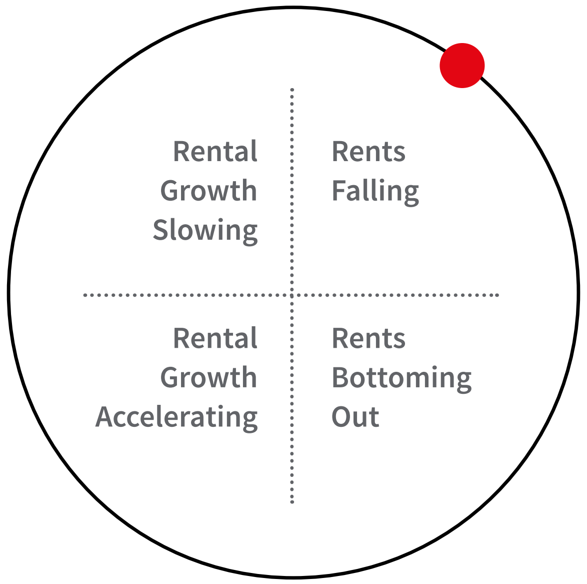
15.8million [6]
Estimated stock

9%-9.5% [5]
Prime yields

5%-7% [5]
Vacancy rate

R70 - R85 [5]
Prime rent

Negative, cyclical downturn
Rental outlook



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[5] Source: Baker Street Properties *[6] Comparative Market Analytics (CMA), 2020*

Hotels

10% [7]
Occupancy

R718 [7]
ADR

R75 [7]
RevPAR

[7] Source: STR Reports, May 2020

Office

Overview

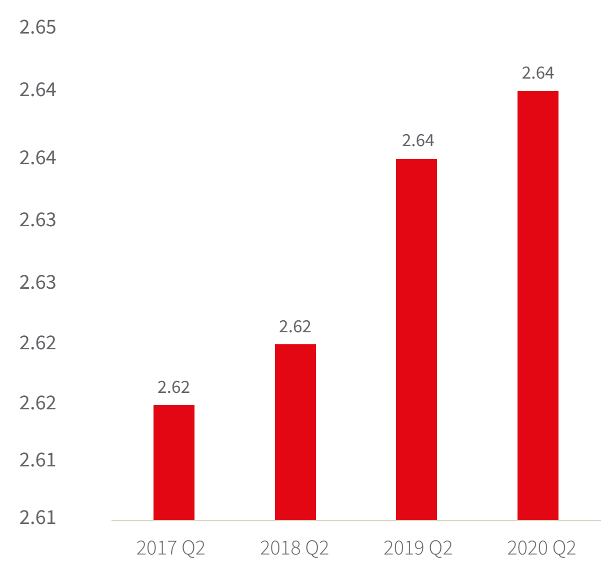
Although Cape Town has maintained resilient office space fundamentals for years, the asset class finds itself transitioning into a cyclical downturn. Rentals across office grade have peaked and are starting to decline. Accordingly, office sector performance is set to continue softening over the medium term. Although revised lockdown restrictions have allowed most sectors to open their doors and trade again, commercial operators have shown a reluctance to go out to market and assess their space options. Many businesses are still operating from home. Cape Town's prominent flex space market has come under particular pressure, as many of its smaller occupiers have been able to continue working from home. In response, operators have started offering aggressive deals to compensate for lost business.

In summary, corporates have started investigating alternative ways to optimize and streamline their work-space requirements. Whilst prioritizing the health and safety of its employees, businesses are having to strike a balance between minimizing costs without compromising work space productivity.

Supply

Office supply in the City of Cape Town is predominantly clustered in the CBD, with total stock estimated at 2.6 million square meters (SAPOA, 2020). The saturated office market has experienced annualized growth in stock of 0.1%. Despite the oversupply, the city has approximately 19,000m2 of commercial office space currently in its pipeline.

