The South Africa Q2 Real Estate Market

eThekwini

City overview

eThekwini Metropolitan Municipality is home to 3.2 million [1] residents and contributes 15% [1] towards South Africa's total GDP. The port city plays a key role in South Africa's trade linkages with the rest of the world. The manufacturing, transport and logistics sectors collectively contribute 44% of eThekwini's economy [2]. These activities continue to drive demand for high quality, integrated warehousing and logistics spaces. The city's robust finance and business services sector has played an increasingly important role in supporting the local economy, contributing 22% towards GDP [2].

These sectors have flourished in nodes such as Umhlanga and Ballito, stimulating the demand for quality office space. In addition, tourism has a firm position among these sectors, contributing to a strong hotels industry.

[1] Source: eThekwini Local Municipality, Port City [2] Source: Oxford Economics, 2020

Office

1.7million [3]
Estimated stock

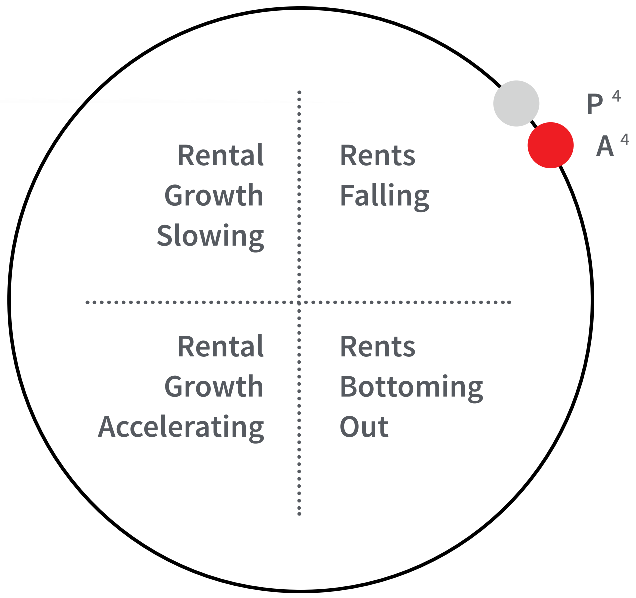
9%-10% [4]
Prime yields

14.9% [3]
Vacancy rate

P = -6.6% A = -2.5% [3]
B = 0.1% C = 0.0%
Annualised rental growth

R180-R230 [(3)(4)]
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.

[3] Source: SAPOA, 2020 [4] Source: Lambie Spark & Associates

Industrial

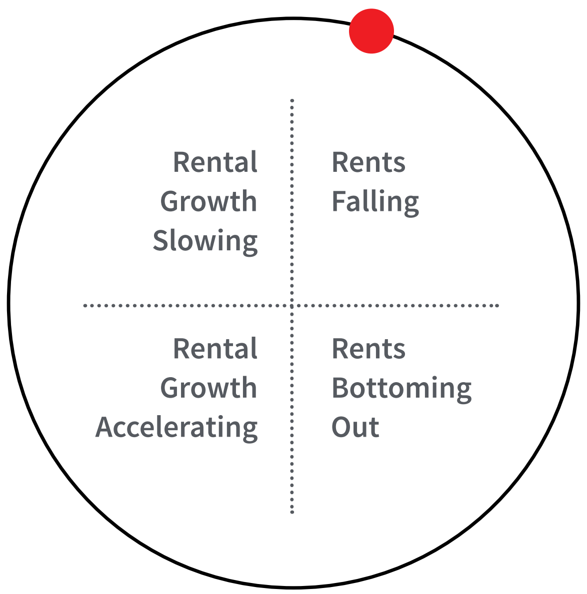
23.3million[5]
Estimated stock

9.5%-10%[4]
Prime yields

7%-8%[4]
Vacancy rate

R85 - R90[4]
Prime rent

Sideways, starting to decline
Rental outlook



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[4] *Source: Lambie Spark & Associates* [5] *Comparative Market Analytics (CMA), 2020*

