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PROPERTY BAROMETER –FNB HOUSE PRICE INDEX AND 2013 OUTLOOK

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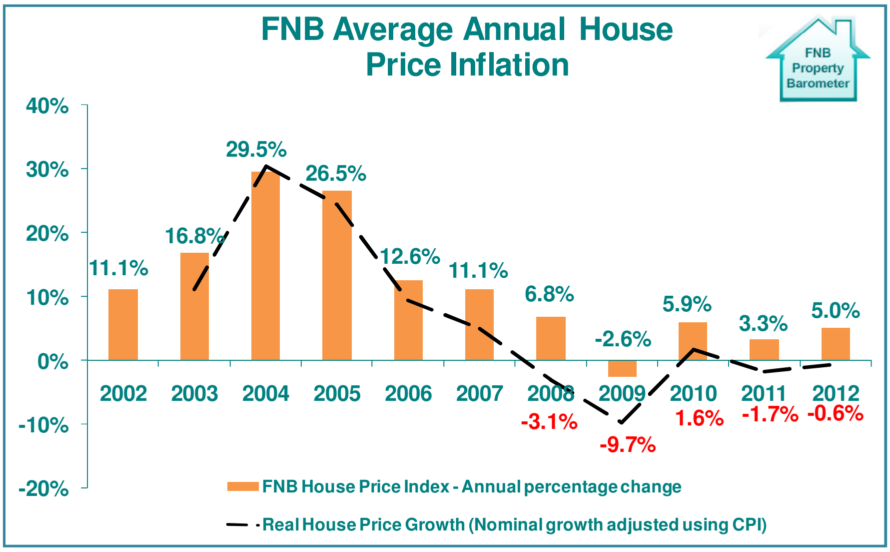
2012 was a slightly better year overall than 2011, in terms of house price performance, but weak economic conditions as we entered this year suggest that 2013 average house price growth may be slightly weaker.

2012 HOUSE PRICE INDEX FINDINGS

According to the FNB House Price Index, the average house price for the entire 2012 rose by 5% compared with the average price for 2011. This was a slight, but not too significant, improvement on the average house price growth of 2011 which measured a lesser 3.3%.

However, in real terms, when adjusting house prices for consumer price inflation, 2012 continued to show mild real house price decline to the tune of -0.6%, which was a lesser decline than the real decline of -1.7% in 2011. Nevertheless, slight improvement or not, the broad real house price "downward correction" continues, as it has for much of the period post-2007.

The average price of homes transacted was R845,106 for 2012, compared with R804,536 in 2011.



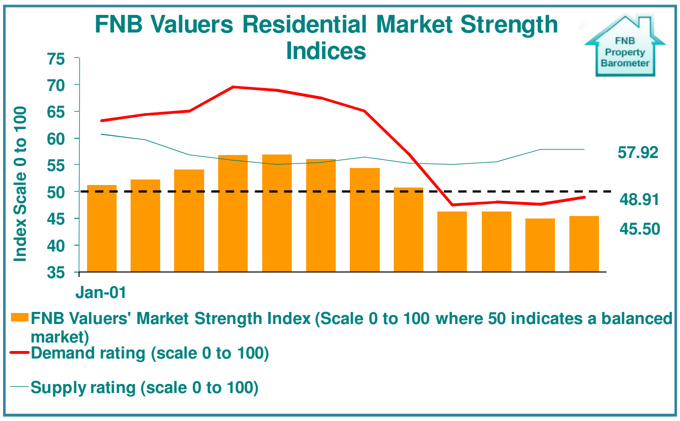
In real terms, the FNB House Price Index remained well-above levels of early last decade, with the real price average for 2012 still 70.7% above the real average price for 2001.

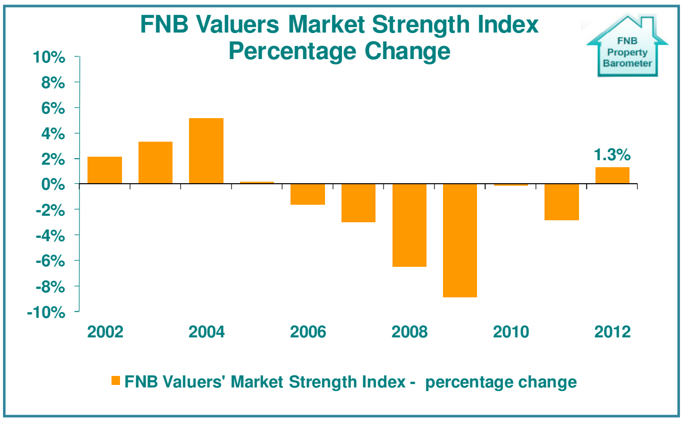
In nominal terms, the 2012 average price was 218% higher than the 2001 price level. Therefore, as at 2012 both real and nominal price levels remained still far above the pre-boom levels of early in the new millennium.

