

The office market is forecast to trend down

Our review of prospects for the office market includes forecasts of demand, vacancies and prime office rentals. These forecasts cover the CBDs and decentralized nodes of Johannesburg, Pretoria, Durban and Cape Town.

On a national basis, our econometric model forecasts an average growth of 8,1% p.a. of *nominal* prime CBD office rentals over the forecast period. This translates to a negative 2,0% p.a. in *real* terms.

The forecasts in this publication are based on economic fundamentals and historical relationships. The Rode econometric model assumes that these historical relationships will continue.

The Cape Town CBD is forecast to put in the best performance, which makes sense, seeing that the city has succeeded best in combating the general decay seen in South Africa's CBDs. *Nominal* growth of 10,1% p.a. is expected in Cape Town over the next 6 years, equal to a negative 0,2% p.a. in *real* terms. The worst performance is expected from Pretoria, with *real* forecast negative growth of 3,6% p.a. from 2003-2008.

Turning to the decentralized nodes, we see

that the best performances are expected from Durban and Pretoria, with average *real* growth of 1,5% p.a. and 0,8% p.a. respectively over the forecast period. The biggest drop is expected to come from Johannesburg decentralized, with negative *real* growth of 4,3% p.a.

The relatively big difference between nominal and real office rentals can be found in the deflator, which is the Bureau for Economic Research's (BER) Building Cost Index (BCI). The building cost index is forecast to average 10,3% over the forecast period, implying that *nominal* rental growth in excess of this has to be achieved before any *real* growth can be realised. Using building costs as a deflator, allows the reader to interpret the graphs from a developer's point of view, which serves as a proxy for the viability of new developments over time.

Office vacancies in all the CBDs, barring Cape Town, are set to worsen from 2003-2008, indicating that office workers will continue turning their backs on the CBDs in favour of the decentralized nodes. In the decentralized nodes, it is predicted that, on average, vacancies will peak this year, whereafter they will slowly start declining as demand starts mopping up the oversupply of office space.

Forecast of grades A+, A & B office vacancies % vacant at year-end

	2002	2003	2004	2005	2006	2007	2008	03-08
Jhb Central*	21,9	24,5	26,0	27,5	28,0	28,5	29,0	27,3
Jhb dec.	13,2	13,0	11,0	9,0	7,0	7,5	7,5	9,2
Pretoria CBD	17,4	17,3	19,1	19,3	19,2	20,0	20,5	19,2
Durban CBD	21,4	21,0	22,0	23,0	24,0	25,0	25,5	23,4
Cape Town CBD	16,3	15,5	14,5	12,0	12,0	11,0	10,0	12,5
Cape Town dec.	10,3	11,0	10,0	8,0	7,0	6,0	6,0	8,0

* Johannesburg Central consists of the Johannesburg CBD and Braamfontein

Forecast of prime office rentals								
Nominal % growth per year								
	2002	2003	2004	2005	2006	2007	2008	03-08
National CBD	5,3	5,0	5,0	8,3	7,6	10,1	12,8	8,1
Jhb CBD	5,2	4,4	4,0	6,7	6,6	8,9	11,8	7,1
Jhb dec.	1,2	-0,4	1,0	5,5	7,7	8,8	11,1	5,6
Pretoria CBD	-1,1	0,0	2,2	6,5	6,9	10,0	12,9	6,4
Pretoria dec.	5,5	7,0	7,9	11,3	11,2	13,6	16,4	11,2
Durban CBD	7,1	7,0	6,2	8,2	7,3	9,4	11,7	8,3
Durban dec.	4,1	13,0	10,4	11,9	10,5	12,1	14,4	12,1
Cape Town CBD	7,2	6,5	6,8	11,0	9,3	12,0	14,7	10,1
Cape Town dec.	0,6	-0,2	1,5	6,3	7,7	11,0	13,5	6,6