Hotels

12%[6]
Occupancy

R739[6]
ADR

R90[6]
RevPAR

[6] *Source: STR Reports, May 2020*

Office

Overview

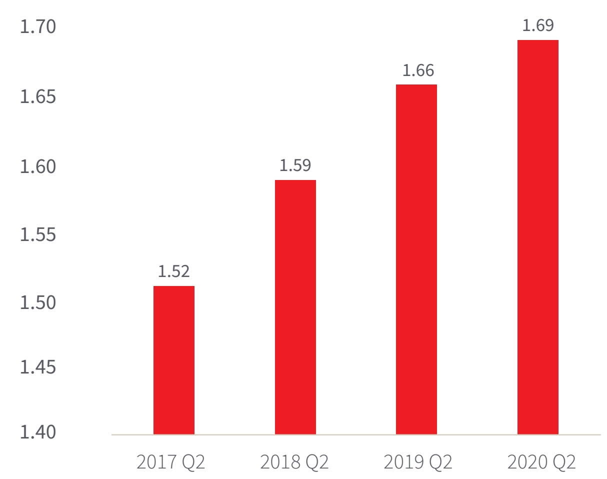
Over the past few years, eThekwini Metropolitan Municipality (hereafter referred to as eThekwini) has maintained some of the highest office vacancy rates country-wide. This has been driven by an overinflated development pipeline, with new buildings frequently coming to market. Subsequently, subdued demand has seen rentals slide sideways, with sub-grade spaces most susceptible to erosion. As rental escalations come under pressure, prime yields look to soften towards the 9%-10% mark. Accordingly, landlords are becoming increasingly aggressive with commercial lease agreements, as focus shifts towards tenant retention. As the market becomes increasingly tenant driven, occupiers are finding price competitive opportunities amongst higher quality office spaces.

Supply

Office supply in eThekwini is dominated by the Umhlanga (including La Lucia) node, with more than 70,000m² of office bulk currently under construction. Albeit, a significant portion of that new bulk has been pre-let and/or pre-sold on sectional title. Specifically, several mixed-use schemes make up the commercial pipeline, reinforcing the trend of Umhlanga being the preferred location of choice for corporate office users and citizens alike. Currently, eThekwini's total work under construction makes up approximately 4% of the national pipeline (SAPOA, 2020).

Historic office space in the CBD has declined sharply over the years, as the majority of traditional corporates relocate to Umhlanga. Much of the city's office space has been converted to student accommodation and residential units. Although some office refurbishments from the likes of Urban Line have taken place, vacancy pressure in the office segment remains high.

eThekwini: total office stock (m² million), 2017 - 2020

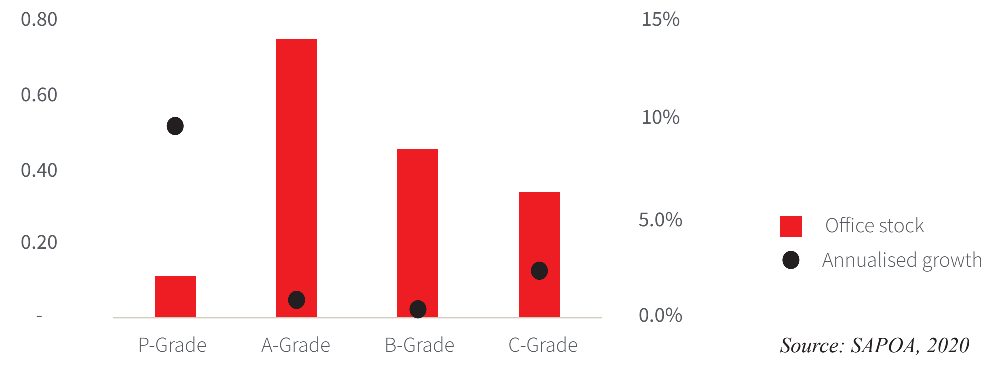


Source: SAPOA, 2020

Although the nation-wide lockdown brought the construction industry to an abrupt stand still, gradual easing of restrictions has seen the building industry commence operations. Subsequently, it is anticipated that approximately 50,000m² of office space will become available in Umhlanga within the next 12 months. This will contribute to the metropolitan's 1.7 million square meters of existing office stock. Total stock recorded an annual growth of 3% by the end of Q2 2020 (SAPOA, 2020).

