

maxigroup
commercial property brokers



BPO – CAPE TOWN?



We set out below a very general overview of the South African commercial property market to assist prospective BPO operators in their research, assessment and selection of suitable accommodation facilities in Cape Town.

We apologise for references to the UK commercial market only.

METHODOLOGY

In respect of the service that we can provide, we would propose the following three stages:

1. **Evaluation** – The first stage in the process concentrates on establishing contact with the space user with an initial trade of information. In essence this stage focuses on information gathering as we assess the nature of the

prospective space user's operation and formulate an accommodation brief based on key requirements.

2. **Site Visit** – Following the initial evaluation process and submission of an initial schedule of accommodation options, we would propose that we arrange a further meeting to elaborate on the specific requirement of the prospect which would require a number of site inspections in order to gauge reaction to selected accommodation options in terms of location specifics and specification. These visits can either be visits to “generic” examples or more specific “target” locations depending on timescale and ability to proceed.
3. **Short List and Acquisition** – This would involve the targeting of a number of suitable options, negotiation of the occupation terms and the final acquisition of the premises. This stage can be facilitated on a remote basis or whilst the prospect is in South Africa. Generally such negotiations are concluded in a time scale ranging between two to four weeks depending on the readiness of the parties to proceed and commit to negotiations.

1. SOUTH AFRICAN PROPERTY OVERVIEW (OFFICES) – Q2-2011

To provide some background, it must be noted that the South African commercial property market remained in a state of total stagnation for almost 10 years prior to 2004 with no real rental growth and high levels of vacancy in most major commercial centres. The expected “boom” in the market after the first democratic elections in 1994 never really materialised until the economy started to grow in 2003 as a result of;

- Continued fiscal discipline from 1994.
- Improved business confidence.
- Perception of improved political risk.
- Relaxed monetary policy by the Reserve Bank.
- Relaxed lending criteria by financial institutions.
- Substantial direct foreign investment into South African companies and equity markets.
- Global demand for South African commodities.
- The awarding of the 2010 Football World Cup to South Africa.
- The growing popularity of South Africa as a tourist destination.
- Recognition of South Africa's importance as an economic “hub” for the increasing business development in sub-Saharan Africa.

These conditions stimulated a strong demand for office accommodation resulting in a major decrease in office vacancy levels, some speculative development and real and substantial rental growth for a sustained cycle of almost five years to early 2008.

So often, by the time property developers interpret economic indicators as being favourable and supportive of a speculative development to meet perceived market demand, the “upward cycle” is already approaching its zenith. Naturally, the construction phase for a large office development can take anywhere between 18 and 36 months (excluding the granting of necessary planning approvals) and consequently office developments are often delivered to the market at the end of such growth cycle.

Fortunately for the Cape Town market, (which is traditionally cautious when it comes to new office developments), comparatively few offices were developed between 2003 and beginning of 2008 so there was not the expected oversupply when the market started to slow as a result of the worldwide financial crisis and the start of the global recession.

Consequently, whilst office rentals have dropped over the last 36 months, the situation has not been as severe as anticipated with an average reduction in achievable contract rental of perhaps 25% to 30% for so called “A” and “B” grade accommodation in greater Cape Town compared to the height of the market in early 2008.

As the economic outlook remains cautious rentals will probably remain flat for the next 24 months but significantly, there is a shortage of “Premium Grade” office accommodation but still, there is no will to develop on risk and banks are not prepared to finance such developments without a substantial lease first being concluded.

2. CAPE TOWN – A GEOGRAPHICAL OVERVIEW

In general terms Cape Town is a City made up of three individual nodes linked by a plethora of residential, industrial and retail urban development.

To understand the geographical dynamics it is probably best to examine each of these three nodes as follows:

Town 1 – Cape Town CBD

The traditional and historic business centre located between Table Bay and the foot of Table Mountain – traditionally called the “City Bowl”. The city is the “common denominator” for all surface transport links with three major arterial roads serving the West Coast Suburbs, Northern Suburbs and Southern Suburbs all converging on the city, as well as rail links and a central bus and taxi terminus (now complemented by the new and expanding IRT “Integrated Rapid Transport” system).

The CBD has in the past been home to the many national and multinational companies and of course is the seat of the South African parliament during the summer. It is restricted in its size due to the physical barriers of the Table Bay and Table Mountain. Overall commercial accommodation is estimated to be in the region of 800, 000 m².

