PROPERTY BAROMETER – SOME BUYING CONSIDERATIONS IN TOUGHER TIMES

In tougher economic times, aspirant home buyers need to consider the future costs that will come with the type of home they buy, as well as the implication surrounding the fact that home values can decline.

2 September 2015

Economic cycles are a fact of life, and households needs to adapt as these cycles unfold.

One of the big myths surrounding the residential property market is that house prices always go up. This is absolutely not true. Granted, in a country such as South Africa, which has a significant general inflation rate with regard to consumer prices and wages, house prices over time should go up more than they go down.

Indeed, if one views the Absa National House Price Index for its almost 50-year history, there has only been an annual average nominal house price decline in 3 of the last 48 years.

National "corrections" in real terms, where prices still inflate but at a lower rate than consumer price inflation, are more common occurrences.

Downward corrections either in "real" terms only, or in all-out nominal terms, should not be seen as a bad thing. Ideally, asset prices should reflect the economic fundamentals of the country and of specific regions or areas. If those fundamentals, such as economic performance, deteriorate, asset prices should correct accordingly. This is a healthy well-functioning market situation to have.

The problem, though, is when home owners are not prepared for an event such as a home value decline, often because they make their buying decision based on the fallacy that the value can never drop. They can be "over-committed" financially as a result, often taking out a 100% loan-to-value bond (plus, sometimes, more debt to finance transaction costs or furniture and appliances for their new home). While the other debt is unsecured, the assumption behind the 100% loan-to-value bond, made by both the lending institution and the home buyers, is that the home's value will hold, and even increase time, thus providing "cover" should financial tough times arrive and the household not be able to service the loan.

Simple stuff, really. The home could quite easily be sold and the home loan debt be settled. The household could then either downscale to a smaller and cheaper home, where its smaller bond costs and lower running costs would become affordable, or it could move into a smaller and cheaper rental home.

And while many of us may think "it will never happen to us", even in these current low interest rate times, our FNB Estate Agent Survey estimates that 13% of sellers are selling in order to "downscale due to financial pressure". That is a significant number, and it was far more significant around the 2008/9 'Financial "Crisis" period.

The big problem here arises when home values fall, because it limits the financially pressured households' ability to "trade out" of their properties. The situation is known as "negative equity", i.e. a situation where the household owes more on the bond than what the home is worth, because the home's value has dropped.

The home can still be sold, but if it can only fetch a lower price, it can mean that there is still some bond debt outstanding.

This is the key reason why banks and homeowners alike would almost always like to see home values rising.

And with the FNB House Price Index still rising year-on-year at 4.9% in August, there would appear little to worry about because home values are rising, right? Well, not quite.

The reality is that the index's pace of inflation has been gradually slowing for over a year-and-a-half, the natural response to a weakening economic growth rate over the past few years as well as rising interest rates.

Whether the index turns to all out decline or not in the near future will depend much on whether the 2nd quarter's contraction in the economy will continue into full blown recession or not, and much of that depends *on outside forces such as China and weak commodity prices.*

But even if the house price index does not decline, important is to understand is that the index represents the national average house price growth trend. When a nation index reaches even low positive growth, the chances are good that there is a portion of homes whose values are in decline, because not all areas perform exactly the same.

Secondly, the probability of home values of household's that do come under financial pressure are more likely to decline, because part of the response to financial pressure/stress is often to cut back on home maintenance, speeding up building depreciation.

And in a weakening economy, which is where we are right now, job security deteriorates and incomes become less secure, raising the chance of financial pressure. On top of this, we are in an interest rate hiking cycle.

It is important that home buyers understand the risks and act accordingly. The usual advice in such times normally goes about limiting borrowing or spending commitments, and there is nothing wrong with that in principle.

We suggest that it goes further than merely limiting the 2 in isolation, but also to consider how certain credit-driven purchases can impact on non-credit driven spending commitments. One can do this by considering limiting the size and value of one's home. The house is the one item that influences spending commitments more than any other single item. The implications extend to home maintenance, the rates and tariffs bill, insurance, and of course all of the furniture, fittings and appliances that we fill our homes up with.

Think about it, the smaller the home, the less space for "stuff" and possibly the less the electricity consumption. The lower the value, the less the rates bill should be (I say "should be"), and the less the "frills such as garden and swimming pool the less the water needs, and of course the less the maintenance needs and insurance costs.

The more we buy a home within our means, with this myriad of future costs in mind, the higher the probability that the home won't exert pressure on our household finances.

This, in turn, heightens the probability that home maintenance can be kept up, and thus reduces the probability that one's home value will fall.

But the positive impact of home maintenance can only go so far. If the market is against you, a home's value can still decline.