eThekwini's office space remains A and B-grade dominated, making up 73% of the metropolitan's total stock. A-grade space has experienced annualized growth, of 1.5%. Interestingly, B-grade space has increased by 0.4%. This is partly due to GLA adjustments and older A-grade space being reclassified/downgraded. Prime office space has experienced the greatest annualized growth (10%), reaching 88,882m² at the end of 2020 Q2 (SAPOA, 2020).

eThekwini: office stock & annual growth by grade, 2017 - 2020



Source: SAPOA, 2020

This growth is a result of multiple building completions taking place over a short period of time, reaching market simultaneously. 90% of eThekwini's prime stock is based in the Umhlanga/La Lucia nodes

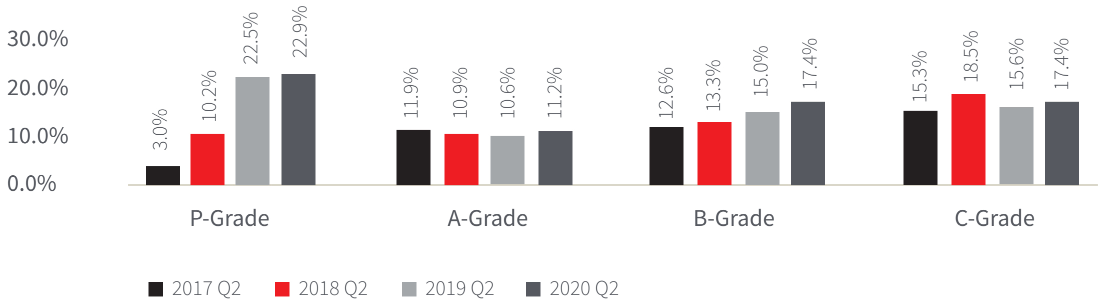
P-grade office space concentration / A-grade office space concentration

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

Peformance

eThekwini's subdued commercial climate coupled with an oversupply of office space continues to drive up vacancy rates. At the end of Q2 2020, aggregate vacancy levels reached 14.9%. These rates are expected to continue climbing over the medium term, as supply outstrips demand. Consequently, vacancy rates and rental escalations will come under significant pressure. Prime office vacancy rates stood at 22.9%, whilst both B and C-grade office spaces show continued deterioration (SAPOA, 2020). Building reclassifications/ downgrades on aging A-grade offices continues to place stock pressure on sub-grade spaces.

eThekwini: vacancy rate by grade

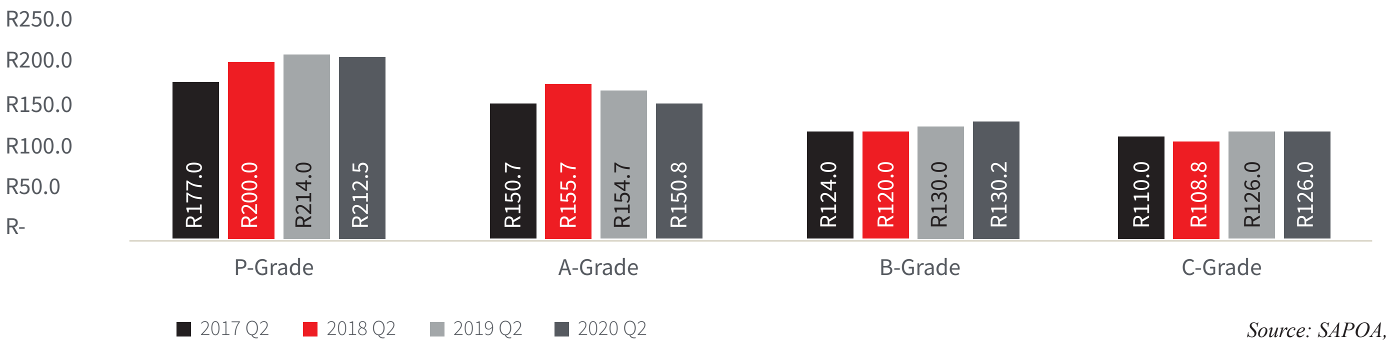


Source: SAPOA, 2020.

