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PROPERTY BAROMETER - AUGUST FNB HOUSE PRICE INDEX

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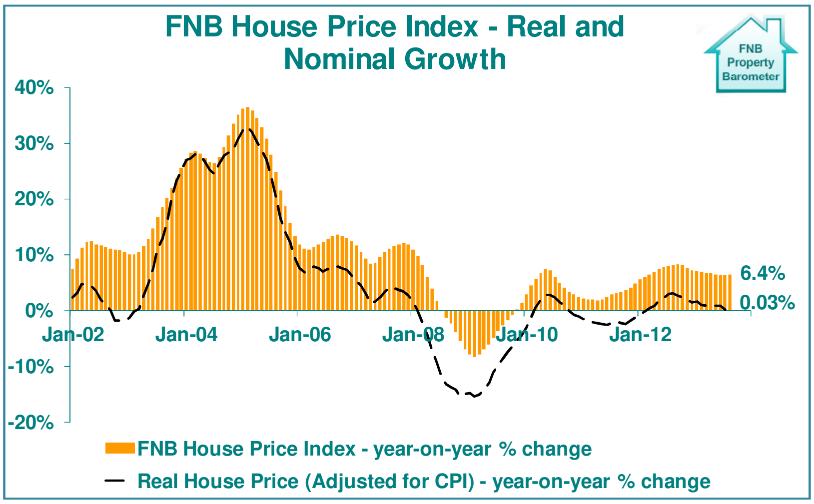
HOUSE PRICE INDEX SHOWS SMALL GROWTH ACCELERATION

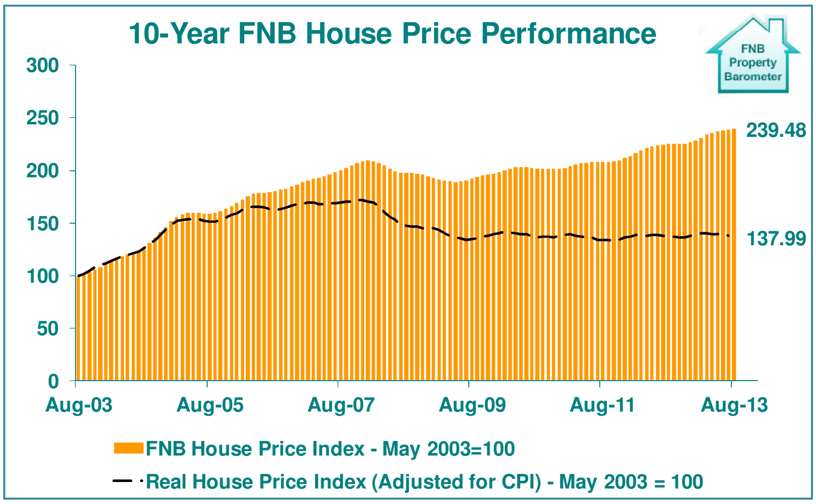
The FNB House Price Index showed a slight acceleration in its year-on-year growth rate, from a previous month's revised 6.3%, to 6.4% in August. This is not a significant rise, and in recent months the house price inflation rates recorded have not been too far away from consumer price inflation rates recorded in the economy.



The average value of homes transacted in the FNB House Price Index was R894,600 .

In real terms (adjusting house prices for general inflation in the economy using the CPI), as at July we were seeing virtually no positive year-on-year inflation, +0.03% to be precise, with consumer price inflation having risen from 5.5% in June to 6.3% in July.

Evaluating longer term performance, compared to August 2003, 10 years ago, the index is up 37.99% in real terms and 139.48% in nominal terms, still suggesting that the full price effects of last decade's residential demand boom have far from worn off , despite a significant downward real correction since late-2007.