During the mid 1990’s Cape Town CBD experienced a large degree of decentralisation as fears that the CBD was declining (high crime rates, inefficiency of municipal services) to the same extent as Johannesburg (Johannesburg’s decline led to the creation of a new CBD in Sandton which was highlighted by the relocation of the JSE in 1999). This decentralisation led to new office nodes being created in peripheral locations and stimulated a new “mini boom” in the Southern and Northern Suburbs.

The CBD has however staged a remarkable “comeback” since 2002 with the ever increasing Victoria and Alfred Waterfront development, the influx of foreign investment, the creation of the Cape Town Improvement District (to manage security, cleaning, public services and infrastructural improvements), the completion of the Cape Town International Convention Centre (shortly to be expanded), the development of many international hotel brands, the development of the Cape Quarter (1 and 2) in De Waterkant, the redevelopment of the airport (Cape Town International), the conversion of many older office building into high value residential apartments, further development of new purpose designed inner city residential complexes and most importantly, the construction of the new Cape Town Stadium for the 2010 Football World Cup.

This “mixed use” cosmopolitan environment has brought people back to the city and it is now seen as a favourable and attractive working environment.

Town 2 - The Southern Suburbs

This area is the traditional “English” suburb and comprises a number of prime residential areas such as Constantia, Bishopscourt, Claremont and Newlands (with the internationally known Rugby and Cricket stadia).

The Southern Suburbs is located “directly behind Table Mountain” when looking at the mountain from Table Bay (the “picture postcard view”). The area is noted for its proximity to well known schools such as Bishops, SACS, Rondebosch and Herschel whilst the residential areas are also close to the “back mountain” portion of Table Mountain National Park with

superb hiking trails, forest walks, Kirstenbosch Botanical Gardens, and the famous vineyards of the Constantia Valley.

The so called “CBD” of the Southern Suburbs is Claremont with the other areas (Newlands, Rondebosch, Kenilworth) all home to various commercial office nodes. These areas are all located in a linear pattern along the M3 and the old Main Road which both run on a north-south axis from the Cape Town CBD round the side of Table Mountain (past the University of Cape Town) and terminate in Tokai (M3) and Simon’s Town (Main Road) on the Indian Ocean side of the Peninsula.

Drive time between Cape Town CBD and Claremont is approx 10 minutes (contra flow to peak hour traffic). Approximate distance – 12 kms. In peak hour traffic anywhere between 30 and 60 minutes.

Town 3 – The Northern Suburbs

This area was originally regarded as the traditional Afrikaans speaking suburb and comprises the following areas: Goodwood, Parow, Bellville, Platteklouf, Tyger Valley, Durbanville and Brakenfell.

The Northern Suburbs are located to the North East of Cape Town CBD and accessed directly via the N1 motorway and the original Voortrekker Road. Drive time between Cape Town CBD and Tyger Valley is approx 20 minutes (contra flow to peak hour traffic). Approximate distance – 20 kms. In peak hour traffic anywhere between 45 and 90 minutes.

The Tyger Valley area has experienced unprecedented growth over the last ten years both residentially and commercially with the Tyger Valley and Durbanville conurbation as the focal business and retail hub. Tyger Valley is recognised as a strong commercial node with excellent retail facilities, modern offices and is within close proximity to many upmarket residential suburbs bordering the edge of the Durbanville winelands. The historic towns of Paarl and Stellenbosch (Stellenbosch University) are both within 25 minutes’ drive.

Additional Areas

The above synopsis does not include a number of other rapidly emerging centres in and around Greater Cape Town. These include the “infill” urban environments situated between the N1 and M3 highways which comprise a number of high density residential areas close to scattered industrial nodes.

One of the fastest growing suburbs in the Western Cape is the Blaauwberg (Blue Mountain) municipality which continues to spread directly North, hugging the West Coast and presently extending some 25 kilometres North of Cape Town CBD. The long term planning for the Cape Town Metropole provides for this area to be extended as far as Saldanha Bay (well over 100 kms) and the establishment of a new airport and city.

It must also be noted that the “Atlantic Coast” suburbs of Green Point, Sea Point, Fresnaye, Bantry Bay, Clifton, Camps Bay, Llandudno and Hout Bay extend south from the Waterfront in a ribbon of development that hugs the coast along the slopes of Table Mountain. These areas are famous for their trendy beaches, restaurants, magnificent homes and sunsets into the Atlantic with some of the most expensive residential property on the African continent.