This however, has created great opportunities for tenants to find competitive commercial lease packages. As new developments are completed, many tenants vacate existing buildings for better quality spaces. This is becoming evident in the Umhlanga area, where good quality office space can be occupied at rates between R125-R150m². Although these buildings are classified as "out-dated", most do not exceed 20-years. Newer developments are being pitched at R185-R230m².

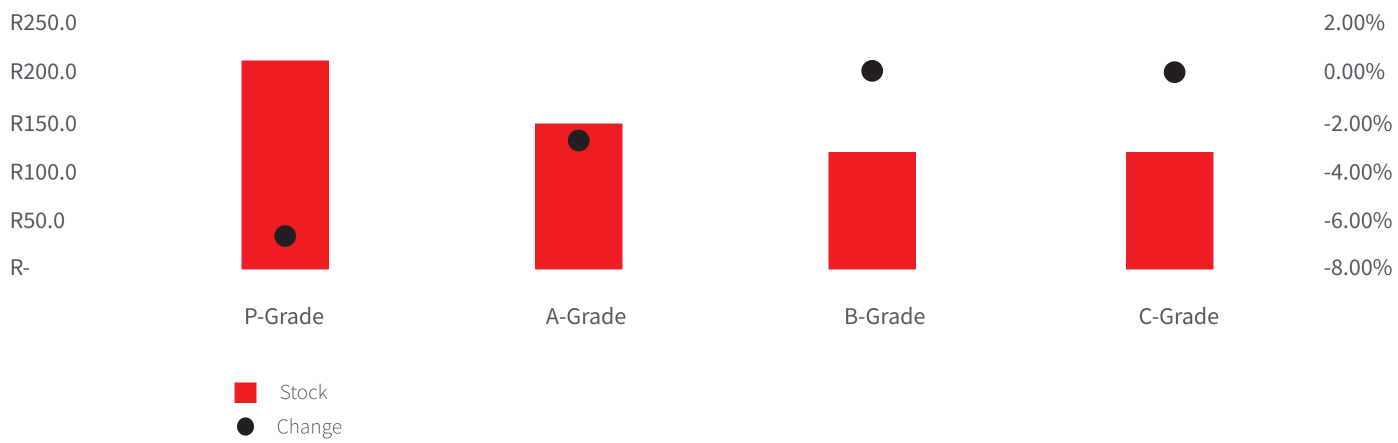
When comparing office nodes, Durban CBD remains an attractive location in terms of competitive rentals, firming to around R90/m². The area offers excellent staff transport and amenities making the node a popular destination for contact center operators. The dense and decaying city center however, means that few buildings possess footprints over 1000m², whilst the risks associated with safety impact corporate image. Decentralized office nodes such as Westville, Riverhorse Business Park, Mount Edgecombe and Cornubia all offer decent quality A-grade options ranging from R125-R150/m². Umhlanga, however, has remained the preferred location of choice for most operators due to the availability of space, quality of buildings, and proximity to supporting services. Pressure caused by a weak commercial environment and escalating vacancies can be seen in the deterioration of gross asking rentals. This has resulted in effectively no real rental growth over the past few years, with escalations typically falling well below inflation levels. Specifically, Prime and A-grade office spaces have shown the greatest softening in response to an oversupplied market. Average prime rentals have declined by 6.6% on an annual basis, whilst asking rentals for A-grade space have shrunk by 2.5%. B and C-grade spaces continue to show no real growth (SAPOA, 2020).

eThekwini: average gross asking rental comparison



Source: SAPOA, 2020.