Real % growth per year (series deflated by BER BCI)								
	2002	2003	2004	2005	2006	2007	2008	03-08
National CBD	-8,5	-5,4	-3,5	-1,7	-1,1	-0,5	0,2	-2,0
Jhb CBD	-8,6	-5,9	-4,5	-3,1	-2,1	-1,6	-0,8	-3,0
Jhb dec.	-12,1	-10,3	-7,2	-4,2	-1,0	-1,6	-1,4	-4,3
Pretoria CBD	-14,1	-9,9	-6,2	-3,3	-1,8	-0,5	0,3	-3,6
Pretoria dec.	-8,4	-3,6	-0,9	1,0	2,2	2,7	3,3	0,8
Durban CBD	-7,0	-3,6	-2,4	-1,7	-1,3	-1,1	-0,8	-1,8
Durban dec.	-9,6	1,8	1,4	1,5	1,5	1,3	1,6	1,5
Cape Town CBD	-6,9	-4,0	-1,9	0,8	0,5	1,3	1,9	-0,2
Cape Town dec.	-12,6	-10,1	-6,8	-3,5	-1,1	0,3	0,8	-3,4

The first accompanying table summarises our year-end vacancy forecasts.

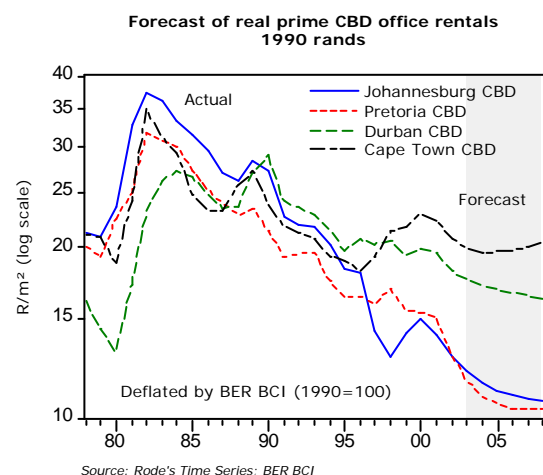
The second table summarises our forecasts for both *nominal* and *real* office rentals. Keep in mind that these figures are averages for the year.

The contract building-cost index, as compiled by the Bureau for Economic Research (BER), is used as the deflator in the accompanying graphs to calculate *real* office rentals. Note that the base year for the BER BCI deflator is set at 1990 (1990=100). This means that, after deflation, rental levels per square metre are expressed in 1990 rands.

The accompanying graph compares the forecast *real* office rentals of South Africa's main CBDs.

On average, the expected decline in the

real office rentals of the Johannesburg, Pretoria and Durban CBDs seems slightly bigger than our December 2002 forecasts. In the Cape Town CBD, the present decline in real office rentals is forecast to last until 2004, before moving back into positive territory.



Readers should take note of the three definitions in the accompanying box as they are used frequently throughout this chapter.

Office demand: Office stock less office space vacant (space on the market for renting irrespective of whether there is still a valid lease over the space), measured at year-end. In other words, demand is office space occupied.

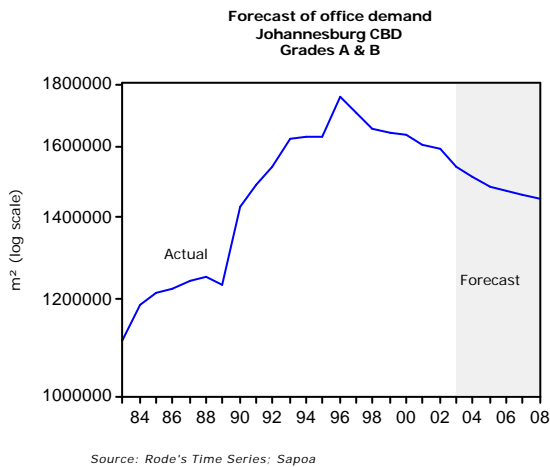
Office stock: Total rentable office space.

Office take-up: Change in office demand (space occupied) over previous year. Where take-up is positive, it can also be called growth in demand.