Century City

Century City is a 250 hectare mixed use development located approx 10 minutes drive time from the Cape Town CBD (contra flow to peak hour traffic) accessible from the N1 national road and bordering onto the West Coast suburbs.

The development commenced in 1999 with the construction of the “Ratanga Junction” theme park and “Canal Walk Shopping Centre” (at 125,000 m² it was the biggest Shopping Centre in Africa).

Further development in Century City over the next few years was gradual however to-date over 270,000sqm of office development has been completed.

Century City is privately owned and was purchased in 2004 by the Rabie Property Group.

Century City has 590,000 m² of developable commercial bulk (approx 230,000 m² remaining for office development) and is ideally located for large corporate office users due to its central proximity to both the Northern and Southern and West Coast Suburbs, extensive retail facilities, excellent security, parking facilities and extensive residential developments within the bounds of the property. Century City is serviced by bus and taxi transport and a rail link close by.

Because of the availability of suitably “zoned” land in Century City, Rabie Group are able to offer new build opportunities for operators wanting to own (or lease) purpose built facilities.

2. SOUTH AFRICAN PROPERTY PROCEDURE

Property procedures in South Africa originated from the English Freehold and Landlord and Tenant legislation and as such are very similar in nature and principle but for a few refinements made over the years.

LEASEHOLD AQUISITION

The system is somewhat different in South Africa in as much that the office market is serviced by brokers (Agents in the U.K) who act as a “middle go between” between Landlord and Tenant.

In comparison to the UK market for example, there are two agents, one acting on behalf of the Landlord and one on behalf of the Tenant, both receiving a fee from these respective parties.

In South Africa, the agent would assist the tenant in the procurement of premises but would be paid commission by the Landlord on a “no cure – no fee” basis.

LEASES

The length of Lease usually depends on the capital expenditure incurred by the Landlord in placing the Tenant but generally periods range from 3 to 10 years depending on the size of the area requirement and nature of the tenant installation. A large lease would be considered to be any area in excess of 1500 m².

1.0 m² in extent is equal to 10.8 ft²

Renewal options are generally for additional periods of 3 to 5 years at “then” market related rentals and escalations to be agreed by an expert or arbitration in the event that the parties cannot reach agreement on the rental terms going forward.

“Turn-key” developments (tenant specific) tend to be for a minimum of 10 years in order to secure development finance and satisfy the lending bank’s investment and risk criteria.

RENTS

Rent is calculated as Rand x m² per month + Value Added Tax (presently @ 14%).

Whenever a rental rate per m² is referred to it is generally understood to mean a **Gross Rental** to include all building operating costs but excluding consumable items such as electricity, water, refuse and sewerage.

Some landlords prefer to break up the Gross Rental into component form as follows;

Base or Net Rental - being the real income component for the Landlord.

Operating Cost – being the cost to manage and maintain the building and its services.

Local Authority Rates and CID Levies / Taxes – being Municipal Taxes levied against the building.

Per example a Gross Rental of say R85 m² p/m + VAT may comprise;

Base Rental – R57.50 m²

Operating Costs – R21.20 m²

Commencing Rates and Taxes – R6.30 m²

Generally rental is quoted as a Gross rental **only** with increases in Local Authority Rates and Taxes passed on for the account of the Tenant on a pro-rata floor area basis. i.e. any increase (applied on the 1st of July each year) over and above the original base rate which was initially included in the commencing Gross rental.

Consumption of Municipal services such as water, sewerage and refuse is now passed on to the Tenant. Budget for ± R3.50 m² p/m + VAT.

Electricity (Common and metered) shall also remain for the Tenant's account. Normal consumption including AC should be in the region of R12 / 15 m² p/m + VAT based on normal business hours operation. This would obviously increase with extended working hours. Overall electricity consumption costs obviously dependent on the type of building, its design, age and services.

ESCALATIONS

Rent is increased ANNUALLY by way of an escalation clause in the Lease. This figure is generally quoted at a market rate of between 8% and 10% per annum compound and currently agreed in a range between 7.5% and 8.5%. There is downward pressure on escalations.

Clearly Landlords try to keep this figure as high as possible. Different rates may be applied to a separate rental components i.e.

Base Rental – 8%

Operating Cost – 10%

Rates and Taxes – Actual Cost.

PARKING

In comparison to say the UK office market, the problem of parking is invariably the same in both countries in that there is generally not enough parking and it is too expensive.

