MEDIA RELEASE: FNB-TPN RESIDENTIAL YIELD DATA.

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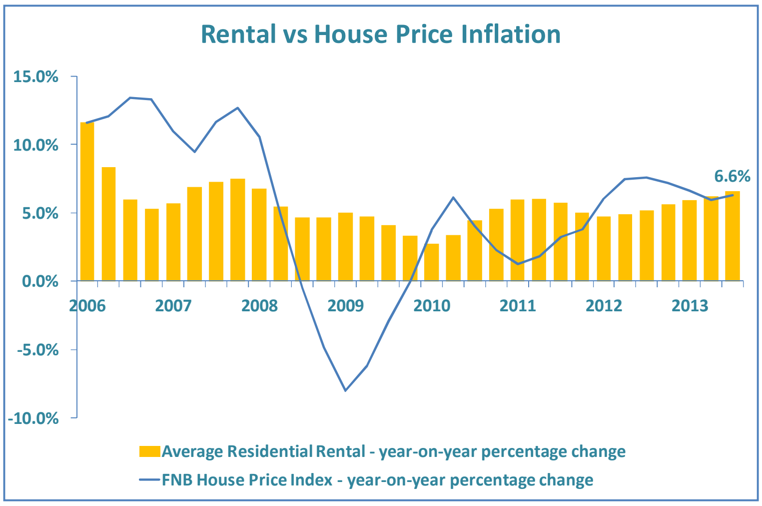
RESIDENTIAL PROPERTY MAY HAVE RECENTLY STARTED TO RECOVER SOME ATTRACTIVENESS AS AN INVESTMENT, AS RENTAL INFLATION BEGINS TO ACCELERATE.

After slow house price growth from 2008 to late-2011 had allowed rentals to play some mild catch-up with residential property values, resulting in rising gross yields over much of that period, a period of improved house price growth performance through 2012 and the 1st half of 2013 translated into a resumption of yield compression (decline).

However, TPN (Tenant Profile Network) surveys a year ago began to talk of growing supply shortages in the residential rental market, and it would appear that rental inflation began to accelerate last year, causing yields to once again start to increase in the 2nd and 3rd quarter of 2013. This once again starts to raise the attractiveness of residential property as an investment purchase mildly.

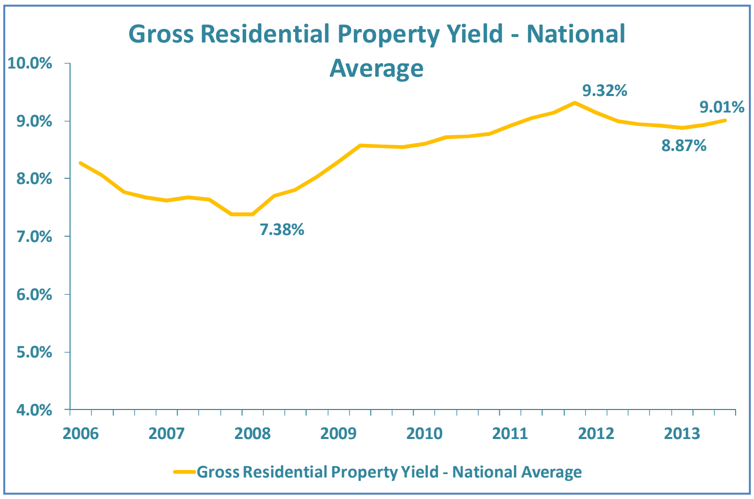
This is the view of John Loos, Household and Property Sector Strategist at FNB Home Loans, and Michelle Dickens, Managing Director of TPN Credit Bureau.



So, while homeowners are often excited by strong house price growth, the aspirant buy-to-let investor may be more excited by news of a rental market that outperforms house price growth. "And", says Dickens, " in 2013 it would appear that this may have begun to happen once more, although admittedly early days, with our updated calculations of average rental inflation having accelerated gradually through last year to reach a rate of 6.6% year-on-year by the 3rd quarter". This was slightly ahead of FNB's calculation of average house price growth during the 2nd and 3rd quarters, helping gross yields slightly higher once more.