This is where there are potential "safety" benefits to buying well within one's means and being able to afford a sizeable "deposit", thereby borrowing at less than 100% loan-to-value, perhaps at 90% of 80%. A lower loan-to-value provides something of an extra safeguard should home values decline, increasing one's chance of being able to "trade out" of a property should tough financial times hit.

People often ask me "is now the time to buy or not"? That's an impossible question to answer. People don't buy homes purely to maximize financial gain. The majority buy homes because they want a place to live in, and don't necessarily want to wait for years for the market to be exactly "right".

But, ***in what appear to be tougher economic and financial times arriving, it appears time for a more conservative home buying approach for many.***

Is a more conservative approach starting to happen yet? For some, the answer would appear, yes, and we see certain hints of this in our FNB Estate Agent Surveys of recent quarter. These signs include a recent decline in the percentage of sellers selling to upgrade to "better" properties, and a rising percentage of sellers selling in order to downscale "due to life stage" (kids have left home and we no longer need such a large and expensive property). In addition, we have seen some decline in the percentage of buyers deemed to be 1st time buyers, as well as in single-status buyers. These often younger buyers can remain in the rental market for a bit longer if need be, or in their family homes. Of the sellers downscaling due to financial pressure, the agents are also starting to indicate that more will "rent down" as opposed to "buying down"

Such an apparent recent shift in home buying/selling patters towards greater conservatism comes at a time when consumer confidence has plummeted. Such a shift currently seems entirely appropriate.

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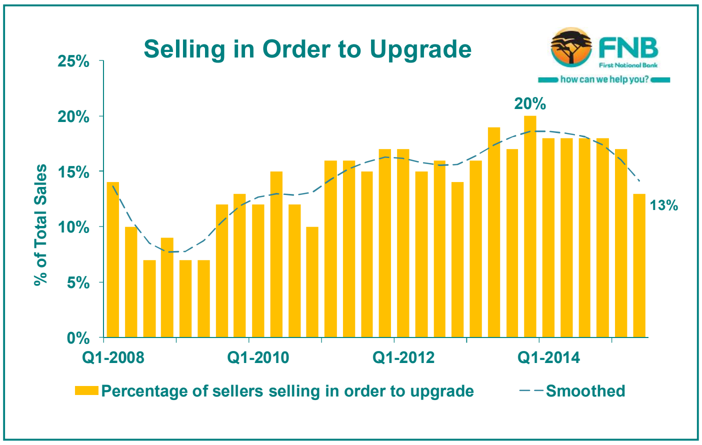
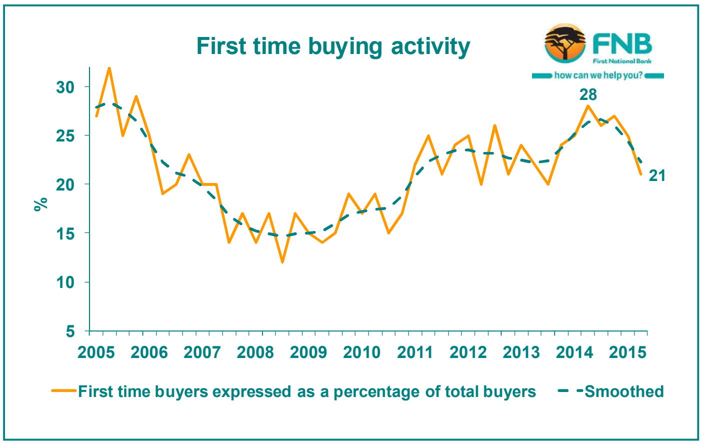
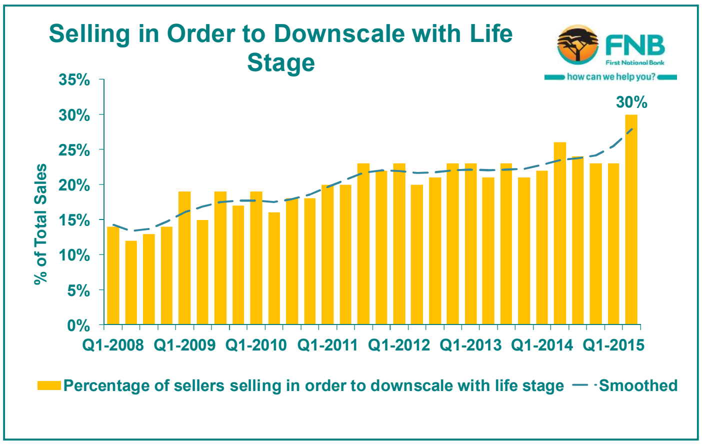
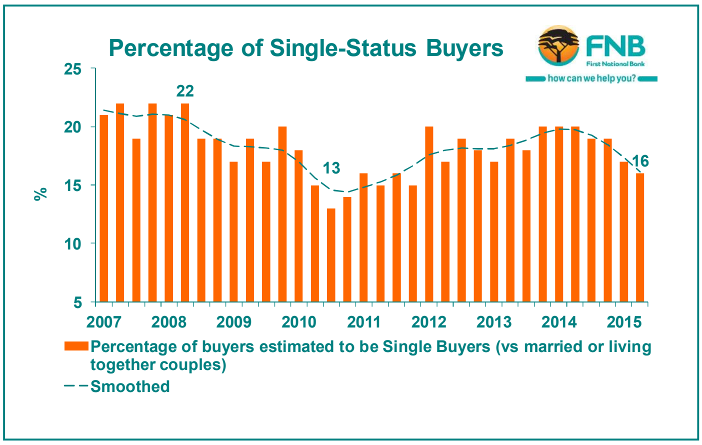
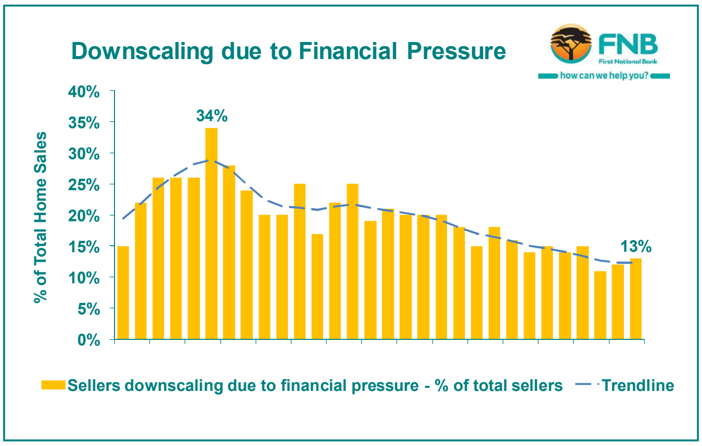
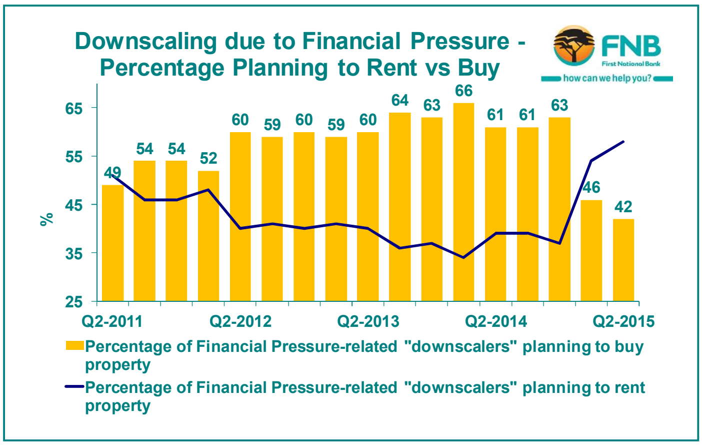