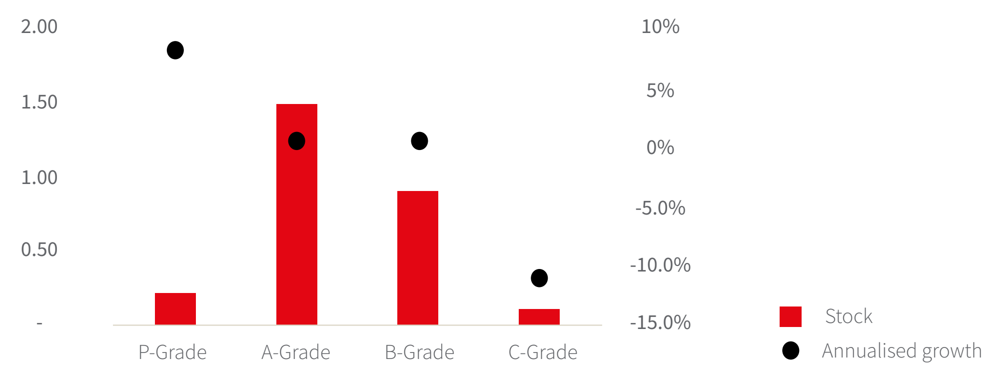
City of Cape Town: total office stock, 2017 - 2020



Source: SAPOA, 2020

Prime grade office space has experienced an annual volume growth rate of 7.6%, largely a result of multiple developments coming to market simultaneously. Stock in C-grade office space on the other hand has shrunk significantly (11.4%), as residential and alternate use conversions of old office stock becomes increasingly profitable for investors and developers alike.

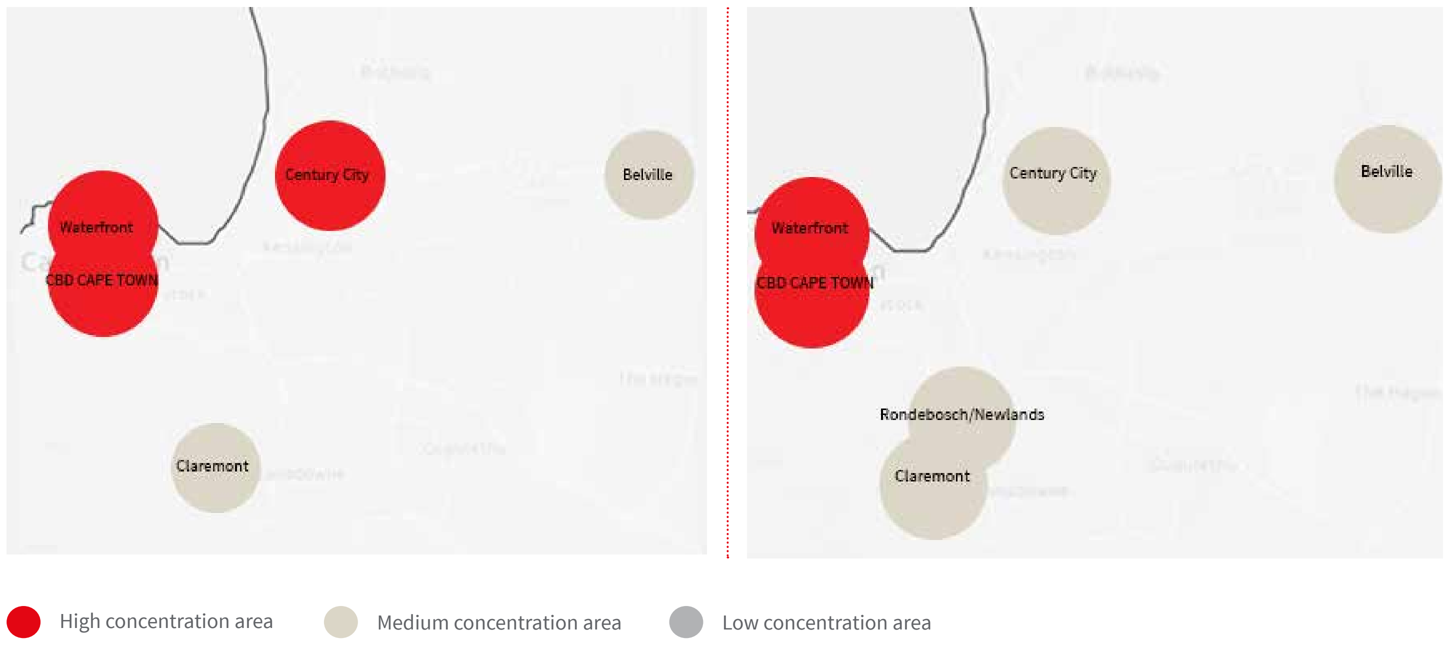
City of Cape Town: office stock & growth by grade, 2020 Q2



Source: SAPOA, 2020

Prime office space in Cape Town is predominantly clustered around Century City, Cape Town CBD and the V&A Waterfront. Total prime stock amounts to 198,560m2 (8% of total stock). A-grade office space is far more prominent, taking up 56% of the city's total stock. The largest volume of occupied A-grade space can be found in the CBD.

