Registered Credit Bureau

Vacancy Survey

Residential Sector
Q2 | 2017

Special Edition by Guest Writer John Loos, FNB Property Strategist

Rental Market in "mediocre" territory with negative real rental growth. But that has a positive side...

In This Edition:

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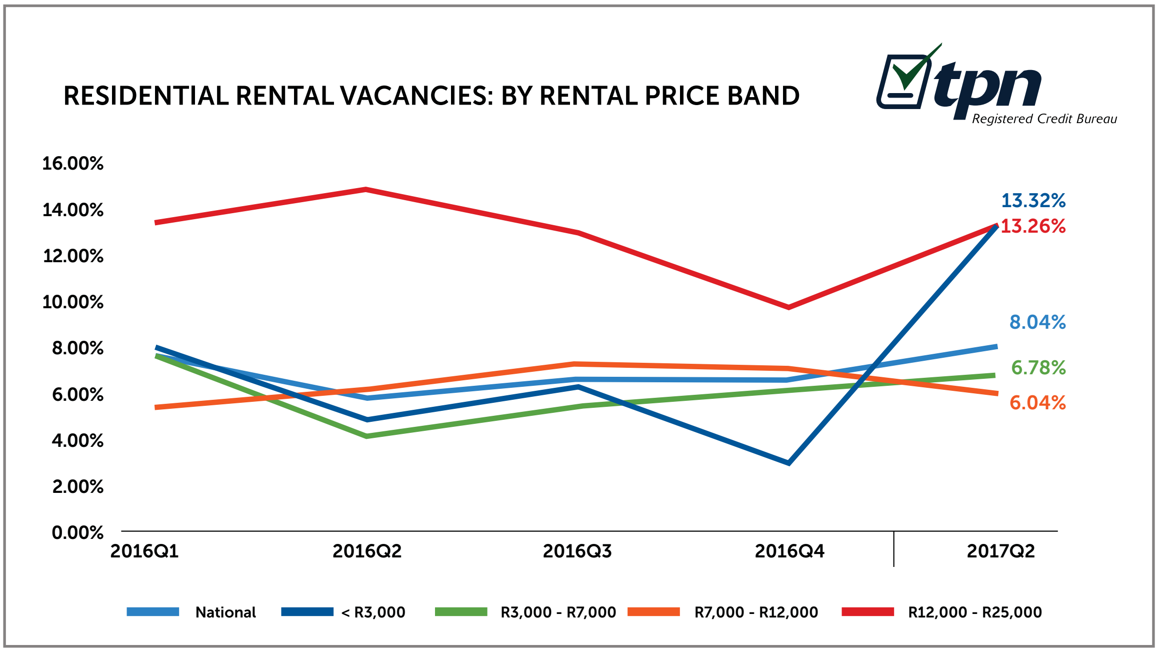
Vacancy Data by Rental Value

The TPN Vacancy Survey asks estate agents and landlords to submit quarterly feedback on how many properties they manage and how many of those managed properties are currently vacant.

For the purpose of this survey, a vacant property is defined as a property which is unoccupied and on the market for immediate occupation.In other words, a property which has not been held back for a reason such as maintenance.

During Q2 2017, 8.04% of residential rental properties were vacant, another increase from the 6.62% in our previous survey.

The TPN Vacancy Survey further categorises vacancy rates by rental price band. The most concerning is the dramatic increase in the vacancy rate for tenants in the below R3,000 per month category at 13.32%. The fact that 13.05% of these tenants' payment behaviour is categorised as "did not pay" helps support the argument that landlords are prepared to hold out for quality tenant placements and that a vacant unit is preferable to a delinquent tenant.