Next we discuss the above-mentioned office nodes in greater detail.

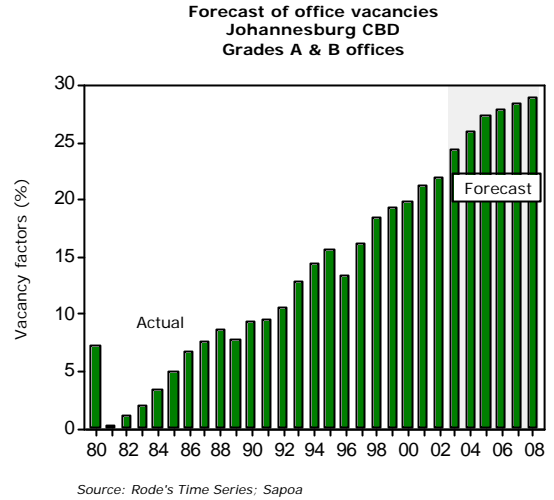
Johannesburg CBD

In the Johannesburg CBD, office demand is expected to carry on contracting (negative take-up). The withering demand for CBD office space is also the main reason why no new office blocks are erected in the city centre.

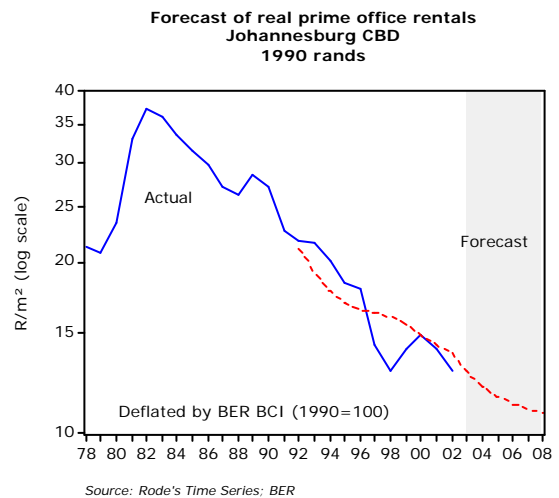


In our forecasts for the CBDs, with the exception of Cape Town, we assumed that the stock in office space would remain unchanged over the forecast period, with any

new office developments taking place in the decentralized nodes.



Office vacancies are set to continue increasing with a vacancy rate of 27,3% forecast for the 6-year period. Although many initiatives have been undertaken to entice office workers back to the CBDs, they have not been successful. These attempts include lower rental offerings, the city improvement districts (CIDs), which have been designed with the purpose of addressing the crime and grime in South Africa's CBDs, and large business, still residing in the Johannesburg CBD, putting their weight behind improving the city centre.



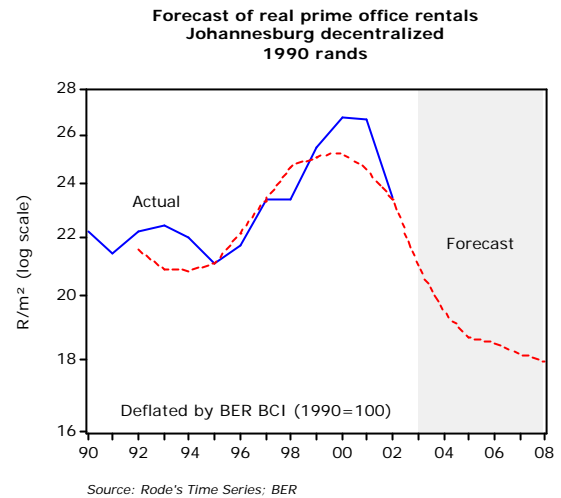
Turning to office rentals, the slump of the last 20 years is predicted to continue, with

real rentals to average negative growth of 3,0% p.a. over the forecast period. This continued weakening in real office rentals makes sense, especially against the backdrop of the expected weaker demand for office space.

