BIZCOMMUNITY

# What is driving SA's office leases?

By Beukes van Heerden

22 Jul 2019

It has been predicted this year that among South Africa's three major commercial segments, office space will be the biggest loser. With a stubbornly high vacancy rate that sees Johannesburg at its highest peak since 2010 at nearly 13%, this is unsurprising given that offices are largely driven by economic growth. Despite these high vacancies, new development activity continues in certain nodes in Johannesburg, with reports anticipating that around 106,420m² of space will come onto the market in high-end nodes during this year and into next. Added to this is a flurry of refurbishments and renovations. Between the often-conflicting needs of property developers and owners, what does the market need?

Image source: Gallo/Getty

According to the South African Property Owners Association (SAPOA) report on office vacancies released in April this year, an interesting trend has emerged that points to a connection between the vacancy rates of different nodes; as one node improves another worsens. What this signifies is a tenant pool that is not growing but rather rotates as tenants look elsewhere for efficient solutions to match their changing workplace needs.

Location is a key driver for companies when seeking office space. As much as 87% of national office development activity occurs in just 10 nodes, with Sandton, Waterfall and Rosebank making up as much as 56% of total office development.

Yet in Sandton, the jewel of Johannesburg's prime nodes, there is a steady increase in vacancies which in 2019 reached an all-time high of 337,000m$^2$. This follows a period of rampant development of capital projects, often for single tenant occupation, where large companies have chosen to consolidate their businesses by bringing all operating facets into one location. The knock-on effect is that older buildings previously occupied by such single tenants are now at risk of standing vacant for long periods of time.

## The case for refurbishment

Property owners are being pushed into refurbishment to attract or retain occupiers who are otherwise enticed away by property developers to new developments. In addition to taking account of the changing trends in the workplace, there is a demand for greener, sustainable design when refurbishing; owners need to prolong the life of aged buildings that look dated or are reaching the "end of life" with the breakdown or inefficiency of their services infrastructure.

Because significant earthworks are unnecessary for refurbishment, this provides a cost-effective solution to revitalising the asset. However, refurbishment requires foresight, skill and experience from initial planning stages through to construction given that retrofitting often demands complex workarounds and ingenuity. Particular client requirements could inadvertently create structural risks, from additional loading due to security rooms with concrete walls that will necessitate floor reinforcements, to raised floors - allowing for flexibility of services such as power and data - which could necessitate changes in the structure of the building.

For occupiers, in addition to operating in a challenging economic environment, they are also faced with fast-changing work requirements and their operations need to accommodate this. Many companies are contracting in terms of usable space required.

South Africans are following the global trend where the work environment is all important, and employee's wellbeing is a central consideration. Replacing the cubicle layout is an 'open work and agile' notion where combining open work areas with flexible spaces enables a positive response to the company's changing needs. Whereas fixed technology was built into space considerations in previous years, now wireless technology allows for portability of equipment and mutable workspaces. Staff members are beginning to use hot desks as well as contained, collaborative spaces, all with healthy light exposure and air flows.

## New developments

Beukes van Heerden, head of capital projects for SADC at Profica

According to SAPOA's office vacancy report, the overall office development pipeline has begun to slow as developers begin favouring a phased or tenant-driven approach. As evidenced in Sandton, developments specifically for a single tenant have grown in prevalence as large companies consolidate their activities into one building.

A critical aspect when developing office space to meet the unique requirements of a single tenant is to 'future proof' the project so that flexibility is allowed for when that tenant may eventually vacate. A failure to do so will stifle the future saleability and rentability of the building due to cost and, or technical constraints.

For new developments, unlet space is a sizeable risk for developers which has a knock-on effect in the greater market. For example, in Johannesburg's Rosebank, a vacancy rate for completed property is recorded at 6.9%, but with the inclusion of unlet developments the figure spikes to a vacancy rate of 16%. This not only affects the developer but has a direct impact on achievable rentals for other new developments and existing buildings in that node.

Due to the significant expense of greenfields developments, most developers look to densify spaces to get more bang for their buck. Over the last few years, as office development activity has soared, city councils began to waive or reduce some requirements such as parking bay numbers which was good news for developers. The caution, though, is for developers to be aware of the practicalities required by South Africa's workforce. For example, at one of the iconic single-tenant developments in Sandton, the client's understanding of staff needs pushed for less densification, requiring as many as six parking bays per 100m² which is on a par with the standard retail parking ratio due.

## The wild card – office to residential conversions

Johannesburg's CBD has been labelled as an urban development zone in a bid to revitalise the city centre. With tax incentives for investors, this is an attractive consideration. Property data and research group Lightstone point to an example of a commercial property in Fox Street that, following refurbishments including a coffee shop, restaurants and apartments, has increased the value of the property from R2.8m in 2017 to R6.2m today.

Converting old office buildings to residential is, for developers, an exercise driven by profit and the consideration of how to maximise the investment optimally and quickly. While it may be a potential solution for both South Africa's housing shortage and neglected Johannesburg CBD buildings, it is not clear whether office to residential conversions would solve vacancies in other nodes. Once again there are complicating factors, from potentially incomplete building records or poor data available at planning stages, through to making deep spaces compliant with access to light and fresh air for domestic use, that demand innovative refurbishment solutions.

## Conclusion

While the sluggish office market begins to make a slow recovery, the challenge of supply and demand will continue to create market pressures. Developers will continue to drive the supply side due to the imperative need for continued investment in capital projects, while demand is linked to the economy and job market.

As property owners scramble to retain and attract tenants, the refurbishment market could be about to come into its own wherever it is able to provide innovative, tailored tenant solutions. Certainly, at Profica we are seeing growth in the office to residential conversion initiatives and we're investigating redevelopment and the origination of redevelopment opportunities that are fast emerging.

While these developments present good potential, the cautionary note for both new builds and refurbishments is to allow for flexibility and future proofing to ensure longer term reasonably low vacancy rates that enable the office segment to produce a solid performance in the property sector.

### ABOUT THE AUTHOR

Beukes van Heerden, head of capital projects for SADC at Profica