FNB'S VALUERS HAVE ALSO POINTED TO SOME IMPROVEMENT IN MARKET STRENGTH FOR 2012 AS A WHOLE

While the FNB Valuers' Market Strength Index (Explanatory notes on page 4) continues to languish at levels below 50, implying that the valuers' aggregated supply rating is stronger than the demand rating, the index nevertheless did point to a mildly better year in 2012, rising by 1.3% on the average strength level for 2011.

Being below a level of 50 probably still points to further real house price decline to come, though, despite the slightly improved level in 2012.



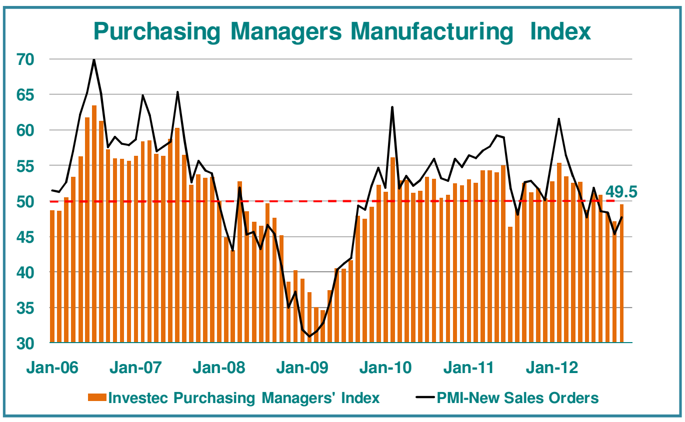


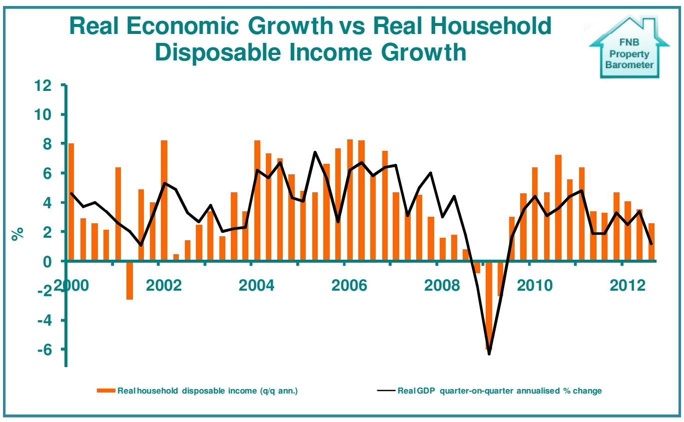
2013 OUTLOOK

In order to look forward into 2013, it is probably necessary to consider some of the economic trends through 2012 as the year progressed. Doing this leads us to the expectation that 2013 will see slower average price growth than 2012, because the 2012 economy was very much a "tale of 2 halves". The biggest contribution to overall house price growth in 2012 was made by economic conditions late in 2011 and in the 1st half of 2012. At that stage, real economic growth momentum was relatively solid, with 3.3% quarter-on-quarter annualized real GDP (Gross Domestic Product) growth being achieved in the final quarter of 2011, followed by still-solid 2.5% and 3.4% for the 1st 2 quarters of 2012 respectively. So we entered 2012 on a strong economic footing.

The same cannot be said for the manner in which we entered 2012. By the 3rd quarter of 2012, the economy had begun to show serious "cracks", with growth slowing to 1.2% as the global economy continued to be pedestrian, and large-scale domestic strike action disrupted economic output. While the GDP data for the final quarter of 2012 is not yet available, various industry statistics suggest that the growth rate may have deteriorated even further. By October, mining output was falling by -7.7% year-on-year, following on a series of declines throughout much of last year, while the Manufacturing Purchasing Managers Index had pointed to contraction in the sector for 3 consecutive months up until November, and some commentators believe that the economy may have contracted in the 4th quarter. Real retail sales growth had also started to show some signs of tapering, growing year-on-year by only 1% in October.

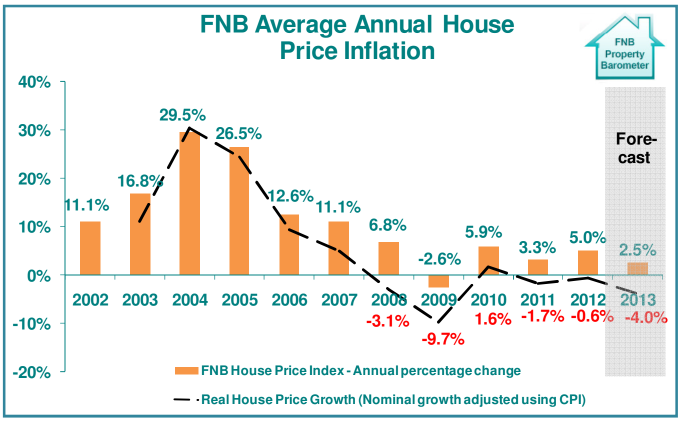
No wonder, therefore, that the FNBBER Consumer Confidence Index was increasingly reflecting a deteriorating household mood as 2012 progressed, declining for the final 3 quarters of 2012. Real household disposable income growth was tapering, as too was household consumption expenditure growth. Although home buying is not classified as consumption, it is that same consuming household that buys the houses, and one would expect that weaker consumer confidence would rub off to a certain extent.