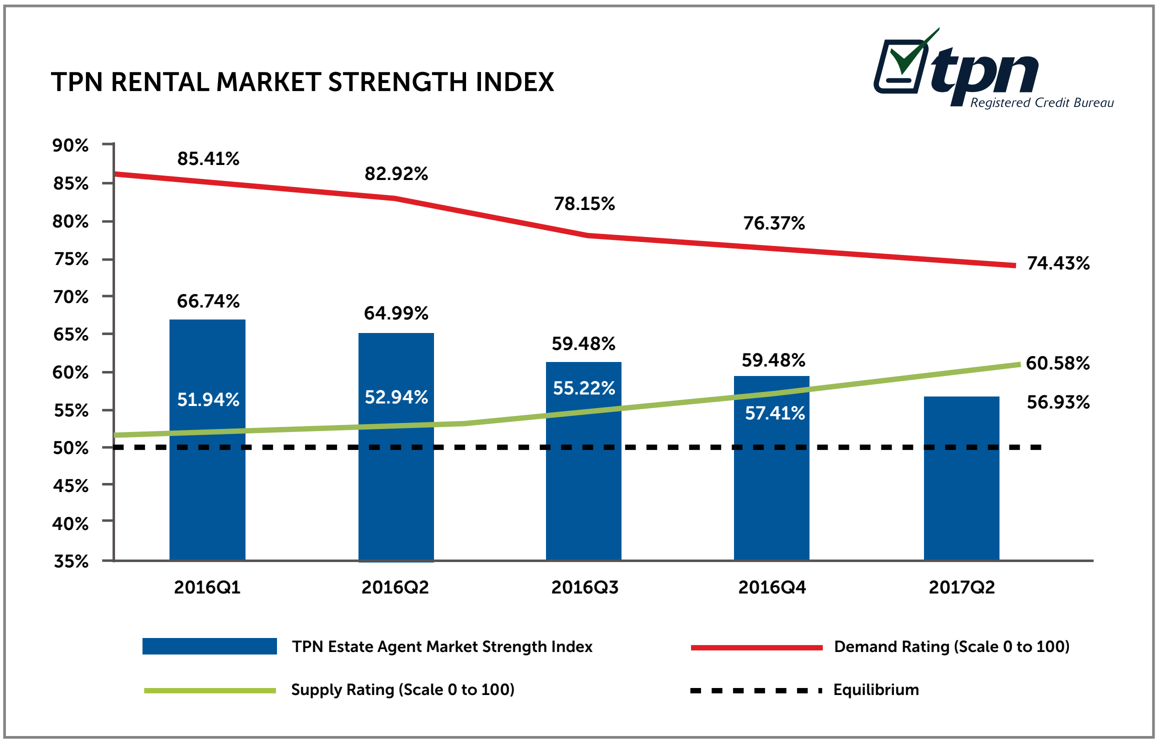


Letting agents perceive a general softening in the balance between demand and supply

TPN surveys a sample of letting agents across the country for their perception of rental market strength in their areas.

We ask them to rate rental demand and rental property supply separately, with 3 answer choices, “strong”, “average” or “weak”. We assign a number to each answer category, “strong” receiving a 100 rating, “average” a 50 and “weak” a zero rating, so that the aggregated response lies somewhere on a scale of 1 to 100. The difference between the Demand Rating and the Supply Rating ((Demand minus Supply)/2) is the TPN Rental Market Strength Index, also on a scale of 0 to 100.