P-grade office space concentration / A-grade office space concentration

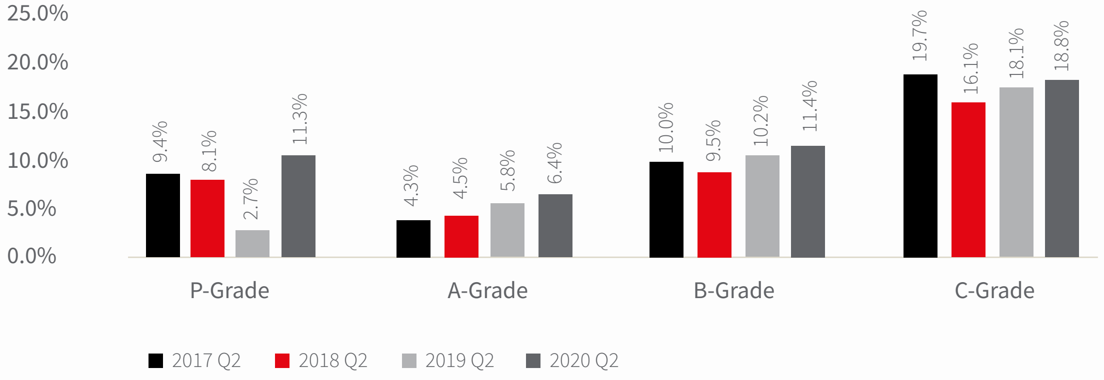


Source: SAPOA, 2020; MapIT, 2020; JLL ,2020

Peformance

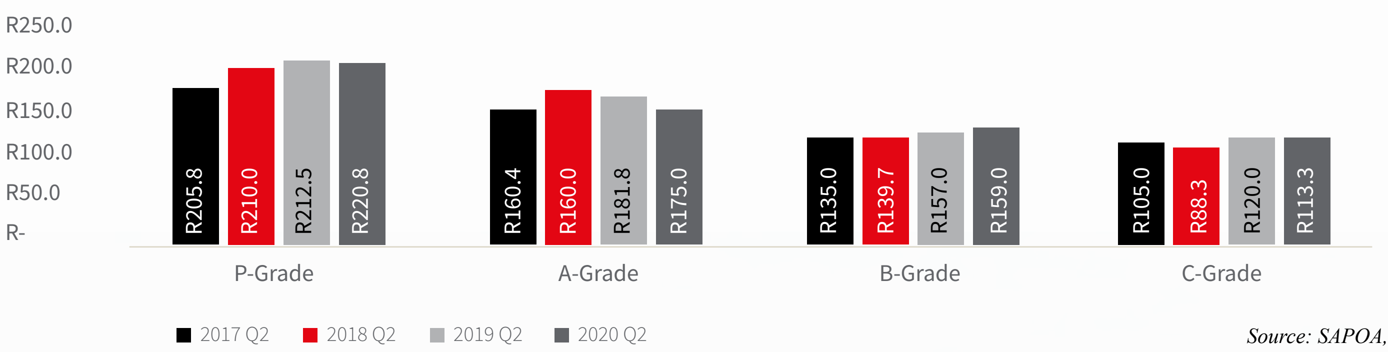
Although Cape Town boasts the lowest average office vacancy rates in the country, its oversupplied market will likely see aggregate vacancy levels exceed the 9% mark towards the end of the year. Prime office vacancy rates stood at 11.3% by the end of Q2 2020, whilst both B and C-grade office spaces show continued deterioration. In contrast, A-grade spaces continue to show occupancy resilience, with vacancy levels remaining steady at 6.4% at the end of 2020 Q2. Average annual rental growth for prime space – albeit positive – has remained below inflation levels over the past few years. Rates averaged R220.8/m² at the end of Q2 2020. A-grade space has alternatively experienced average annual contractions of 3.7%, reaching R175.0/m². C-grade office space rentals show the greatest deterioration, declining by 5.6% annually, averaging R113.3/m².