The end of the major strike disruptions of late-2012 should lead to some better economic growth quarters early in 2013. However, the reality is that we have approached and gone into 2013 on a very weak economic footing, suggesting that the early stages of this year could be a relatively soft period for house price growth. As such, we expect house price growth for the year 2013 as a whole to be slightly more subdued than 2012, and pencil in nominal average rise of 2.5% for the year.

Given that consumer price inflation looks set to be more around 5 to 6% this year on average, that would imply further "downward correction" in real price terms (when house prices are adjusted for CPI inflation).



Certain key issues remain similar to recent years. They include:

- *Ongoing financial pressure for many households, an overhang of the credit boom of last decade, which would lead one to expect that the search for affordability in housing remains priority for many.*
- *Above-CPI inflation rises in municipal rates and utilities tariffs are set to remain problematic for home owners, and this can also exert some pressure on house prices, especially on the higher priced and larger sized end of the market.*
- *While further economic weakness can lead to further interest rate reduction, recent years have suggested that the Reserve Bank is reluctant to cut, and any downward movement in rates (such as the lone rate cut in 2011) is likely to be almost insignificant.*

Finally, the upside of expected very low price growth in 2013, for future aspirant investors at least, is that we would expect yields on housing to broadly increase further, as they have been doing gradually since after the boom years, slowly improving property's attractiveness as an asset class.

Notes:

Note on The FNB Average House Price Index: *Although also working on the average price principle (as opposed to median or repeat sales), the FNB House Price Index differs from a simple average house price index in that it could probably be termed a "fixed weight" average house price index.*

One of the practical problems we have found with house price indices is that relative activity shifts up and down the price ladder can lead to an average or median price index rising or declining where there was not necessarily "genuine" capital growth on homes. For example, if "suburban segment volumes remain unchanged from one month to the next, but former Black Township (the cheapest areas on average) transaction volumes hypothetically double, the overall national average price could conceivably decline due to this relative activity shift.

This challenge of activity shifts between segments is faced by all constructors of house price indices. In an attempt to reduce this effect, we decided to fix the weightings of the FNB House Price Index's sub-segments in the overall national index. This, at best, can only be a partial solution, as activity shifts can still take place between smaller segments within the sub-segments. However, it does improve the situation.

The FNB House Price Index's main features are as follows:

- *The weightings of the 10 sub-segments were determined by their relative transaction volumes over the 5 years from 2003 to 2007. The weightings are fixed (to be revised periodically):*

- *Sectional Title:*
  - *Less than 2 bedroom (Weight – 0.0718)*
  - *2 Bedroom (Weight – 0.2106)*
  - *3 Bedroom (Weight – 0.101)*
  - *4 Bedrooms (weight – 0.0031)*
  - *More than 4 Bedrooms (Weight – 0.0002)*
- *Full Title:*
  - *Less than 2 Bedrooms (Weight – 0.053)*
  - *2 Bedrooms(Weight – 0.1092)*
  - *3 Bedroom(Weight – 0.3561)*
  - *4 Bedroom (Weight – 0.0811)*
  - *More than 4 Bedroom(Weight – 0.0139)*

- *The Index is constructed using transaction price data from homes financed by FNB.*
- *The minimum size cut-off for full title stands is 200 square metres, and the maximum size is 4000 square metres*
- *The maximum price cut-off is R10m, and the lower price cut-off is R20,000 (largely to eliminate major outliers and glaring inputting errors).*
- *The index is very lightly smoothed using a Hodrick-Prescott smoothing function with a Lambda of 5.*

Note on the FNB Valuers' Market Strength Index: **When an FNB valuer values a property, he/she is required to provide a rating of demand as well as supply for property in the specific area. The demand and supply rating categories are a simple "good (100)", "average (50)", and "weak (0)". From all of these ratings we compile an aggregate demand and an aggregate supply rating, which are expressed on a scale of 0 to 100. After aggregating the individual demand and supply ratings, we subtract the aggregate supply rating from the demand rating, add 100 to the difference, and divide by 2, so that the FNB Valuers' Residential Market Strength Index is also depicted on a scale of 0 to 100 with 50 being the point where supply and demand are equal.*