Johannesburg decentralized

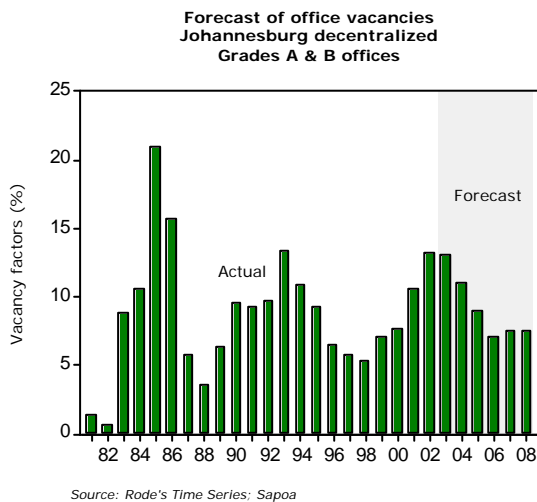
On the whole, the Johannesburg decentralized office market is expected to remain under pressure for the next six years. This is reflected in our forecast of both office vacancies and real rentals.

Concerning office vacancies, we forecast that vacancy levels will start declining this year after reaching their peak in 2002. The softening in vacancy levels should continue up to 2006, whereafter a slight increase is expected as the market is again met by a growing oversupply. On average, decentralized Johannesburg office vacancies are expected to come in at 9,2% from 2003-2008.



Real rentals are calculated using the BER BCI as deflator.

The forecasts in this publication are based on economic fundamentals and historical relationships. The Rode econometric model assumes that these historical relationships will continue.



Turning to *real* office rentals, the dip, which commenced in 2002, is expected to continue for the length of the forecast period. The decline in real office rentals is the result of a growing oversupply, as reflected by the steady increase in Johannesburg decentralized office vacancies. Real rental growth is forecast to average a negative 4,3% p.a. for the forecast period.

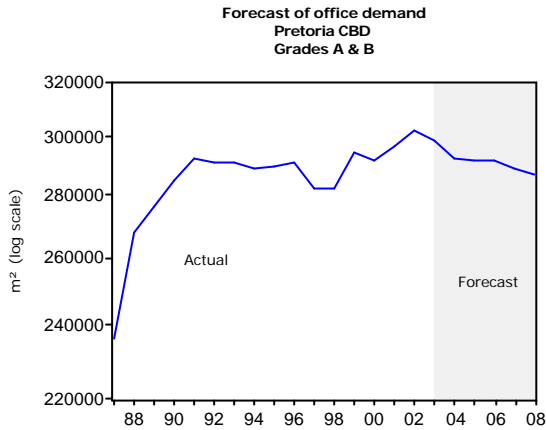
This issue of *Trends* does not include a forecast for Johannesburg decentralized office demand, as was the case in the previous issue. Given the extremely strong upward trend in office demand over the last decade, it proved very difficult to get an appropriate regression equation for the forecast that would produce anything other than the optimistic upward trend continuing.

Pretoria CBD

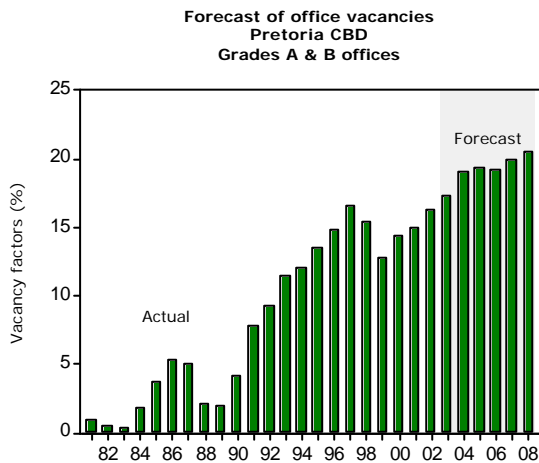
As is the case in the Johannesburg CBD, office demand in the Pretoria CBD is also predicted to contract over the next six years. Still, the drop is not expected to be as severe as in the case of the Johannesburg CBD.