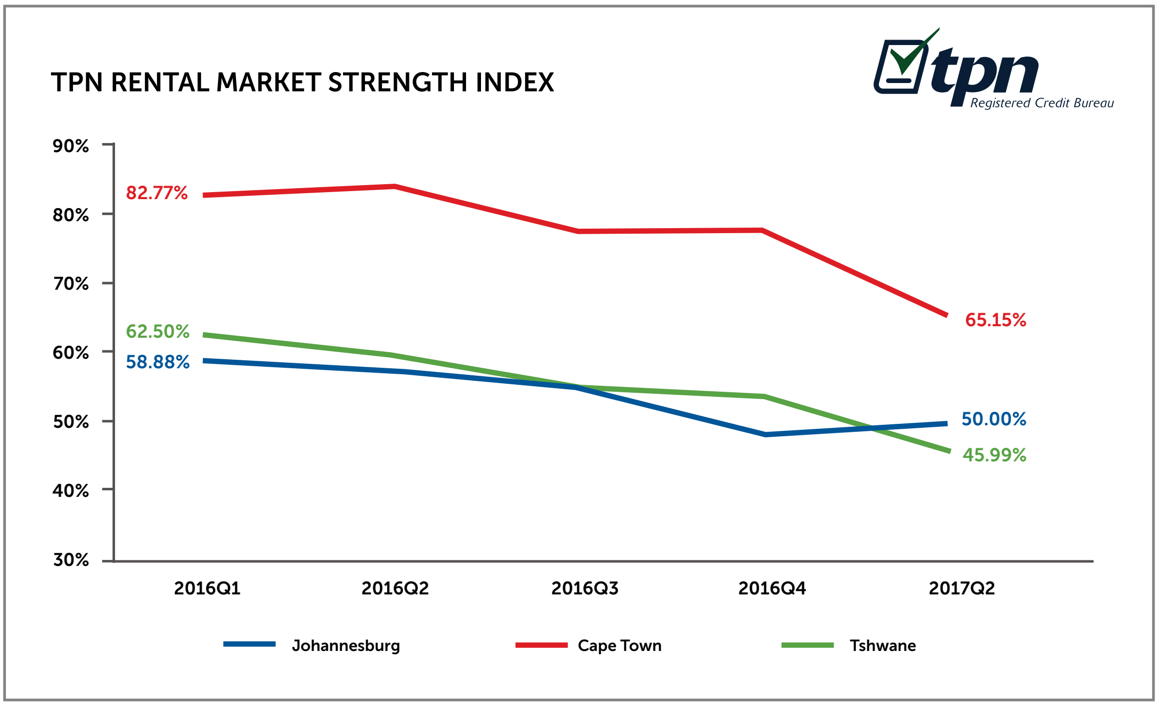
From a level of 66.74 in the 1st quarter of 2016, each subsequent survey has returned a Market Strength Index reading lower than the previous one, reaching 56.93 by the 2nd quarter of 2017. This is the result of a combination of a declining Demand Rating and a rising Supply Rating.

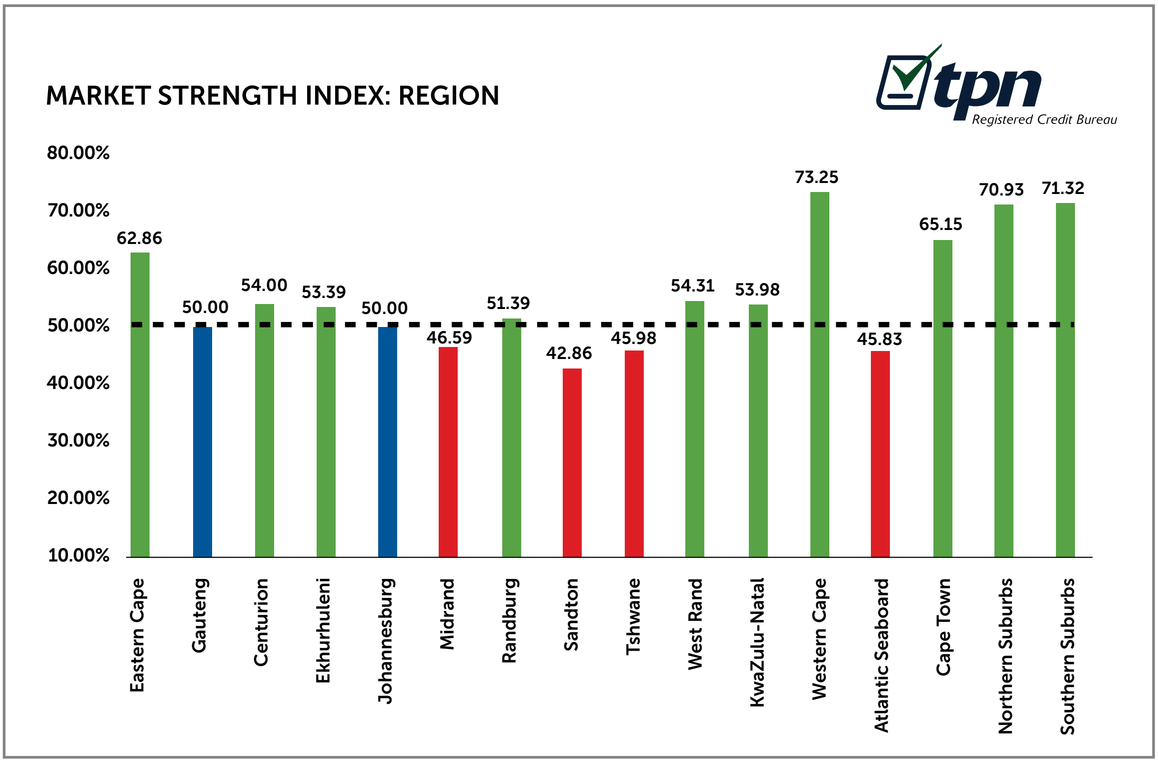


Of 3 of the major metros, i.e. Joburg, Tshwane and Cape Town, the Cape Town Market Strength Index remains by far the highest with a reading of 65.15 in the 2nd quarter of 2017, compared to Joburg’s 50 and Tshwane’s 45.99.

