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FNB Property Barometer

PROPERTY BAROMETER

Residential Property Affordability Review

Late-2017 saw further national residential affordability improvements, according to the FNB Residential Affordability Indices, and the improving trend probably continued early in 2018

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MARKET ANALYTICS AND SCENARIO FORECASTING UNIT

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Housing affordability improvements continued slowly in the final quarter of 2017, thanks to a weak national housing market.

Both of the 2 key FNB Housing Affordability measures, i.e. the Average House Price/Per Capita Income Ratio Index as well as the Bond Instalment Value on the Average-Priced House/Per Capita Income Ratio Index, saw quarterly declines (improvements) in the 4th quarter. Important related affordability measures such as the Price-Rent Ratio and the all-important Household Sector Debt-Service Ratio have recently also shown further improvement (decline) too.

KEY POINTS

- For both credit-dependent as well as cash home buyers, the broad 2-year improving trend in home affordability continued late in 2017. Both the 2 main FNB Housing Affordability measures showed mild declines in the 4th quarter of 2017, implying some further home affordability improvement.
- The 1st Home Affordability measure, namely the "Average House Price/Per Capita Disposable Income Ratio Index", declined (improved) by -1.1% in the 4th quarter of 2017 after a prior quarter's -0.2% decline.
- The 2nd measure, namely the "Installment Value on a new 100% Bond on the Average Priced House/Per Capita Disposable Income Ratio Index", also declined (improved), to the tune of -1.1% quarter-on-quarter, after a prior quarter's -1.9% decline.
- The ongoing improvements in affordability are likely to have continued in the 1st quarter of 2018, given that very low house price growth of 2.7% in the 1st quarter was unlikely to have kept pace with Nominal Per Capita Income growth.
- The FNB Housing Affordability Ratio Indices remain high by historic standards. We believe that they are still in part reflective of a 5%+ growth SA economy prior to 2008, and not of a far weaker growth economy of recent times. However, emerging signs from the FNB Estate Agent Survey of market strengthening early in 2018 may begin to disrupt the home affordability declining trend during the 2nd half of 2018. But for the 1st half of the year, at least, we still expect to see more declines in the FNB Affordability Indices when the numbers become available.

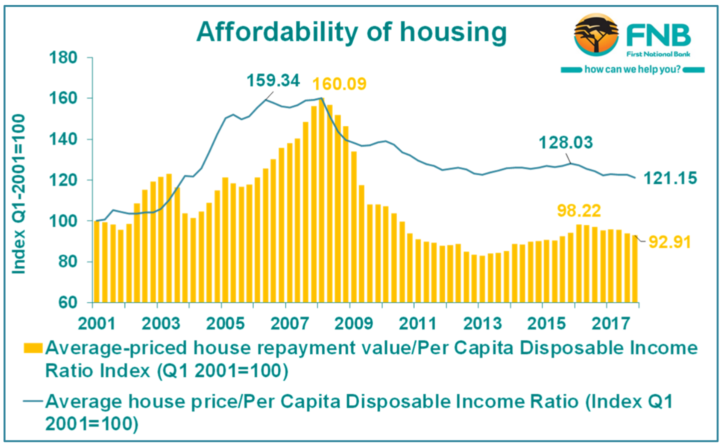
FNB HOME AFFORDABILITY RATIOS

Both of the quarterly FNB Housing Affordability Ratios pointed to further residential affordability improvement in the final quarter 2017.

Mild affordability improvements through last year were a reflection of a weak housing market through 2017, resulting in slow average house price growth that could not keep pace with Per Capita Household Income growth, while interest rates assisted slightly in the 3rd quarter by being lowered by 25 basis points last July.

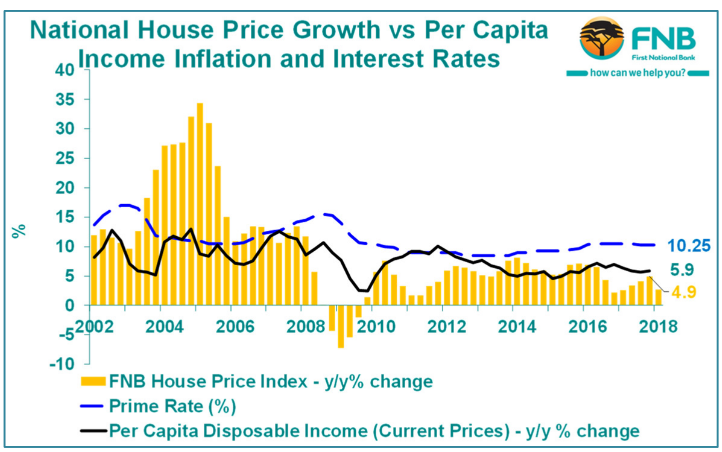
For both credit-dependent as well as cash home buyers, home affordability improved slightly in the 4th quarter of 2017, continuing an improving national affordability trend which has been intact through 2016 and 2017, according to the 2 FNB Home Affordability Indices.