As for office vacancies, the forecast is also negative. Office vacancy levels of A & B offices are expected to remain basically unchanged for 2003, slowly edging up again from 2004 onwards. Still, the vacancy situation is not expected to be as bad as in

the Johannesburg and Durban CBDs. On average, Pretoria CBD office vacancies are predicted to come in at 19,2% for the forecast period.

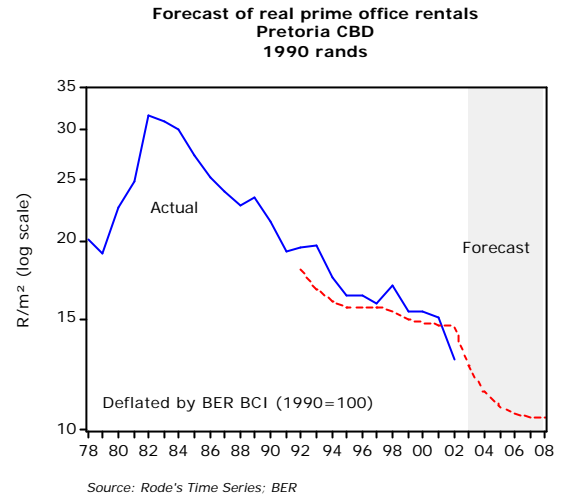


Source: Rode's Time Series: Sapoa



Source: Rode's Time Series: Sapoa

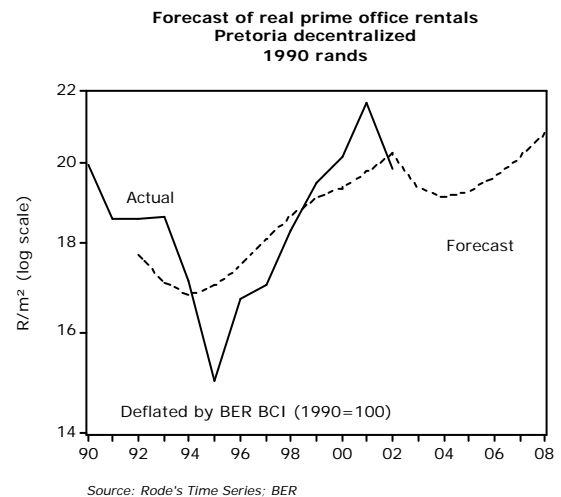
In light of the bleak picture painted by Pretoria CBD office demand and vacancies, the weakened *real* rental forecast does not come as a surprise. According to our econometric model, real office rentals are set to average a negative 3,6% p.a. over the forecast period. However, the decline is expected to decelerate towards the end of the forecast period, turning positive in 2008. If the forecast is realised, it will mean that real Pretoria CBD office rentals will have been in a secular downswing for 26 years.



Source: Rode's Time Series: BER

Pretoria decentralized

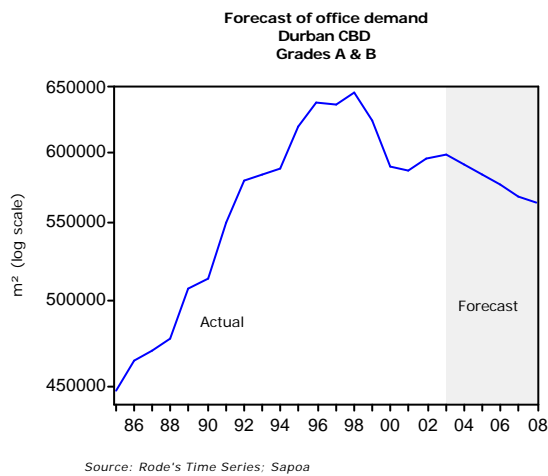
Real rental growth in Pretoria decentralized is projected to remain negative in 2003 and 2004, before turning positive for the remainder of the forecast period. In contrast to the forecast for real decentralized Johannesburg office rentals, the early expected recovery in real decentralized Pretoria rentals could be attributed to the area's relatively strong office take-up, as well as low and stable vacancies. Furthermore the rentals in Pretoria decentralized are still relatively low compared to the other cities' decentralized nodes — hence offering more upside potential. From the accompanying graph, we also see that the forecast real rental level for 2008 is not expected to exceed the level of 2001.