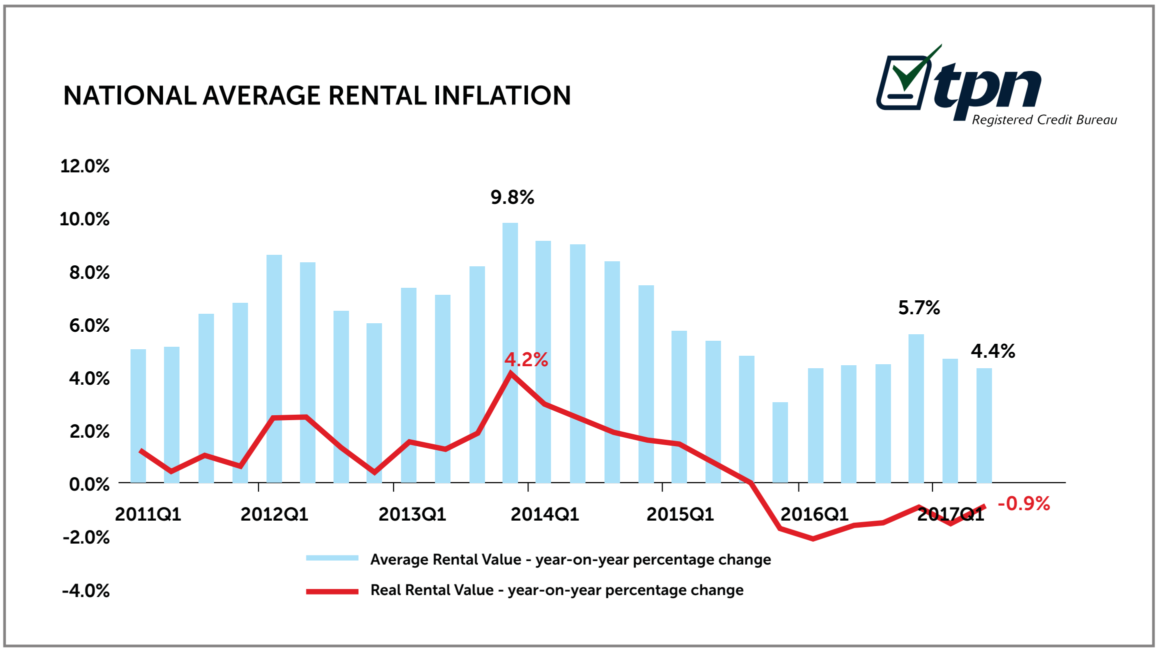
Softening between demand and supply
(continued)

However, off a very high base, the Cape Town Index is declining more noticeably than those of the latter 2 metros, which we suspect is due to that city's mounting affordability challenge after a period of very strong rental as well as house price inflation.





