

JLL H1 report shows industrial, logistics properties registering steady growth

According to JLL's *Logistics and Industrial Market Overview, South Africa*, which covers H1 of 2022, the development of logistics properties has gained significant momentum countrywide over the past ten or so years. This has been driven by the growing global economy and the impact this has had on imports, exports, and retailers in South Africa.



Massmart Riversand Distribution Centre. Source: Supplied

The report states that demand was heightened during the pandemic as global supply chain disruption forced retailers and courier services to reconsider procurement, storage, and distribution systems.

JLL research manager for sub-Saharan Africa Mieke Purnell said, "From a logistics supply delivery perspective, most recent construction in South Africa has been tenant-driven, although where there has been speculative development, this has quickly been taken up. Interestingly, committed development units have generally exceeded 30,000m² GLA, whereas speculative units are commonly between 8,000m² and 15,000m². To this end, there is a marked shortage of well-located, quality stock greater than 20,000m² available."

"Strong demand in this sector is expected to continue over the medium term at least. South Africa remains a small market, however, and e-commerce does not yet comprise a large enough proportion of retail trade sales to drive real estate decisions. A demand and supply equilibrium may therefore be approaching," adds Purnell.



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22 Sep 2022



Impact of building cost inflation, rising interest rates

According to the report, the primary factor affecting development and the pace of delivery is concerned with building cost inflation and the rising interest rate environment. Previously, land availability was considered an issue, but precedents have been set for re-zoning agricultural land, and access to arterial routes dominates proximity to key ports. The volatile nature

of pricing within the steel industry is a dominant concern for developers who are now being 'forced' to pass this increased expense on to tenants. Interest rate hikes further impact developers' cost of capital and project yield.

The report further states that for several years before the pandemic, the industrial and logistics rental markets favoured tenants over property owners. Landlords were typically price-takers, with both parties bound by tenants' affordability levels. This continues to be the status quo with respect to older/B-grade stock, although dynamics have shifted considerably in terms of logistics properties. Several landlords within this sector are now reporting a "price setting" narrative, supported by the shortage of available stock and mandated by rising interest rates and construction costs as previously identified.

"Real rental growth in this sector remains marginal or negative overall, as the country battles with rising inflation and related factors, however the urgency with which the sector is growing bodes for a positive trajectory going forward. Net rentals for high-spec logistics properties are currently in the vicinity of R70–R80/m², even as lease lengths extend past ten years. Until recently, developers have been absorbing building cost inflation (particularly steel prices), which has limited rental growth in the sector. Looking ahead, it is expected that these expenses will be passed on to the tenant through provisions included in the lease agreement that is concluded prior to construction," added Purnell.



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Lease terms

A key feature within the logistics sub-market, according to the report, are the generally longer lease terms which are both a function of amortising costs over an extended period and due to the purpose-built nature of facilities. These further strengthen tenure, and occupiers also typically invest significantly into the fit-out of these premises. The weighted average lease expiry term (WALE) for the logistics sector thus exceeds ten to 12 years.

According to the report, the secondary sector is still facing major affordability constraints, with landlords being forced to make concessions in order to retain tenants and minimise vacancies. This sub-sector has seen little to no nominal rental growth over the past three years minimum, resulting in negative real rental growth overall. There are indications of better rental growth prospects arising in the short to medium term, however, as these types of properties are inherently more affordable. It appears that cost-conscious occupiers are re-considering premises in older areas that are typically more centrally located and have a relatively more stable power supply. The trade-offs made with respect to security and conveniences do need to be taken into account.

"As increasingly more occupiers consider this option, the scope for advancing rentals in the R50 to R55/m² band is improving. Another manner in which developers and landlords are addressing cost or affordability concerns is based in the design of new buildings being developed. Features such as more volumetric capacity on a smaller floorplate (the latter

being the determinant of rent) and specialised flooring that reduces the wear and tear on equipment are prime examples of this. While such properties may be more expensive to develop, securing a good tenant on a longer lease enhances their feasibility,” added Purnell.



Inside Cotton On's new R300m head office and warehouse in Gauteng

Lauren Hartzenberg 25 Jul 2022



Industrial investment activity

The report notes that most industrial investment activity over the past two years has related to Reits disposing of secondary or non-core stock. In 2021, industrial deal flow in South Africa amounted to R4.3bn, roughly half of which is allocated to prime logistics assets. Favourable performance within the logistics sector has resulted in there being a general lack of prime or core stock available. Developers and Reits are generally holding on to their prime logistics warehouses as they are considered core stock that can deliver a sustainable yield.

The report clarifies that the above figures do not include vacant land sales, although it is worth noting that in the first half of 2022, several such deals were reported. Where vacant secondary stock has changed hands, prices have been determined on a rate per-unit basis, rather than yield or ROI. Buyers in this category are either owner-occupiers or private investors/developers undertaking speculative value add investments. Many of these premises are also being converted into more contemporary ‘shared’ facilities that are suited to small users and last-mile logistics operators.

Where prime stock changed hands in the logistics sub-sector, yields have been ranged around 8%, a rate that is not realistically achievable in other asset classes currently, except perhaps dominant regional or neighbourhood convenience shopping centres. From a logistics perspective, the Pepkor Isando DCs were recently sold at an estimated disposal yield of between 9 and 10%. This is the largest sale that has taken place in this sector in 2022 thus far. Industrial deal flow for 2022 to date amounts to approximately R1.6bn, which is short of the R1.9bn worth of transactions recorded over the same period (January to August) in 2021. Approximately 74% of these sales relate to industrial property in Johannesburg and surrounds, and a further 20% relate to Cape Town. Several of these transactions are Reit disposals.



Construction at Richmond Park in Cape Town well underway

19 Jul 2022



The return on investment for this category of landlords (following the capex required to upgrade older properties) originates in the higher through-rentals achievable. Tenants benefit from the synergies associated with being situated in established industrial nodes, and access to shared facilities or amenities being more affordable.

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