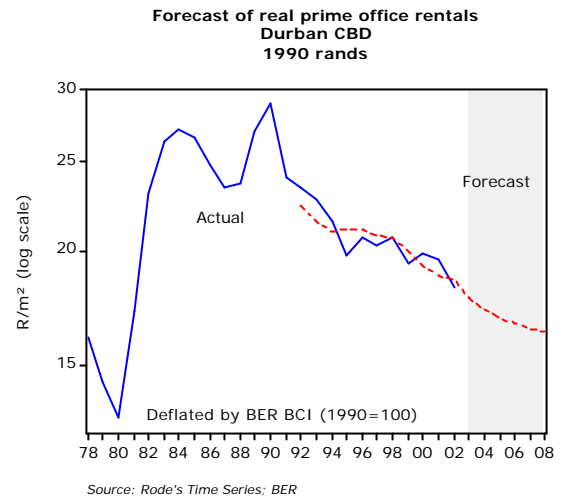
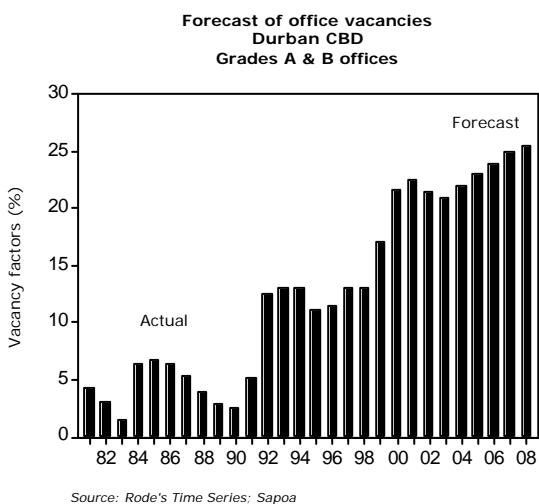
Source: Rode's Time Series: BER

Durban CBD

In the Durban CBD, take-up is projected to come in negative over the forecast period, after having been positive in 2001 and 2002. The contracting demand is in line with our predictions for the Johannesburg and Pretoria CBD, and can be attributed to the continued decanting of office workers to the decentralized nodes.

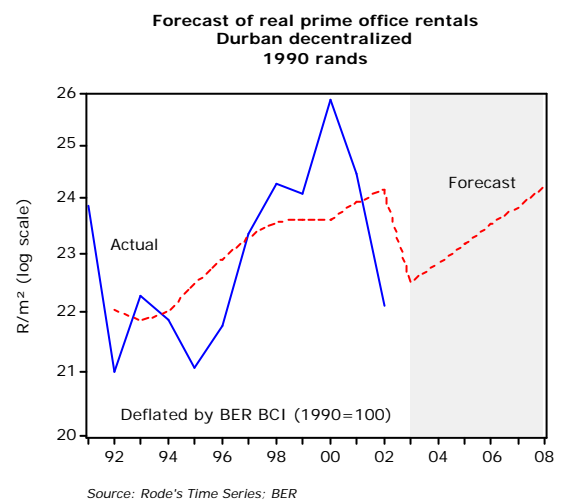


Office vacancies in the Durban CBD are forecast to deteriorate further over the next six years, barring the slight improvement predicted for 2003. Hence the projected continued drop in *real* Durban CBD office rentals makes sense. *Real* office rentals in the Durban CBD are forecast to average a negative 1,8% p.a. over the forecast period. Furthermore, the decline in real rentals is expected to decelerate gradually over the next six years.



Durban decentralized

Our econometric model forecasts *real* Durban decentralized office rentals to recover from 2003 onwards, after still showing negative *real* growth of 9,6% in 2002. Although the forecast for Durban decentralized may seem a tad optimistic, it is not totally impossible, especially in light of the current healthy office take-up and stable vacancy factor in the area.