Average rentals across South Africa saw their inflation slow again in Q2 of 2017



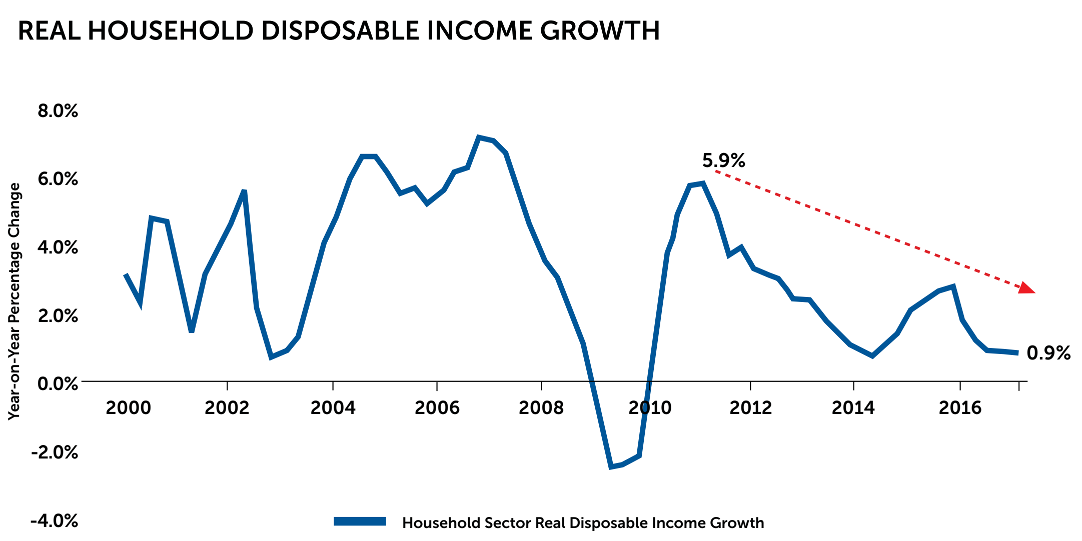
On a national average basis, TPN's average rental value inflated by 4.4% year-on-year in the 2nd quarter of 2017. This represents the second consecutive quarter of slowing year-on-year inflation from a 2.5 year high of 5.7% as at the final quarter of 2016.

This rate of rental inflation is now well-below the 9.8% high point reached in the final quarter of 2013. A broad slowing in economic growth since 2012, and then a period of mild interest rate hiking from early-2014 to early-2016, have arguably served to subdue the rental market in recent times, limiting rental inflation to lower single-digit rates.

In real terms, adjusting for CPI (Consumer Price Index) inflation, the year-on-year rate of change has been in negative territory consistently since the final quarter of 2015, recording a - 0.9% decline in the second quarter of 2017.

Average rentals across South Africa saw their inflation slow again in Q2 of 2017 (continued)

The mild additional pressure on the rental market in recent years has thus been seen in the form of both mild deterioration in tenant rental payment performance since 2014 as well as in the form of considerably more subdued rental inflation since then.



This should hardly be surprising, given that the weak economy and the mild rise in interest rates both exerted substantial pressure on Real Household Disposable Income Growth, which has slowed all the way from a 5.9% year-on-year high at the beginning of 2011 to 0.9% by the 1st quarter of 2017.

There is a good side to slow rental inflation

While landlords will not necessarily be pleased with their lack of "pricing power", a slow rental inflation environment is not all bad. Actual Rentals, and Owner Equivalent Rentals (Derived from Actual Rentals), together are the largest component in the Consumer Price Index, accounting for 17.04% of the overall CPI.

This means that the residential rental market can have a material influence on interest rate movements, given that the SARB (South African Reserve Bank) has an official CPI inflation target of between 3% and 6%. Should the rental market strengthen significantly, it can contribute to upward pressure on interest rates therefore.