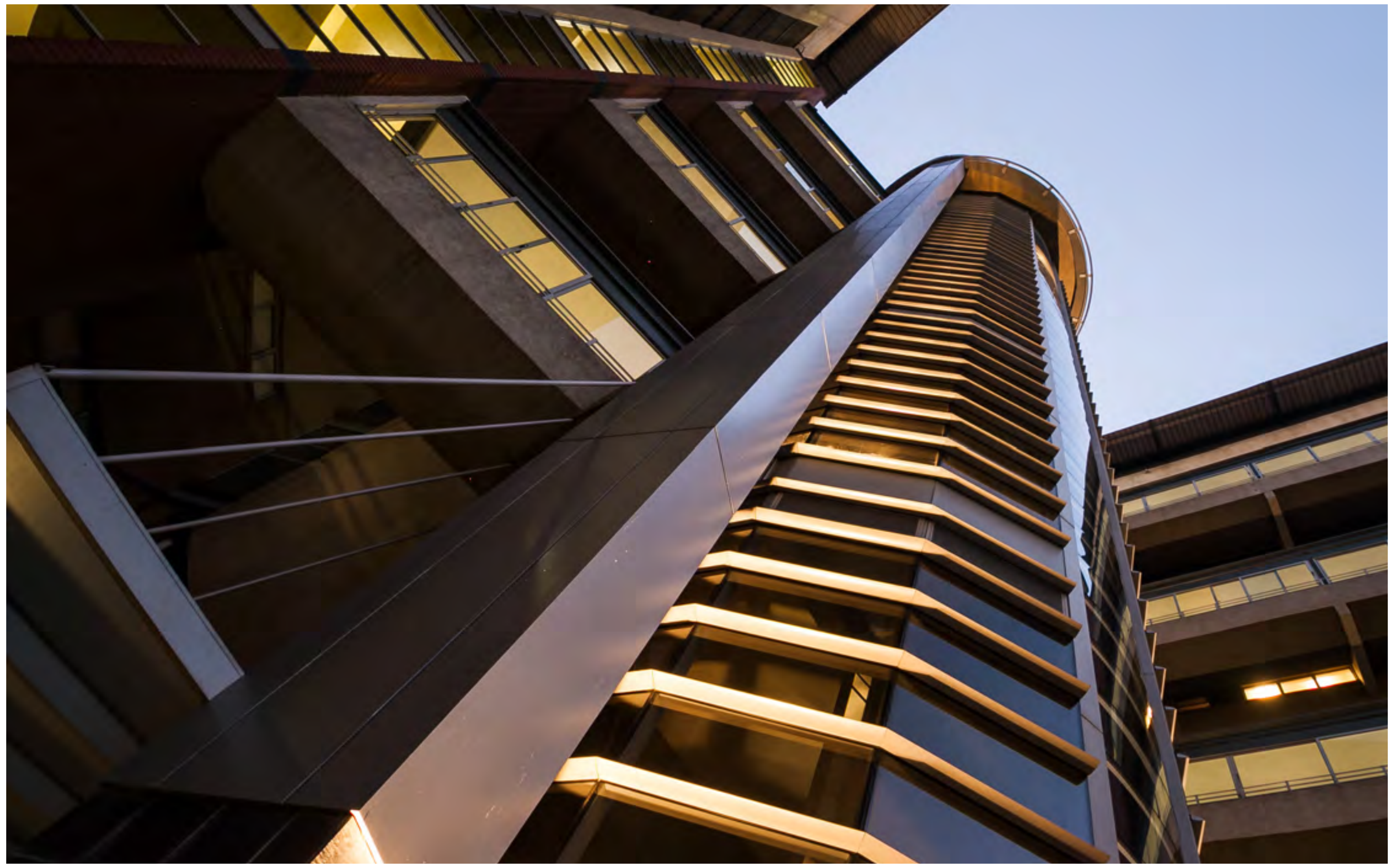
eThekwini: gross asking rental & growth, 2020 Q2



Source: SAPOA, 2020.

Outlook

Over the short to medium term, rentals are expected to compress whilst vacancies escalate. This will be primarily driven by weak 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. Whilst corporate demand is expected to shrink, new office stock is set to come to market over the next 18-months. This will play into the hands of occupiers, as more competitive deals will be offered as landlords negotiate aggressively to retain their tenants.