City of Cape Town: office vacancy rate by grade, 2017 - 2020



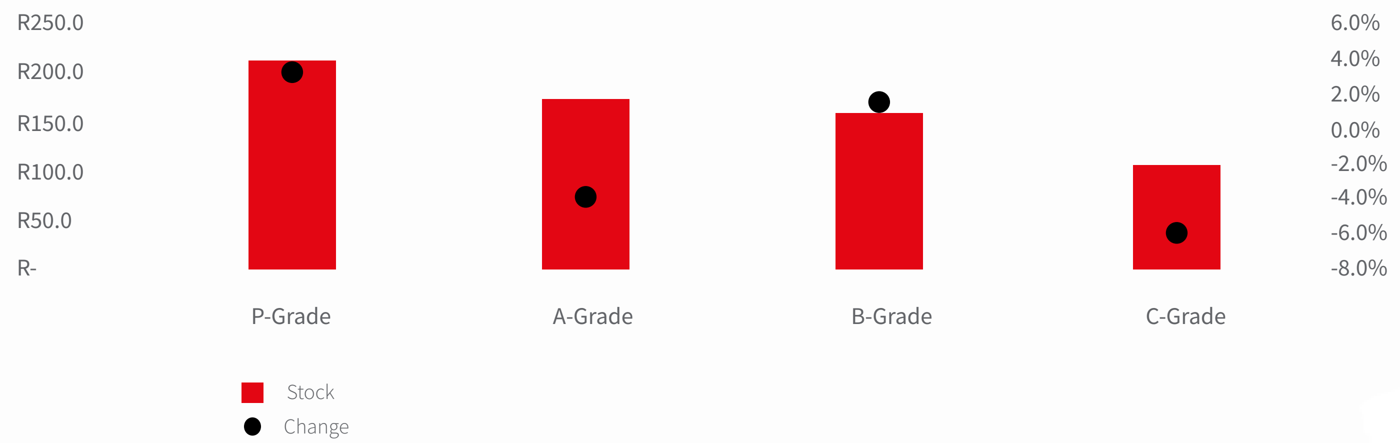
Source: SAPOA, 2020.

City of Cape Town: gross asking rental comparison by grade, 2017 - 2020



Source: SAPOA, 2020.

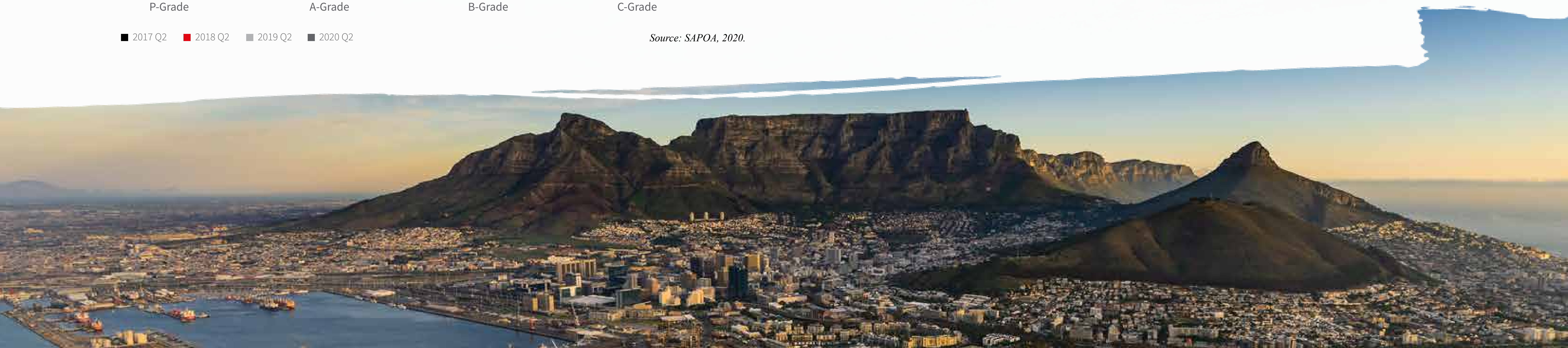
City of Cape Town: gross asking rent & annual change, 2017 - 2020



Source: SAPOA, 2020.

Outlook

Cape Town's saturated office market is likely to see continued rental contractions and escalations in vacancies over the medium term. This will be exacerbated by reduced corporate demand, as businesses scale down and restructure their work space requirements. Corporate re-entry strategies are taking center stage, as new health and safety regulations reshape staff configuration requirements in the work space. Many businesses may opt for rotational staff models, where a balance between traditional office space, home-based setups and flex office space are adopted. Location convenience offered by flex space establishments will allow employees to bridge the gap between where they live and where they work. This may result in a shift away from CBD occupancy, with smaller scale intra-city/suburb occupancy options becoming more prominent. Subsequently, employees based in Belville may start tapping into the flex-space market in Century City, reducing the commute to the CBD. This could see traditional office landlords structuring joint deals with flex space operators to share the risk.