There is a good side to slow rental inflation
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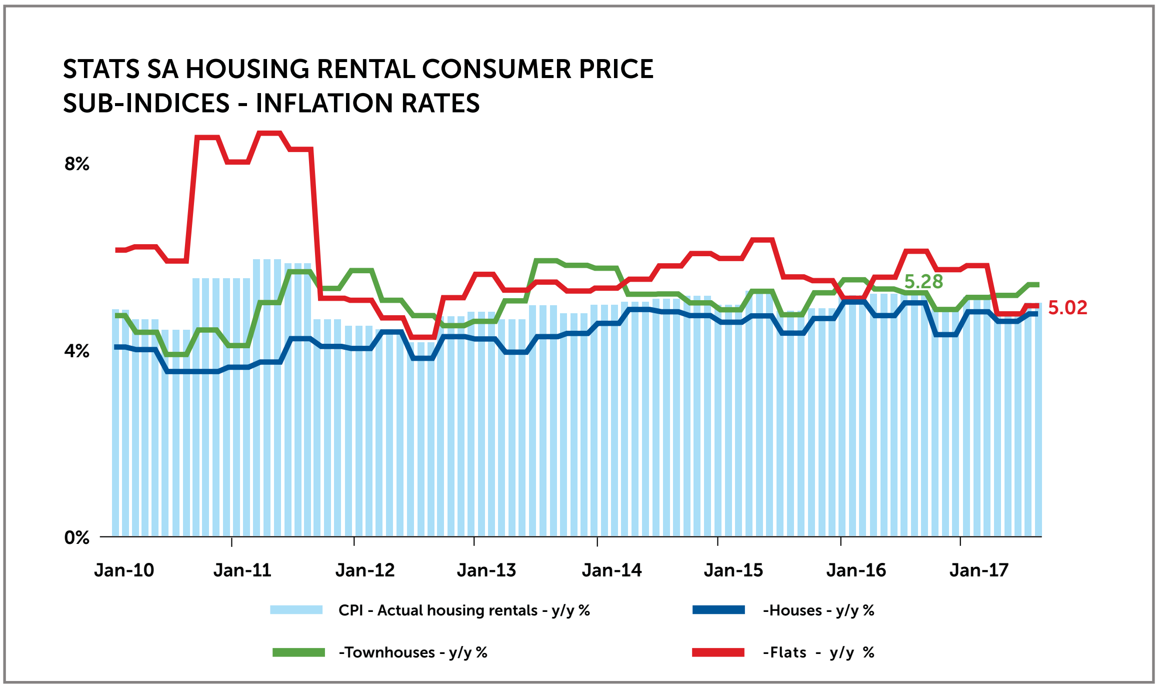
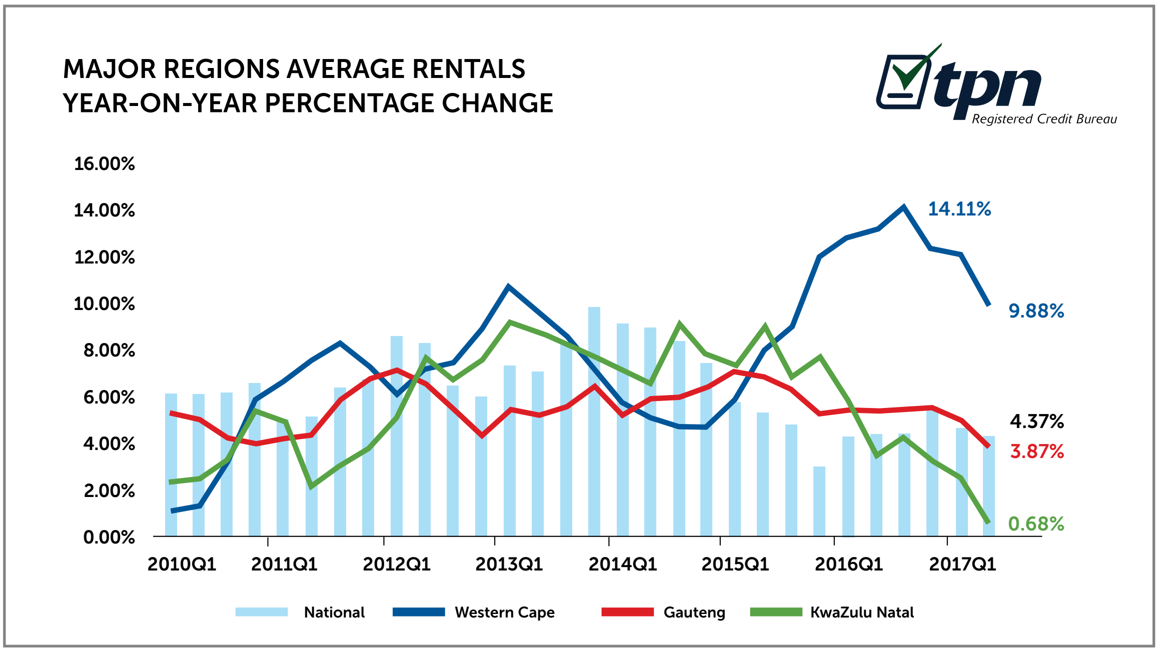


StatsSA's own measure of Actual Rental inflation is different to that of TPN, but its measure also points to rental market mediocrity. Its Actual Rental year-on-year inflation rate of 5.02% is down from a multi-year high of 5.28% reached in 2016. More importantly, though, is that at 5.02%, and Owner Equivalent Rentals inflating slightly slower at 4.92%, CPI rentals don't really exert any meaningful upward pressure on interest rates at present, being firmly within the 3% - 6% inflation target range.