Industrial

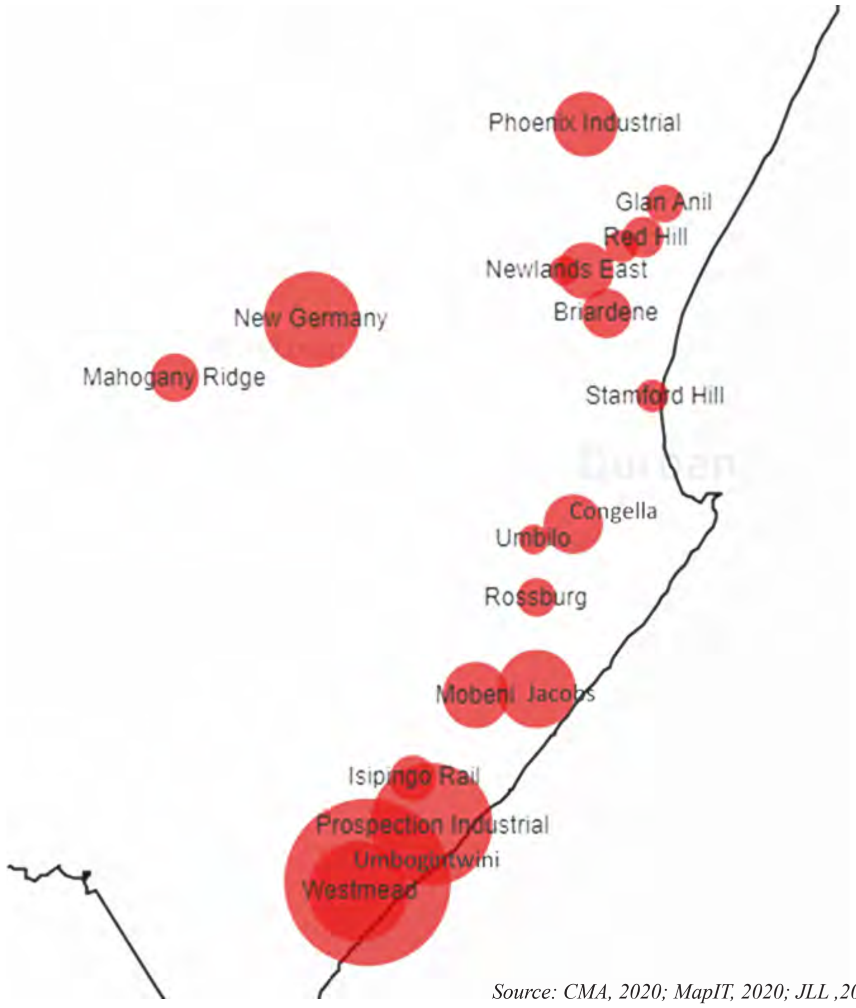
Overview

A healthy industrial project pipeline has been overshadowed by investors and developers alike pulling out of major deals. The economic shock caused by Covid-19 and the subsequent nationwide lockdown, has forced many operators out of business. A number of properties throughout the greater Durban area are starting to come on to the market with long established companies losing contracts and closing down operations. Landlords are becoming more negotiable on rentals and industrial deals are being agreed at 15%-20% below asking rentals.

Supply

Currently, there is approximately 23.3 million[7] square meters of industrial zoned stock in eThekwini. Key decentralized industrial nodes including Umbogintwini, Propspection Industrial and Westmead make up more than 50% of the metropolitan's total stock (CMA, 2020). Demand for these areas is bolstered by eThekwini's manufacturing, transport and logistics sectors, making up 44% of the metropolitan's economy (Oxford Economics, 2020).

Leading property funds such as Fortress and Equites who own large tracts of industrial land, will find it challenging to secure tenant driven deals as pipelines continue to dry up and demand declines. This is evident with current developments including Clairwood Industrial Park and Cornubia Industrial Business Estate, where no tenants have been secured yet.



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

[7] *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

On existing leases, many landlords are being forced to bring down rentals and escalations, using extended lease adjustments to recover costs. Correction of rental escalations are starting to move towards CPI + 1%, as no occupiers are willing to pay the typical rates of 8%+ in the current market. Yields have started to soften, moving from 8% to just below 10%. Vacancy rates have moved out from the first quarter's 5% levels and are expected to climb between 7%-8% over the short to medium term. Though the spike in e-commerce sales has had a significant impact on the logistics and warehousing landscape, it is anticipated that many smaller operators will be heavily impacted by the economic slowdown. Whilst pre-Covid-19 saw prime asking rentals reach R85-R90, recent deals have shown landlords offering discounts of up to 15%-20%.