The 1st measure, namely the "Average House Price/Per Capita Disposable Income ratio Index", declined (improved) by -1.1% in the 4th quarter of 2017, following on a -0.2% decline (improvement) in the previous quarter. This continues a broad declining (improving) trend that started in the 1st quarter of 2016. This Affordability Index has declined (improved) cumulatively by -5.4% since its 7-year high reached in the final quarter of 2015



The 2nd affordability measure, namely the "Installment Value on a new 100% Bond on the Average Priced House/Per Capita Disposable Income Ratio Index", also declined (improved) by -1.1%% in the 4th quarter of 2017, after a -1.9% decline in the prior quarter (with the 3rd quarter of 2017 having had the additional affordability benefit of a lone 25 basis point interest rate cut).

This index has been on a broad improving (declining) trend since a 7-year high reached in the 1st quarter of 2016 (the quarter in which the last interest rare hiking cycle ended), and has declined by -5.4% cumulatively since then.



The continuation of the affordability improvements in the 4th quarter of 2017 came as a result of average house price growth underperforming Per Capita Disposable Income of the Household Sector, the former rising by 4.9% year-on-year in that quarter, and the latter by 5.9%. As there were no interest rate movements in the final quarter of last year, both of the FNB Home Affordability Indices declined (improved) by a similar magnitude.

It is likely that this home affordability improving trend continued into the 1st quarter of 2018 too. We say this, because we already have average house price growth for the 1st quarter, which turned out to be a lowly 2.7% year-on-year. This is likely to have once again underperformed Per Capita Income growth in that quarter.

In addition, a further 25 basis point interest rate cut took place in March, further enhancing affordability as we moved towards the 2nd quarter of 2018.

So how affordable is the housing market?

So how "affordable" or "in-affordable" is the housing market? The 2 affordability measures are still vastly improved (down) on their late pre-2008 boom time highs around 2006-2008. The Average House Price/Per Capita Disposable Income Index is -24.3% down on its revised boom time high reached in the 1st quarter 2008, while the New Bond Installment/Per Capita Income Ratio is -42% lower than its 1st Quarter 2008 high point.

On the other hand, though, the House Price/Per Capita Income Ratio Index is still +21.14% above the 1st quarter 2001 "pre-boom" level, so it is still far from "cheap". But keeping property values still "temporarily" comparative, affordability-wise, to early-2001 has been a period of abnormally low interest rates in recent years, which has meant that the Loan Instalment/Per Capita Disposable Income Index is actually -7.1% below (more affordable than) the 1st quarter 2001 level.

South Africa's currently low interest rates thus continue to assist in sustaining the relatively high real house price levels (by SA's historic standards) that we currently experience.

SECTION 2: OTHER KEY AFFORDABILITY MEASURES RELATED TO HOUSING

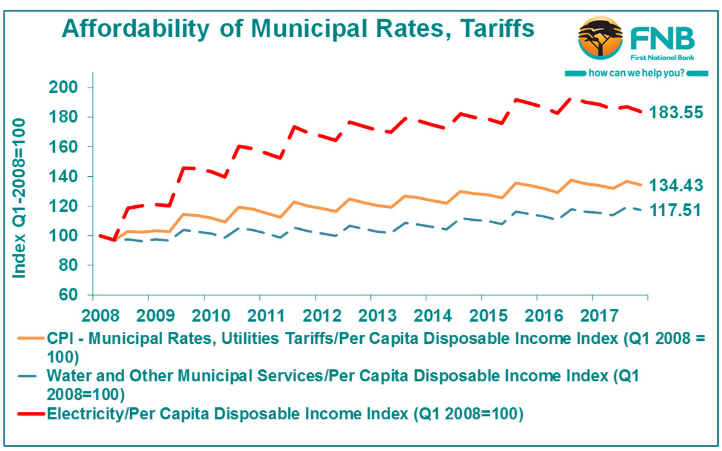
THE HOME RUNNING COST-RELATED AFFORDABILITY PICTURE

Estimates of home running cost-related affordability

One good news development for home owners has been a significant slowdown in the rate of inflation of electricity tariffs, with NERSA not allowing Eskom its extreme tariff hikes of prior years.

In this section, we consider measures of affordability that are related to the home, i.e. those that are running cost related, and to this effect we use components of the CPI (Consumer Price Index) to construct an affordability index for Municipal Rates and Tariffs, along with an index for Maintenance and Repairs Costs.

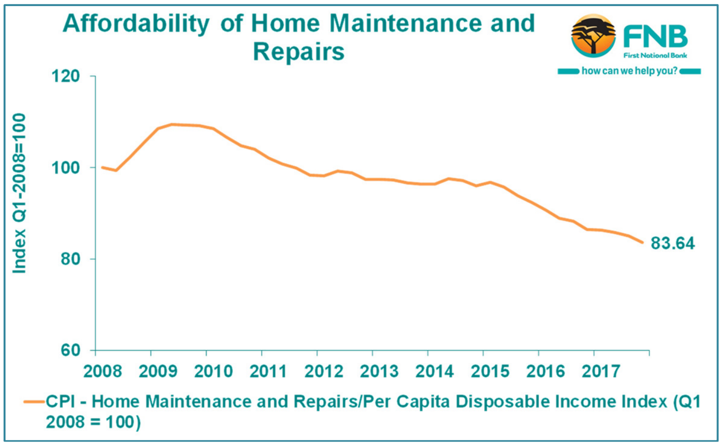
The "Municipal Rates and Tariffs/Per Capita Disposable Income" Index has moved higher through the 2008-2017 period. This affordability measure has deteriorated (risen) by 34.43% from the beginning of 2008 to the 4th quarter of 2017.