This FNB-TPN Residential Yield dataset is the combined result of TPN rental data, along with FNB's house price data and its Automated Valuation Models (AVMs). In short, the approach has been to take all of the properties for which TPN rental data exists, utilise the AVM to estimate a current value on the property, and then to calculate the initial yield on all such properties.

THE NATIONAL YIELD TREND



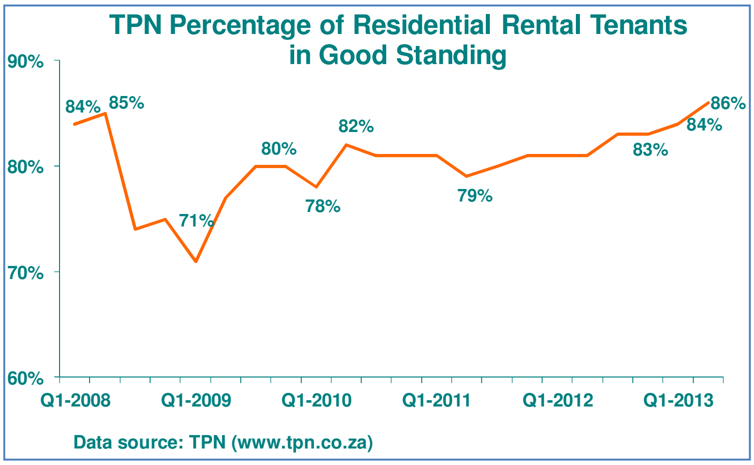
Looking at the data of the FNB-TPN National Average Initial Yield on Residential Property, as at the 1st quarter of 2013, the revised National Gross Average Yield on residential property was estimated at 8.87%. By the 3rd quarter of 2013 it was slightly higher at 9.18%.

This is not a significant rise as yet, but it is significant in the sense that the upward movement of the most recent 2 quarters has arrested a prior declining trend starting back in 2012.

Loos cautions that "it is not yet a given that this recent renewed yield increase is the start of a sustained upward trend. Bear in mind that the FNB House Price Index has also been showing renewed acceleration in recent times, on the back of mounting supply constraints in the home buying market as well. So, with both the rental and buying markets experiencing more significant supply shortages recently, it would seem, it could be an interesting race between rental and house price inflation in the near term". He says that "when interest rate hikes finally arrive, one would perhaps expect to see rental inflation start to win the race more noticeably, with rental becoming a relatively more attractive option in times of higher interest rates, and home buyer demand receding". But for now its "neck and neck".

Loos does emphasise that these yields are still gross yields, meaning that landlord operating costs associated with the property have not yet been included in the calculation to get to a net initial yield. "At this stage", he says, "we don't have the data required to calculate net yields".

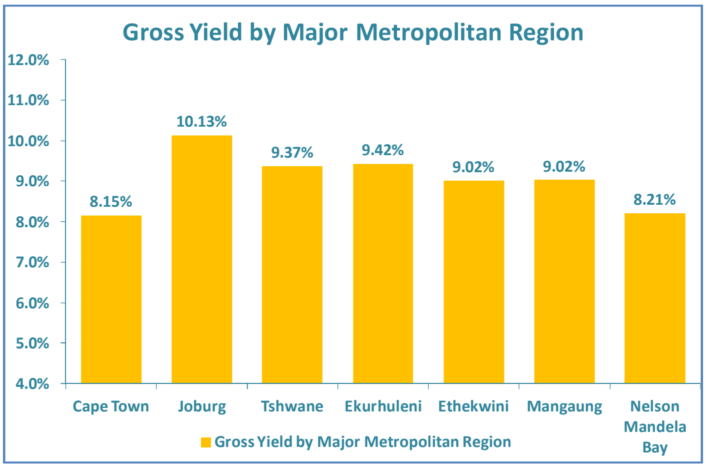
How attractive is a 9% gross initial yield for buy-to-let buyers? "That's always debatable", says Dickens, "given that the consideration is always between yield vs risk, but the positive thing is that the attractiveness appears to once again be improving on both scores. In addition to a mild increase in yields, on average tenants have become more reliable payers as the economic recession of 2008/9 has faded more and more into the past".

