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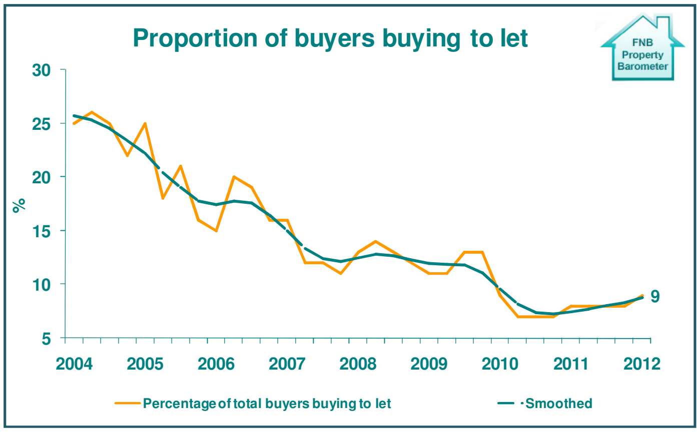
PROPERTY BAROMETER –RESIDENTIAL BUY-TO-LET AND RENTAL MARKET

Buy-to-let buying remains weak, with the FNB Estate Agent Survey pointing to only very slight improvement, and agents don't appear to expect much to change in the near term

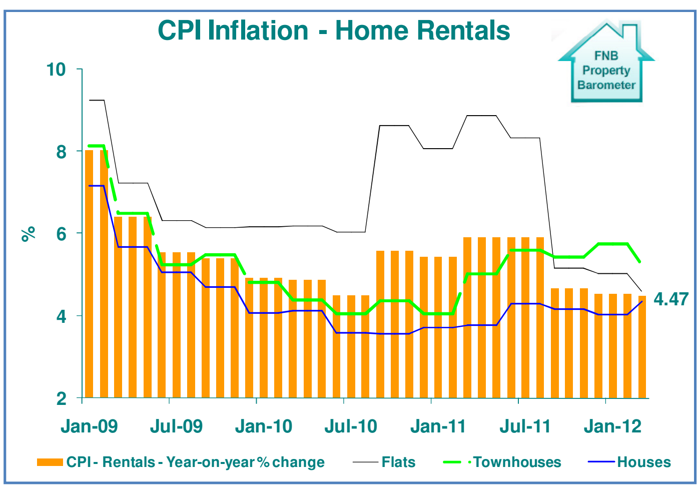
25 April 2012



As mentioned on various occasions, in an environment where the household sector is under significant financial pressure, basics are key, and primary residential demand is king. This is visible in ongoing weakness in buy-to-let demand for residential property, as reported in the FNB Estate Agent Survey.

The 1st Quarter 2012 FNB Estate Agent Survey points to an only marginal improvement in buy-to-let buying. When expressed as a percentage of total buying, by-to-let buying edged up slightly to 9%, from 8% in the previous 4 quarters. From a 7% low point late in 2010, agents are thus suggesting that there has been very slight improvement in the level of buy-to-let buying, given that overall buying volumes in the residential market have also risen mildly in recent years.

But this percentage remains weak in comparison to the estimated 25% back in early-2004 at the height of the property boom. Besides widespread household financial pressure still being in existence, and often only "masked" by very low interest rates currently, the mediocre performance of the rental market would also not appear to make buying to let an overly attractive option at this stage.