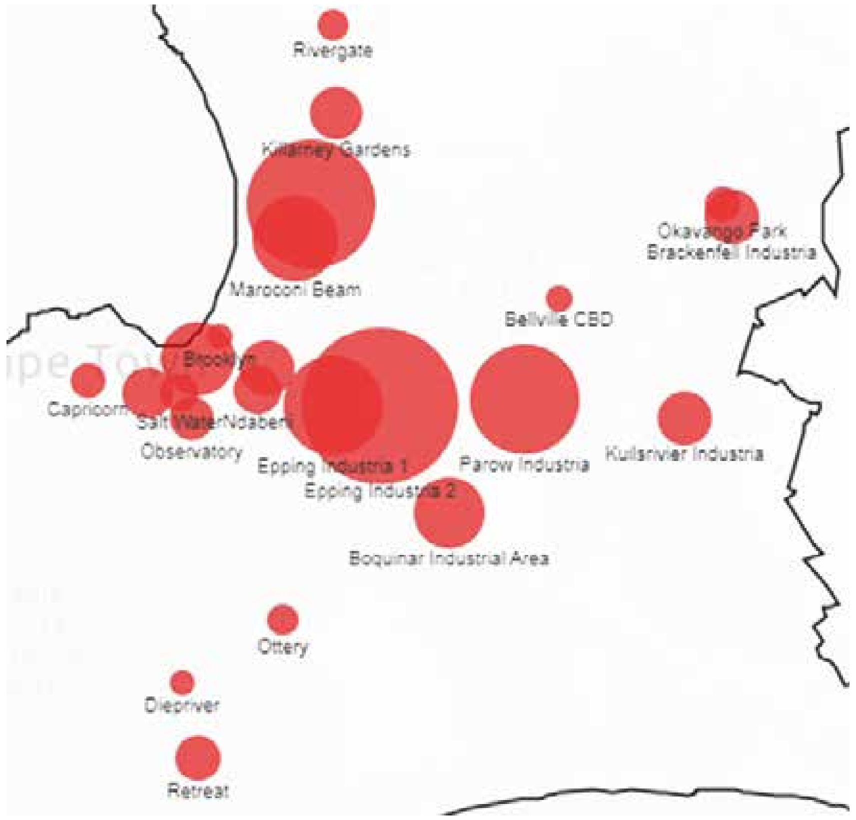
Industrial

Overview

There has been a far more proactive approach to viewing properties across industrial segments, as tenants have been readily available and willing to go out and view buildings (more so than commercial tenants). All recent movement in the industrial sector has been in the logistics and warehousing segments. During the lockdown, deals in the industrial space took place where logistics and warehousing facilities were fitted out medical supplies. Over the short term, further calls for existing warehouses to be temporarily equipped with emergency beds is anticipated, as the peak of South Africa's Covid-19 infections is forecasted to strike at the end of August.

Supply

Currently, there is approximately 15.8[8] million square meters of industrial zoned stock within the City of Cape Town and its decentralized nodes (CMA, 2020). Some of these areas include Epping Industria, Montague Gardens, Parow Industria and Marconi Beam. These decentralized nodes account for 56% of the metropolitan's industrial zoned stock (CMA, 2020). Demand for these industrial areas is largely driven by manufacturing, transport and logistics sectors, making up 35% of the city's economy (Oxford Economics, 2020). The current development pipeline summates to 274,000m², with the likes of Massmart, DSV and Roche developments set to place over the next 12-18 months.



Source: CMA, 2020; MapIT, 2020; JLL ,2020.

[8] Source: Representative of listed stock zoned for industrial use only, covering primary nodes. As a result, special and consent use spaces are not included in the sample.

Peformance

The average gross asking rental range for multi-tenant industrial blocks in Cape Town range between R70-R85/m². Traditional industrial manufacturing space continues to experience the lowest vacancy rates ranging from 1.6% - 2%, with annualized rental growth declining to levels below 5%.

Industrial warehousing and distribution spaces have shown a spike in national vacancy levels, increasing from 3.0% at the end of 2018 to 5.1% by the end of 2019 (SAPOA, 2020). Cape Town's industrial spaces have shown similar performance trends, with average vacancy levels in the logistics and warehousing space ranging between 7% - 8%. Multi-tenant logistics spaces are anticipated to achieve average yields of 9% - 9.5% and are likely to continue softening over the medium term.