Selling in Order to Upgrade
FNB First National Bank
how can we help you?
25%
20%
15%
10%
5%
0%
% of Total Sales
20%
13%
Q1-2008
Q1-2010
Q1-2012
Q1-2014
Percentage of sellers selling in order to upgrade
Smoothed


First time buying activity
FNB First National Bank
how can we help you?
30
25
20
15
10
5
%
28
21
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
First time buyers expressed as a percentage of total buyers
Smoothed


Selling in Order to Downscale with Life Stage
FNB First National Bank
how can we help you?
35%
30%
25%
20%
15%
10%
5%
0%
% of Total Sales
30%
Q1-2008
Q1-2009
Q1-2010
Q1-2011
Q1-2012
Q1-2013
Q1-2014
Q1-2015
Percentage of sellers selling in order to downscale with life stage
Smoothed


Percentage of Single-Status Buyers
FNB First National Bank
how can we help you?
25
20
15
10
5
%
22
13
16
2007
2008
2009
2010
2011
2012
2013
2014
2015
Percentage of buyers estimated to be Single Buyers (vs married or living together couples)
Smoothed


Downscaling due to Financial Pressure
FNB First National Bank
how can we help you?
40%
35%
30%
25%
20%
15%
10%
5%
0%
% of Total Home Sales
34%
13%
Sellers downscaling due to financial pressure - % of total sellers
Trendline


Downscaling due to Financial Pressure - Percentage Planning to Rent vs Buy
FNB First National Bank
how can we help you?
65
55
45
35
25
%
49
54
54
52
60
59
60
59
60
64
63
66
61
61
63
46
42
Q2-2011
Q2-2012
Q2-2013
Q2-2014
Q2-2015
Percentage of Financial Pressure-related "downscalers" planning to buy property
Percentage of Financial Pressure-related "downscalers" planning to rent property