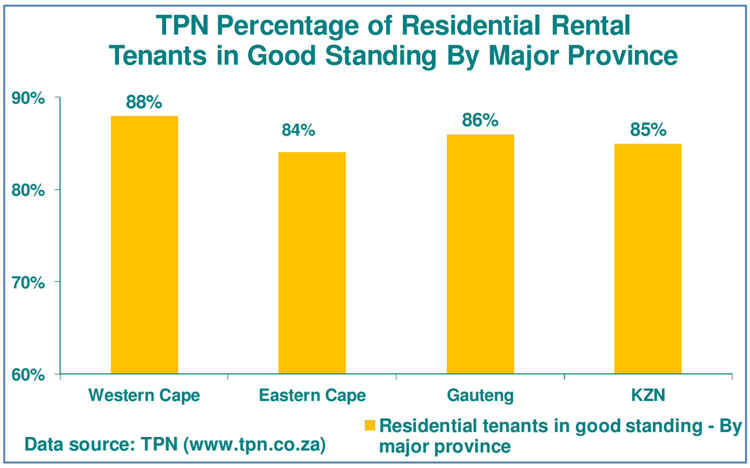


Referring to TPN data regarding "tenants in good standing" with their rental payments, she points out that from a 71% low in early-2009, the percentage of tenants in good standing had risen to 86% by the 2nd quarter of 2013. "Tenant risk has thus also declined".

REGIONAL YIELD COMPARISONS

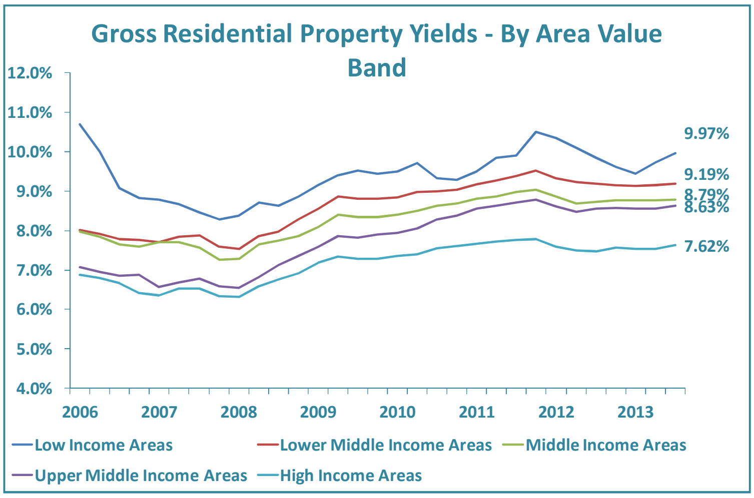
Which regions have the best yields? "Broadly speaking, it would appear that the principle of higher risk=higher return more-or-less holds true when comparing yields by major region", Dickens says. "As at the 3rd quarter of 2013, the 3 Gauteng metros, namely City of Joburg (10.13%), Ekurhuleni (9.42%) and Tshwane (9.37%), had the highest yields, followed by Ethekwini metro (9.02%) in KwaZulu-Natal. At the same time, we see KZN and Gauteng Provinces recording slightly poorer payment performance by tenants than the Western Cape, with 85% of tenants in good standing in KZN and 86% in good standing in Gauteng. By comparison, City of Cape Town (88%), which forms the lion's share of the Western Cape Province, has the lowest gross yield (8.15%) of the major metros. The relatively low Eastern Cape "in good standing" percentage of 84% is a bit surprising, as that region also often has one of the better tenant performances, but data from smaller cities and regions can be a little bit more volatile due to sample size.