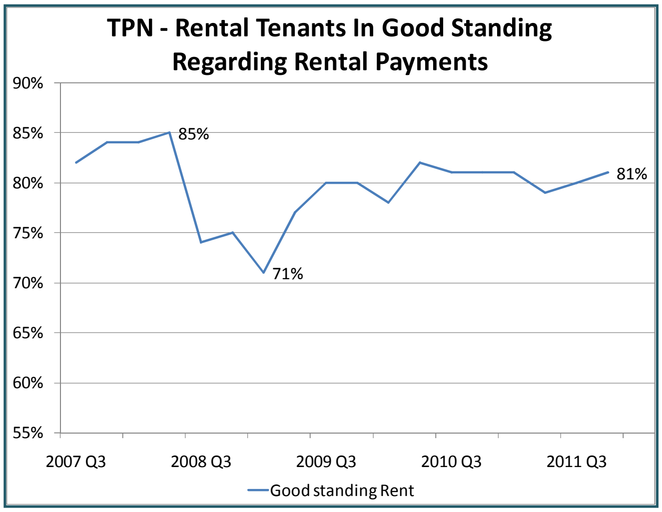


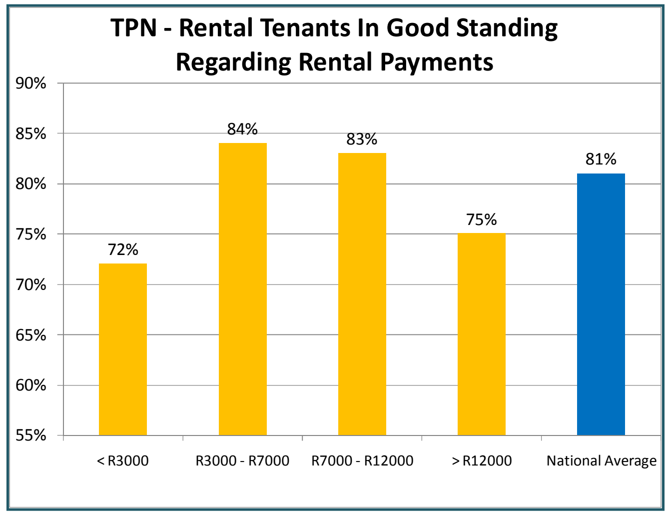
It must be said that South African rental data is "soft". StatsSA provides some insights via its consumer price index (CPI) surveys. The most recent survey points to modest rental inflation which, given current house price inflation in the region of 8% year-on-year according to FNB data, would probably be doing little to increase average yields on residential rental properties.

The CPI for rentals in March showed 4.47% year-on-year inflation, slightly lower than the previous quarter's rate of 4.53%. After showing some promise of strengthening in 2010 and early-2011, the CPI for rentals has thereafter shown a weakening growth trend. Whilst this is good from a point of view of keeping overall CPI inflation under control, and thus interest rates low, it does little to make buying to let more attractive. Townhouse rental inflation was the strongest in March according to StatsSA, at 5.2%, but only house rental inflation (4.34%) showed some increase.

Nevertheless, while we still await a meaningful rental inflation surge to make buy-to-let investment more attractive, there have been some signs that certain rental market fundamentals are improving. For one, low buy-to-let buying implies slow rental property supply growth, gradually laying the foundation for a future shortage which would lead to stronger rental inflation. And according to TPN (Tenant Profile Network), the percentage of tenants that are in good standing with regard to rental payments has increased recently. In the 4th quarter of 2011 this percentage reached 81%, the 2nd successive quarter of increase. This is significantly better than the 71% low reached at the end of 2008.

Broken up into rental segments, it would appear that the middle segments are financially the healthiest. Below R3,000/month rentals one saw a lowly 72% of tenants being in good standing, whereas the Above-R12,000/month Segment fared little better at 75%. In contrast, the R3,000-R7,000/month (84%) and the R7,000-R12,000/month (83%) Segments achieved considerably higher percentages of tenants in good standing.

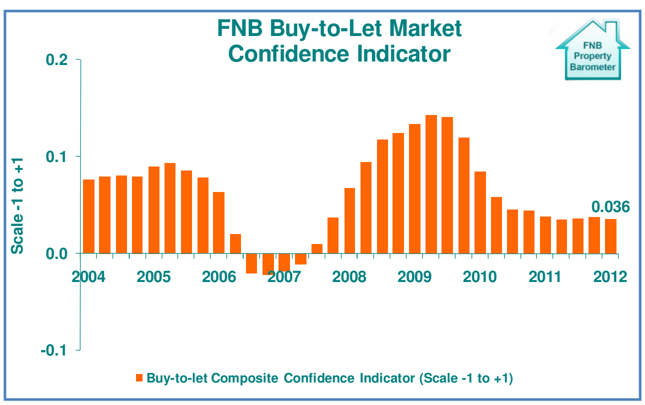




CONCLUSION

For the time being, buy-to-let buying remains weak although having improved very mildly. The buy-to-let market awaits the combination of a more attractive yield on residential property, which would be driven by stronger rental inflation, a better household sector financial situation, and for some aspirant investors significantly better capital growth prospects.

Weak buy-to-let buying, however, does lay the foundation for the ultimate recovery of the rental market by constraining supply. At present, it would appear that the agents surveyed believe that significant strengthening in the rental market may be some way off. What do the surveyed estate agents say? In the survey we ask them to state whether they expect buy-to-let demand to increase (which gets a rating of +1), stay the same (rated as zero) or decline (rates as -1).



The FNB Buy-to-let Market Confidence Indicator is the average of these different ratings, and the 1st quarter survey came out slightly positive at 0.036, slightly lower than the 0.038 registered in the previous quarter. This would suggest that the survey panel as a group is biased slightly towards strengthening buy-to-let demand in the near term, but the level suggests no expectation of "fireworks", with the confidence rating having declined from a peak of 0.14 back in the 3rd quarter of 2009.

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