In short, when it comes to the rental market, landlords always have to be careful what they wish for, because a very strong rental market could mean higher interest rates from time to time, meaning that if you have borrowed heavily in order to acquire a buy-to-let home, higher rental inflation could also mean higher costs of servicing one's debt.

Regionally, the Western Cape remains the star performing rental market, although signs of a slowdown are becoming evident



While the national average rental inflation rate has been dragged lower by a broad-based provincial slowing, one province bucked the broad slowing inflation trend until very recently, and this was the Western Cape.

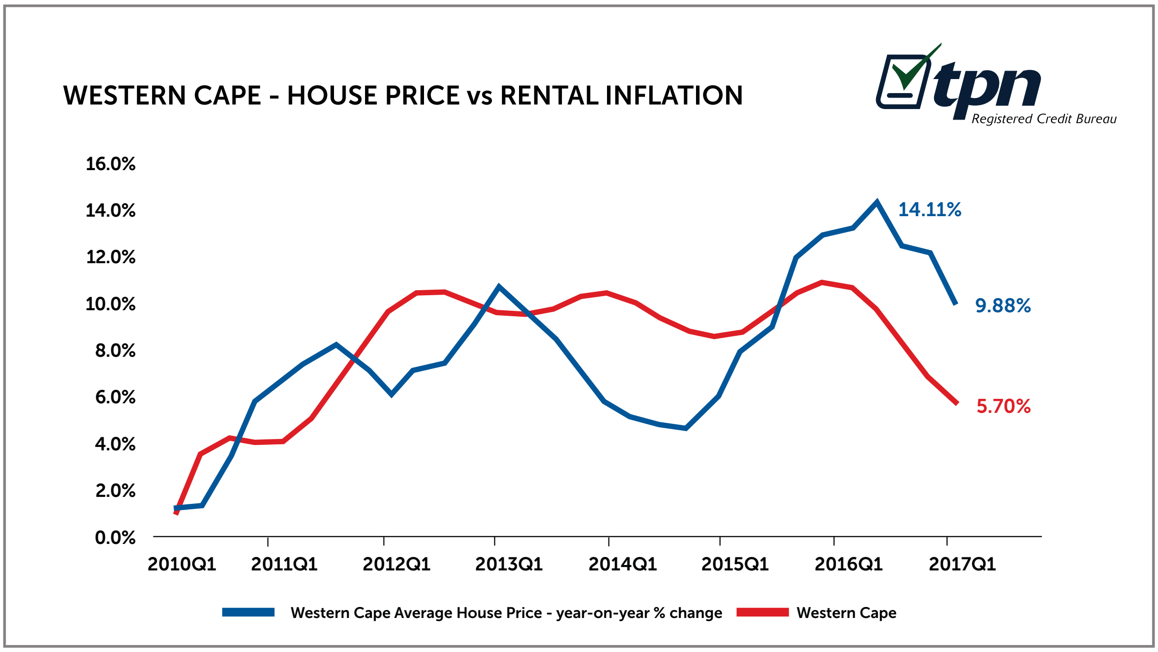
The Western Cape's strong residential buying market has been well-documented in recent years. But perhaps less has been said about its rental market, which has also been very strong recently.

The province has benefited from a strong inflow of middle-to-higher income migrants from elsewhere in the country, while simultaneously lacking in land for new development. Strongly rising home prices, amounting to an affordability deterioration which has been reflected in very low levels of first time buying in the Western Cape, has most probably contributed to a solid increase in rental housing demand, resulting in high rental inflation.

Western Cape remains the star performing rental market (continued)

The Western Cape's year-on-year rental inflation rate peaked at a very high 14.11% in the 3rd quarter of 2016.

However, not only has housing affordability become a challenge in the province, but so too rental property affordability, and after 3 quarters of slowing, the province's rental inflation has reached 9.88%. This remains a very strong rate, but is expected to slow further in the near term along with slowing house price growth.