SEGMENT YIELD COMPARISONS

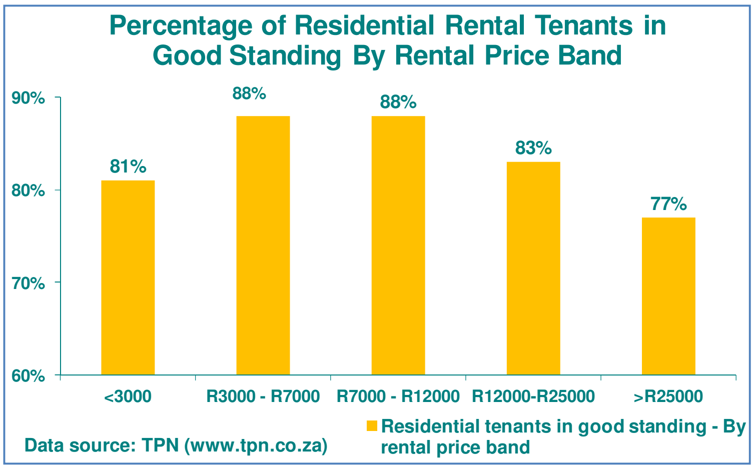
What then of comparative yields by price segment? "To gauge this", Loos says, "we have segmented suburbs based on the average value of the homes in them, into 5 "area value bands".



In Low Income Areas (average home value below R600,000), the average national yield was estimated at 9.97% for the 3rd quarter of 2013. In Lower Middle Income Areas (Average home value from R600,000 to R900,000), the yield was slightly lower at 9.19%, followed by an average yield of 8.79% for the Middle Income Areas (average home value between R900,000 and R1.2million), and 8.63% for Upper Middle Income Areas (average home value from R1.2m to R1.5m). There then exists a more significant gap in yield between Upper Middle Income and High Income Areas (average home value above R1.5m), whose gross yield is a relatively lowly 7.62%.

Loos adds, “in short, cheaper areas on average offer higher gross yields, whereas the high end areas appear less attractive”. He admits that the counter argument which could be used by those fans of higher end properties would be that lower income areas carry a higher risk, and thus should come with a higher yield.

“However, this story doesn’t entirely appear to hold true”, he says. “Using TPN data regarding the percentage of tenants in “good standing” regarding their rental payments, we do indeed see that the lowest TPN rental band, i.e. homes with monthly rental below R3,000, has a relatively low percentage of tenants in good standing, to the tune of 77%. Many of these homes probably fall in so-called Affordable Areas. Moving up to the next rental band, homes with rental between R3,000 and R7,000 per month show a significantly better 88% of tenants in good standing, many of such homes probably falling in the Lower Income area value band. This percentage stays relatively high at 88% in the R7,000-R12,000 monthly rental band, with many of these homes probably in the Middle Income Areas, supporting the view to this point that as one moves up the property/rental value ladder the tenant risk diminishes, and that this risk should be reflected in lower yields.”



However, he goes on to point out that “this line of reasoning goes awry in the next rental categories up, with the R12,000-R25,000 monthly rental band showing a lower percentage of tenants in good standing to the tune of 83%, which gets even worse in the R25,000+ monthly rental category at only 77%. Many homes in these highest 2 rental categories would fall into the High Income area value bands, suggesting that this top area value band is a somewhat tough place to operate for some landlords, while yields are not compensating for this apparent higher risk.”