Outlook

Once markets stabilize, industrial segments are set to remain tenant focused. The market is likely to see more instances of shorter leases being signed (i.e. 2-3 years as opposed to 5-years), whilst escalation rates could be reduced and linked to CPI.

The landlords' focus is to retain tenants and to avoid long term vacancies and subsequent costs. Accordingly, we anticipate that current lease agreements may be temporarily re-negotiated to accommodate tenant's affordability.

Alternative tenant relief packages may range from rental discounts, deferrals, tenant installation allowances and payment holidays. Lease term extensions may offer marginal trade-off benefits for the lost rental.

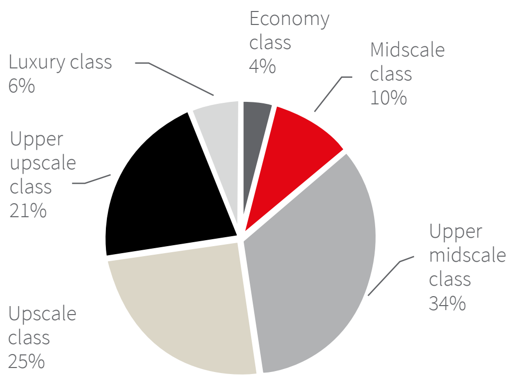
Hotels

Overview

Greater Cape Town is the largest hotel market in South Africa and caters to a more balanced mix of demand than the other major markets in South Africa. This is mainly due to tourist appeal of the city. As at December 2019, Cape Town Centre had 13,394 keys, of which the majority (34%) fall into the Upper Midscale Class (34%). In Q4 2019, three hotels with a total of 196 keys entered the market and included the Labotessa Cape Town (7 keys), Signature Lux Hotel by ONOMO Foreshore (157 keys) and Latitude Aparthotel by TotalStay (32 keys).

A significant decline in arrivals was experienced from March, as the implementation of global travel restrictions along with South Africa's impending lockdown brought South Africa's hotel industry to a standstill. All international borders and airports have been closed for tourism since the lockdown started. Due to its greater reliance on international travel, Cape Town will be more negatively impacted and the recovery more protracted.

Cape Town supply by segment (2019)

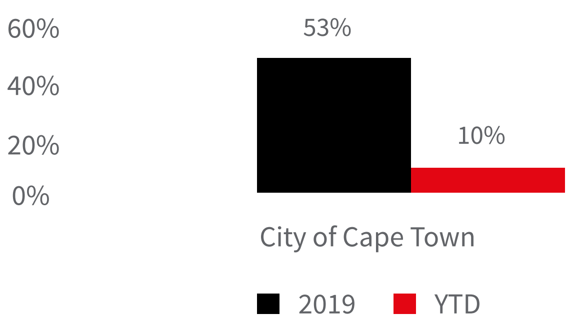


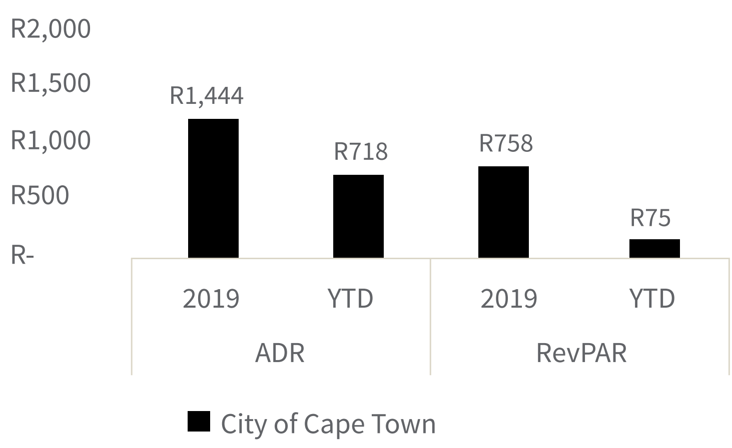
Peformance

Hotel occupancy levels in Cape Town reached record low levels of 10% by the end of June 2020. This equates to an annualized contraction of 80%, declining from 53% in June 2019.

Average daily rate (ADR) and revenue per available room (RevPAR) experienced similar pressure, respectively declining by 50% and 90% over the same period (STR, 2020). Due to the nature of the crisis, we do not advise that much weighting is placed on these performance metrics, and the focus should now turn to re-opening and recovery.

City of Cape Town occupancy comparison / City of Cape Town ADR & RevPAR comparison: YTD





Source: STR May Reports, 2020.

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