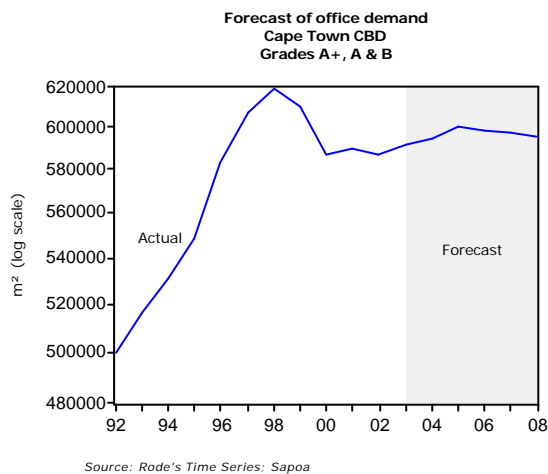


Cape Town CBD

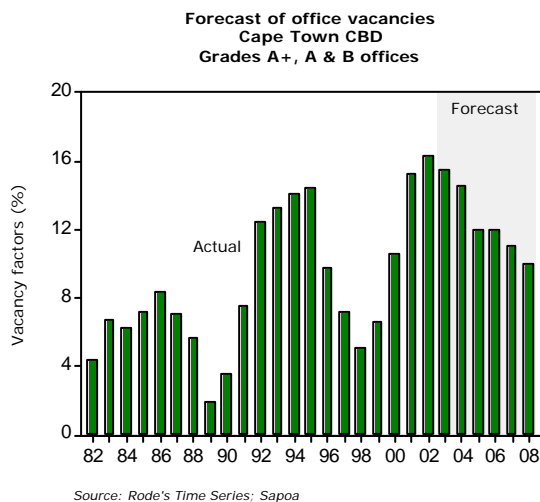
The Cape Town CBD is the only city centre where a recovery in the office market is still hoped for because steps to rectify the

decaying state of the Cape Town CBD were taken just in time.

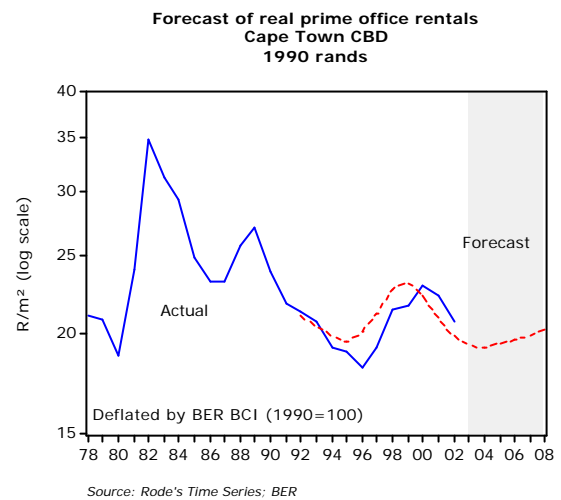
The turnaround initiatives in the Cape Town CBD, driven primarily by the successful implementation of the city improvement district (CID) programme, have already seen some major capital investments returning to the CBD, with the expectation of even more to come. In addition, the new Cape Town International Convention Centre on the Foreshore should lend further impetus to the renaissance. Hence our forecast of increased take-up up to 2005 seems totally plausible.



Office vacancies for grades A+, A & B offices are expected to soften after reaching a high of 16,3% in 2002. On average, office vacancies are forecast to come in at 12,5% for the six-year period.



Real Cape Town CBD office rental growth is set to remain negative in 2003 and 2004, before turning positive from 2005 onwards as the benefits of stronger office demand and lower vacancies start flowing through. Notwithstanding the real growth in office rentals from 2005 onwards, the average real growth for the forecast period is still set to come in at a negative 0,2% p.a.