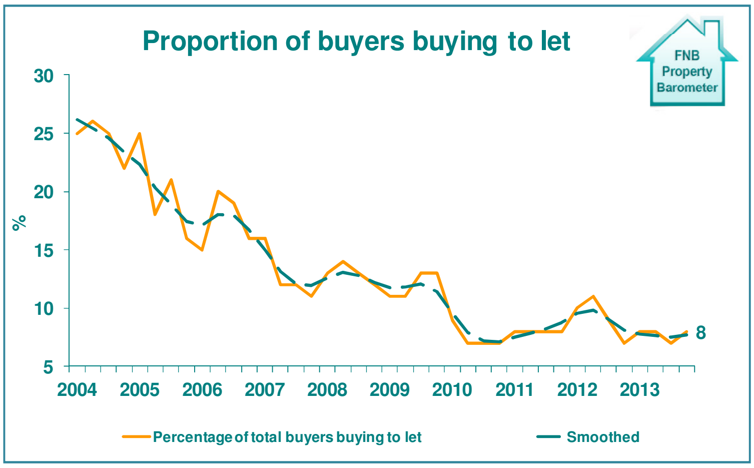
“Therefore, the “sweetspot” from a landlord risk/yield point of view appears to be in the Lower-Middle-to-Middle Income area value bands, and where many rentals probably fall between R3,000 and R12,000/month.”

OUTLOOK

Regarding the prospects for a stronger rental market, a potential driver of higher and more attractive yields in future, Dickens says that “we have heard a significant number of letting agents reporting stock shortages in recent times, and under such conditions we would expect further acceleration in rental inflation in 2014.

“An early-2013 survey conducted by TPN amongst rental agents did point to significant rental property supply constraints. In fact, 94% of respondents indicated a shortage of rental properties.

Loos suggests that, "at some point we would expect the prolonged period of low interest rates and an improved home buying market to lead to a rise in buy-to-let home buying. Such a trend may emerge in 2014, although I would think it may be some time before any increase in buy-to-let buying would meaningfully change any supply constraint in the rental market, and so would concur with an expectation of rental inflation going higher in the near term."



"To date, our FNB Home Buying Estate Agent Survey has yet to show any strong increase in buy-to-let buying, implying slow growth in the number of rental properties. In our 4th quarter Estate Agent Survey, respondents estimated 8% of home buying being for buy-to-let purposes. While slightly higher than the prior quarter's 7%, this percentage is still very low compared to earlier years of the survey, and has shown little noticeable improvement since around 2010."

Summing it all up, Loos and Dickens believe it possible that "we may see some further mild increase in gross yields in the near term as rental inflation rises. However, this may not be a large increase, as house price inflation also looks to be accelerating." They thus remain of the view that we'll probably have to wait for the next significant jump in residential yields, which will probably only take place the next time interest rates rise, boosting rental inflation while subduing house price growth. And the FNB expectation remains for such an event to take place from 2015 onward, after another year of sideways movement in interest rates in 2014."

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Notes:

Data Sources: TPN and FNB

Yield Compilation Methodology:

After including a few "data cleaning filters", the estimates of initial yields on residential properties have been produced. Because rental variations appear to vary far greater from the mean than house prices do (possibly due to the absence of professional valuer guidance in the rental market), we find it better to use median yields than average yields for rental segments.

The national average yield is therefore a combination of mean and median. We start by compiling median yields for property area value bands in the major rental regions, i.e. the 6 major metros and "the rest of SA", by area value bands. The value bands are:

- Low Income Rental Areas: Areas with average home value below R600,000
- Lower-Middle Income Rental Areas: Areas with average home value between R600,000 and R900,000
- Middle Income Rental Areas: Areas with average home value between R900,000 and R1,2million
- Upper-Middle Income Rental Areas: Areas with average home value between R1.2m and R1.5m
- High Income Rental Areas: Areas with average home value higher than R1.5m.

The median yields of the regional segments are then rolled up into regional and national weighted averages based on weightings determined by the rental volumes in the segments and regions.

Average Rental Index Compilation Methodology

The average national rental index is compiled in order to assess the change in the average rental amount for all rental properties where there was a previous rental contract in place.

Rental contracts are matched to the previous rental contract for the same property. Where there is a historic rental contract on record, an average of all new rental amounts is derived for each quarter. The time series is then smoothed using a Hodrick Prescott filter with lambda of 3 and a year on year growth rate is then calculated.