Specifically in respect of BPO facilities, South Africa has yet to develop in the same way that say the U.K BPO industry has over the last 10 years.

The U.K moved from:

1. Inner city to,
2. peripheral office locations to,
3. purpose built out of town sheds, usually located in Enterprise zones and close to major Motorways or A roads.

The main benefit of these locations is space and the ability to accommodate vast areas of parking at low (or no) cost.

South Africa has yet to make this third step with the majority of existing call centres being located within the CBD or peripheral office parks but there are some exceptions beginning to emerge.

The CBD offers varied parking opportunities such as bays allocated to the tenant within the building (usually between 1 to 3 bays per 100 m² depending on the age of the building), nearby parking garages and “on street” parking or open parking lots operated by private companies.

Out of town office parks generally provide greater parking ratios of between 4 or 5 bays per 100sqm.

Expect to pay;

Inner City

Garage parking – R850 to R1200 per bay per month + VAT.

Surface parking (peripheral not connected to the building) – R250 to 350 per bay per month + VAT.

Decentralised Office Park

Garage parking – R600 to R850 per bay per months + VAT.

Surface parking – R350 to R450 per bay per month + VAT.

NB – In a country with high unemployment such as SA people will gladly utilise public transport or operate car sharing schemes. Depending on the salary levels of the agents, it is estimated that you will require 0.20 bays per seat or possibly 2.86 bays per 100 m².

1500 agents x 7 m² (per seat) = 10, 500 m² ÷ 300 bays = 1 bay per 35 m² (**2.86 bays per 100 m²**). This obviously really depends very much on the pay level of the agent and location of the proposed facility.

SECURITY / DEPOSITS

In South Africa most landlords will look for a 3 month rental deposit and some form of company or personal surety to guarantee the lease obligation dependent of course on the risk profile and covenant of the tenant.

INSTALLATION ALLOWANCES AND LEASE INCENTIVES

Landlords do not (at present) offer large rent free periods but would rather concentrate the negotiation on rental, escalation and tenant installation allowance – expect a one or two month rent free period at the most plus a period of “beneficial occupation” allowing sufficient time for the tenant’s contractors to carry out the installation of the premises (“the installation works”) prior to the commencement of the lease.

Tenant Installation Allowances (TIA) are very much geared towards the lease period agreed to and obviously the initial hand over specification of the premises prior to the application of any Tenant Installation Allowances (TIA)

As a “rule of thumb”, one can generally expect to negotiate a TIA equal to one month’s rental (plus VAT) for every year of the lease period – obviously payable up-front and to be expended on fitting out the premises and not furniture, IT or telecoms.

Assuming that the building is a completed shell with AC (air conditioning) and ceilings, the T I allowance will provide for partitioning, floor covering, adjustments to AC, lighting and power.

A new build with the office floor delivered as a shell specification – “off shutter” concrete ceiling, screeded concrete floor and electrical distribution board only, will require a budget of approximately R2300 m² + VAT for a complete installation to include AC. Most landlords seem to offer between R1500 m² and R1800 m² + VAT as a T I allowance against a so called “shell specification” leaving the tenant (unaware) that the TI will carry an additional cost burden of perhaps R500 m² to R800 m² to be rentalised or paid for upfront by the tenant. **See spreadsheet attached.**

RENTAL LEVELS (ALL FIGURES EXCLUDE VAT)

Offices in SA are generally referenced as either “AAA” or “Premium” grade, “A” grade, “B” Grade and “C” Grade.

These can be (**currently**) explained as follows:

AAA or Premium Grade - Rentals between R120 – R180 /m² p/m

New development, state of the art architecture, high rise or secure office park environment, good parking ratio, superior finishes, security and location.

A Grade - Rentals between R90 – R120/m² p/m

Modern office building, high rise or office park environment but approx 5 -10 years old, good parking ratio, superior finishes and good security.

B Grade - Rentals between R50 – R90/m² p/m

Approx 10 years plus with dated architecture and finishes often in need of updating. Low parking ratio usually 1 bay per 100 m² or less

C Grade - Rentals between R35 – R50/m² p/m

Approx 50 years plus, difficult floor plan, basic or retro fitted AC (“window rattlers”), no parking and basic finishes and security.

Industrial / Warehouse Structure (with convertibility) – R25 to R35/ m² p/m “as is” (prior to conversion).

New or old industrial building situated within semi commercial area mixed use environment.



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