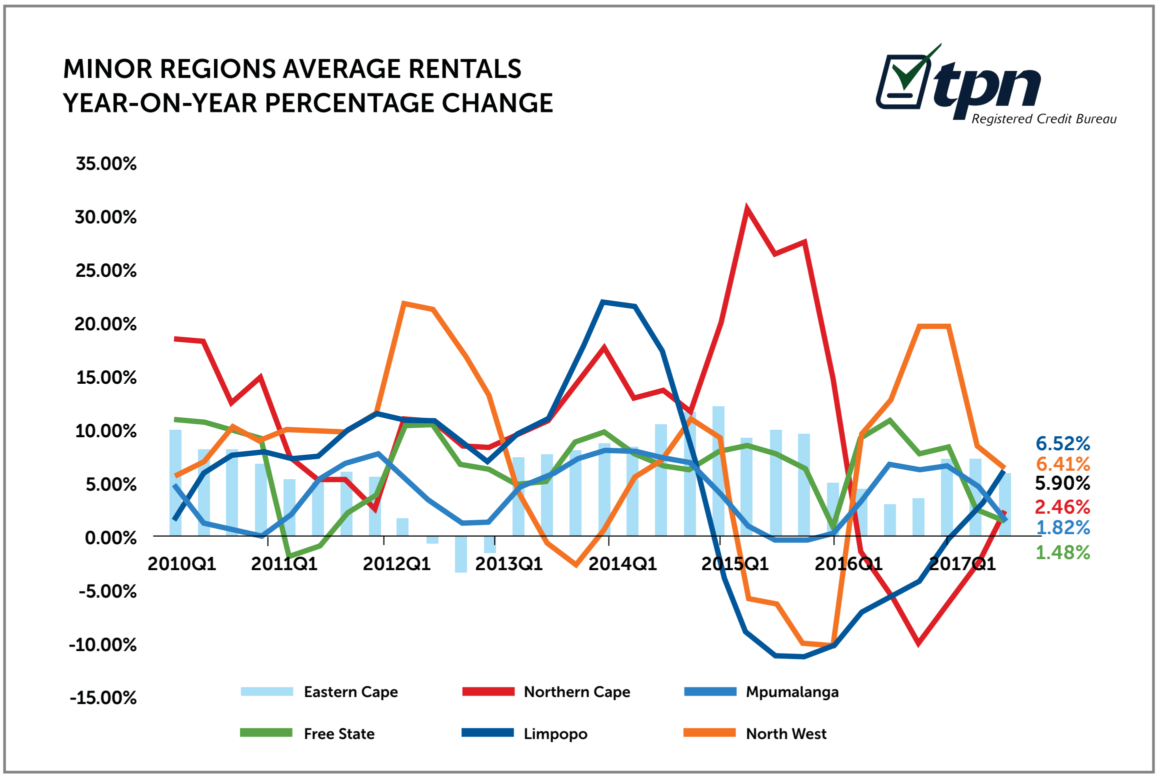


The province's house price inflation rate has slowed to 5.7% year-on-year by the second quarter of 2017, from a multi-year high of 10.8% reached in the 1st quarter of 2016. The home buying affordability deterioration should thus be slowing, albeit not yet an improving affordability situation.

The "weak-link" amongst the major provinces is KZN with rental inflation of a mere 0.68% year-on-year, which may be reflecting of this manufacturing-dependent province hitting a weak economic patch as its major industry suffers in recessionary conditions.

In the remaining provinces, rental inflation is by-and-large mediocre

In the minor 6 provinces ("minor" from an economic point of view), 3 of the 6 took a dip into average rental deflation around 2015 or 2016. These provinces were Northern Cape, Limpopo and North West. It is possible that the slowdown in mining production in these highly mining-dependent provinces took its toll economically. However, all 3 have since seen a return to positive rental growth. For the 6 minor provinces, rental inflation is by-and-large mediocre, the province with the highest rental inflation in the 2nd quarter being Limpopo with 6.52% and the lowest being the Free State with 1.48%.



The 3 minor provinces that saw noticeable average rental deflation through either 2015 or 2016 also have some of the highest Mining Sector exposures of all the provinces relative to the size of their economies. While the Mining Sector contributes 7.9% to national GDP (Gross Domestic Product), in the case of North West Province Mining accounts for 31.2% of its GDP, Limpopo 26.8% and Northern Cape 17.3%. Mpumalanga also has a high Mining percentage to the tune of 23.6% of GDP, but perhaps its large Coal Mining Sector has somewhat more stability given that much of it is supplied to Eskom as opposed to being sold on more volatile global markets, and this could have cushioned the "blow" on the rental market.