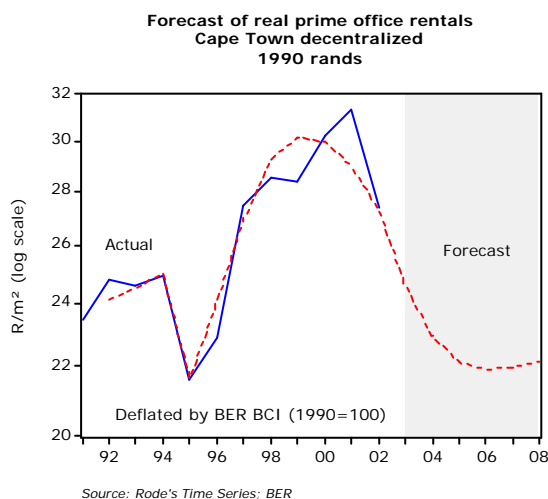
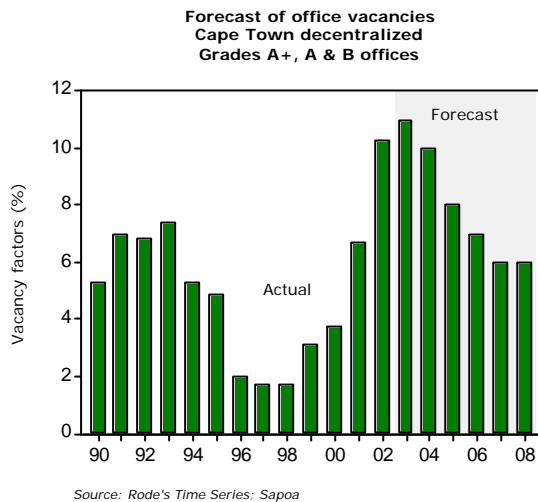
Lastly, although the forecast for the Cape Town CBD seems promising, we do not think that it will lure office workers back in their droves. Postulated reasons for this are the absence of a reliable and safe public transport system and a shortage of parking, not to mention the road bottlenecks (N1 and N2). Growth will be dependent on tourism, leisure and residential uses.

Cape Town decentralized

The Cape Town decentralized office market has been in the doldrums since 2002. This was to be expected after office vacancies shot up from a meagre 1,7% in 1998 to 10,3% in 2002. However, we forecast vacancies to reach their apex in 2003 and to start their declining path thereafter. Office vacancies are set to average 8,0% from 2003-2008.

The weight of the oversupply of office space on Cape Town decentralized office rentals is expected to be felt up to 2006, whereafter positive real growth is projected

to set in again. An average negative real growth rate of 3,4% p.a. is predicted for the forecast period.



Readers should take note that the forecasts for Cape Town decentralized vacancies do not include the vacancy factors for Century City, the V&A Waterfront and Westlake. The reason for this is that the historic data used in our econometric model is sourced

from Sapoa, who do not include these nodes (except Century City for the last quarter of 2002) in their surveys. However, even if these nodes were included, we would still have expected the office vacancies for Cape Town decentralized to come down.

In sum...

To summarise, office demand in all the main CBDs, barring the Cape Town CBD, is expected to contract. This is in line with the expected continued decay of these CBDs and the concomitant exodus to the suburbs. The softer office demand, together with the continued increase in office vacancies, barring Cape Town again, will cause *real* rentals to fall further. In the Cape Town CBD, real office rentals are forecast to dip in 2003 and 2004, before turning positive again from 2005.

Turning to the decentralized office nodes, Johannesburg *real* rentals are forecast to remain under pressure for the full length of the forecast period. In Pretoria decentralized, the present dip in real office rentals is forecast to continue until the end of 2005, before turning positive. The most encouraging performance is expected from Durban decentralized, where positive real rental growth is predicted from 2003 onwards, after only two years of negative real growth. In Cape Town decentralized, conditions in the office market are set to remain tough, putting downward pressure on real rentals. However, the tide is expected to turn positive from 2007.

This concludes our section on the office market. ■