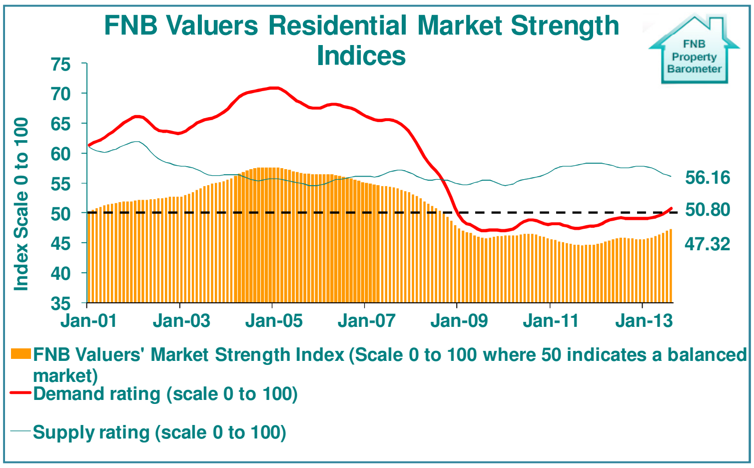


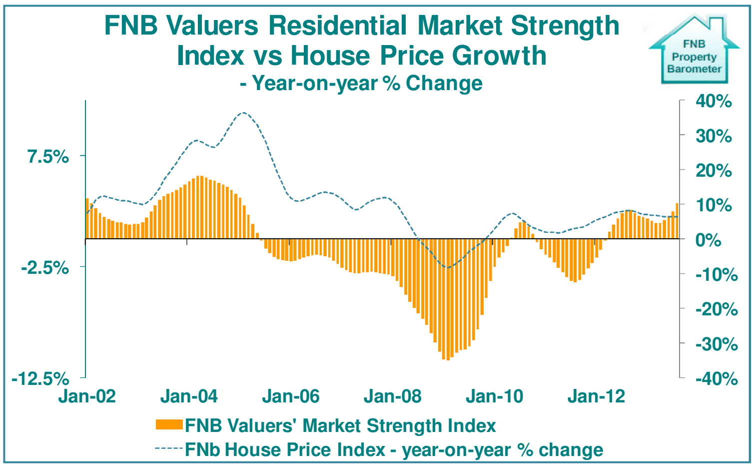
Looking at the more recent past, however, in real terms the index is -19.8% down on last decade's revised real price peak reached in December 2007, while in nominal terms it is a mere 14.6% higher, so price "correction" has been in progress.

FNB'S VALUERS PERCEIVE AN IMPROVED BALANCE BETWEEN SUPPLY AND DEMAND

Turning to the FNB Valuers' Market Strength Index, FNB's Valuers have indicated that recent relative market strength has been the result of the combination of positive residential demand growth as well as a more constrained supply of residential stock on the market.

Since early-2012, the FNB Valuers' Market Strength Rating Index has shown gradual positive year-on-year growth after a 2011 decline. However, it still remains below the crucial level of 50, at 47.32, implying that the residential demand rating of 50.8 is still weaker than the 56.16 Residential Supply Rating. This arguably explains why we have not yet seen strong house price growth in real terms, because, while they do see supply being a little more constrained, the constraint is still far from being extreme.





CONCLUSION

The residential market is in an interesting "space" at present. On the one hand we have had signs of gradually improving demand along with increasing supply constraints. On the other hand, we have had a slowing pace of real household disposable income growth in recent times, resulting in weakened consumer confidence according to the FNB Consumer Confidence Index. It thus seems to be a case of the housing market moving in the opposite direction to the consumer economy.

Or is this really the case? Perhaps, rather, it is case of us having become so used to weak housing market performance from 2008/9 onward, that 6-7% house price growth appears strong. But in actual fact this range of house price growth is only just keeping ahead of consumer price inflation, and is thus not yet strong in real terms. And so it probably shouldn't be yet. The FNB Valuers' Market Strength Index remains below 50, still pointing to the valuers as a group rating supply as stronger than demand. In our FNB Estate Agent Survey, while more agents are pointing to stock constraints, the estimated average time of houses on the market still seems a bit long at around 17 weeks (2nd quarter survey), also not yet suggesting an "extreme" demand relative to supply just yet.

Therefore, while the residential market has been "on the mend" for some time, in terms of demand relative to supply, it is a slow process, and 6-7% average house price growth should not be seen as "strong" given where our country's general inflation rate is.

It is also a very "sane" market at present, it would seem, free of large-scale speculative activity, and the general feedback seems to be a market where new buyers "shop around" and "bide their time"

So, while the housing market is in a relatively good space at present, it's nominal inflation rate is not yet impressive when view in real terms, and so it probably shouldn't yet be.

But if one evaluates average house price growth since after the 2008/9 recession, one sees to "mini—surges" in growth. One was back around 2010, in reaction to big interest rate cutting through 2009, and the 2^{nd} was from late-2011 to date after a short lull. The 2^{nd} mini-surge, has been far more sustained, despite demand growth actually being far more significant back in 2009/10 at the time of the 1^{st} post-recession surge. That the 2^{nd} mini price "surge" has been more sustained than the 1^{st} one is reflective of better market fundamentals this time around. Gradual demand growth slowly been mopping up the oversupplies (helped by very low levels of new building activity), household financial stress has gradually been reduced, and periods of real (adjusted for consumer price inflation) house price decline have slowly made house prices more realistic.

The market "healing" process as always is low, but it is happening.

ADDENDUM - 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 short term 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.

With our 2013 re-weighting exercise, we have begun to segment not only according to room number, but also to segment according to building size within the normal segments by room number, in order to further reduce the impact of activity shifts on average price estimates.

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

- *The weightings of the sub-segments are determined by their relative transaction volumes over the past 5 years, and will now change very slowly over time by applying a 5-year moving average to each new price data point. The sub-segments are:*

- *Sectional Title:*
  - *Less than 2 bedroom – Large*
  - *Less than 2 bedroom – Medium*
  - *Less than 2 bedroom – Small*

  - *2 Bedroom – Large*
  - *2 bedroom – Medium*
  - *2 bedroom – Small*

  - *3 Bedroom and More - Large*
  - *3 Bedroom and More - Medium*
  - *3 Bedroom and More - Small*

- *Full Title:*
  - *2 Bedrooms and Less - Large*
  - *2 Bedrooms and Less - Medium*
  - *2 Bedrooms and Less - Small*

  - *3 Bedroom - Large*
  - *3 Bedroom - Medium*
  - *3 Bedroom - Small*

  - *4 Bedrooms and More - Large*
  - *4 Bedrooms and More - Medium*
  - *4 Bedrooms and More – Small*

The size cut-offs for "small", medium" and "large" differ per room number sub-segment. "Large" would refer to the largest one-third of homes within a particular room number segment over the past 5 year period, "Medium" to the middle one-third, and "Small" to the smallest one-third of homes within that segment.

- *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.*