Outlook

We anticipate that there may be increasing pressure from tenants to sign shorter leases (i.e. 2-3 years as opposed to 5-years), whilst escalation rates could be reduced and rather linked to CPI. The landlords' focus is to retain tenants in an effort to avoid the costs associated with long term vacancies. Therefore, we expect possible re-negotiations of existing leases between parties where rentals have escalated beyond "market levels". Lease term extensions may offer marginal trade-off benefits for the lost rental. Whilst signs of rental corrections already emerged before the pandemic outbreak, it is anticipated that the economic down turn will simply accelerate this process over the short to medium term.

Hotels

Overview

eThekwini has a mature hotel market, which is dominated by local owner operators who have strong experience in the market. The market relies primarily on domestic corporate travel but enjoys a higher weighting of domestic leisure travel than other major markets in the country. KwaZulu-Natal has 173 hotels with 13,940 keys, averaging 81 keys per hotel. The provincial market is categorized into four categories by STR Global, namely; Durban and Surrounds, Umhlanga, Drakensberg & Midlands Regional and Zululand. The majority of the supply is positioned in the 4-star upscale (39%) and 3-star upper midscale (29%) segments. The majority of hotel supply in KwaZulu-Natal is independent (58%) made up primarily of guesthouses and smaller boutique hotels. The most notable hotels which comprise of branded accommodations include Protea by Marriott, Southern Sun and Garden Court.

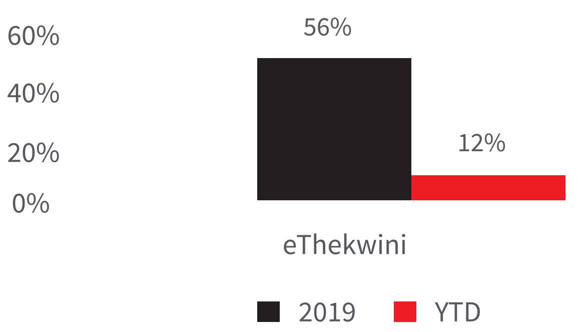
KwaZulu-Natal consistently ranks amongst the top three domestic tourism destinations, along with Western Cape and Gauteng. The pristine beaches, game reserves and mountains have made it particularly popular with the leisure segment, and as the second most populous province, it enjoys strong demand from the VFR segment. The northern areas such as Ballito, Umhlali and Hluhluwe are driven primarily by leisure demand. Additionally, the Durban CBD market is particularly dependent on government demand, which in recent years has been under increasing pressure, as austere policies have limited spending on hotel accommodation.

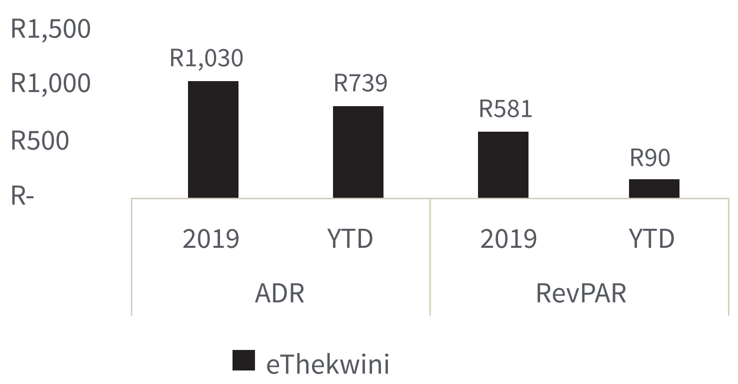
Hotels in the Umhlanga node are enjoying the strongest performance, underpinned by the emergence of the node a corporate center. This bodes well for hotels based in Umhlanga & surrounds; however, continuing urban decay and commercial activity moving northwards, coupled with muted economic growth will hamper performance for hotels in the Durban CBD. Tourism is likely to remain primarily domestic in the short to medium term.

Peformance

From a performance perspective, hotel occupancy levels in the City of eThekwini reached levels of 12% by the end of June 2020. This equates to an annualized contraction of 78%, declining from 56% in June 2019. Average daily rate (ADR) and revenue per available room (RevPAR) experienced similar pressure, respectively declining by 28% and 84% over the same period.

eThekwini occupancy comparison / eThekwini ADR & RevPAR comparison: YTD





Source: STR May Reports, 2020.

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