Major upward pressure has been exerted on this index by high inflation in the area of electricity tariffs, but moderated in part by less extreme Municipal Rates and Non-Electricity Tariffs cost inflation. The Electricity Affordability component has been the most troublesome part of the Rates and Tariffs bill, and its affordability index escalated (deteriorated) by a massive 93.4% from the beginning of 2008 to the 3rd quarter of 2016, on the back of major multi-year Eskom tariff hikes. This alarming rate of increase has since moderated, however, and this Electricity Affordability Index ended 2017 a lesser 83.55% up on the beginning of 2008 level.

The Water and Non-Electricity Tariffs/Per Capita Disposable Income Index has risen (deteriorated) by a more moderate 17.51% from 2008 to the 4th quarter of 2017.

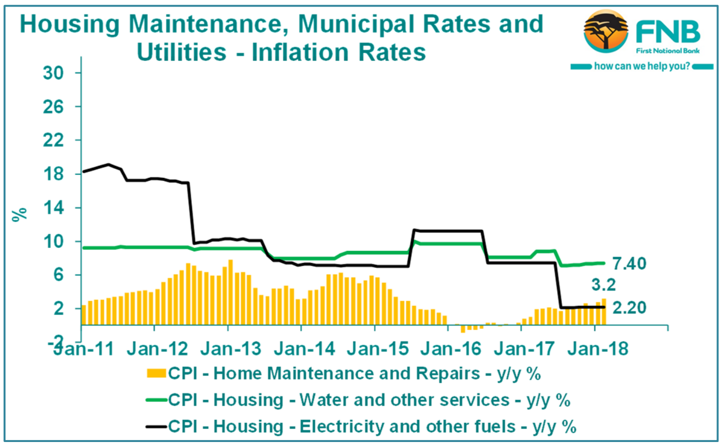
The Home Maintenance and Repairs/Per Capita Disposable Income Index, however, has actually declined by -13.4% over the period.



Of late, the CPI (Consumer Price Index) for Electricity and Other Fuels shows relatively low year-on-year inflation of 2.2%, while the CPI for Water and Other Services (includes assessment rates) appears more "troublesome" at a higher 7.4% rate.

The CPI for Home Maintenance and Repairs measured a lowly 3.2% in February, having been in low single digits ever since emerging from a period of mild deflation back in 2016.

This pricing weakness in the Maintenance and Repairs market is possibly due to a partial "crowding out" of this economic sector by municipalities and utilities with their extreme tax/tariff hikes.

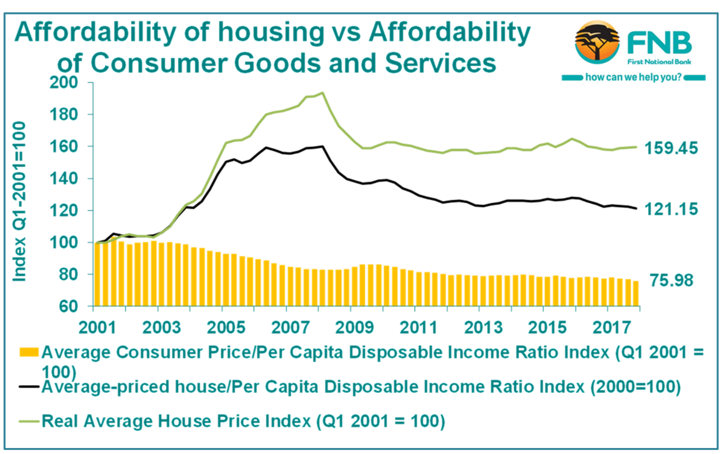


COMPETITOR PRODUCT AND RELATED AFFORDABILITY

Real House Prices

It is also important to consider the "price competitiveness" of housing versus consumer goods and services that in part compete with it for a share of household disposable income.

Relative to where we started back in 2000, at the start of the housing and consumer booms, housing remains significantly worse off today. Limited housing supply back in those boom years, when demand surged, led to massive house price growth and resultant affordability deterioration. By comparison, affordability of consumer goods and services continued to improve throughout the boom years, with especially the importable consumer goods not experiencing major supply constraints and resultant price inflation surges during demand booms.



Therefore, despite the Average House Price/Per Capita Disposable Income Index (Q1 2001 = 100) being significantly down on its late-2007 high, by the 4th Quarter of 2017 it still sat at 121.15, 21.15% up on the 1st quarter of 2001, while the Average Consumer Price/Per Capita Disposable Income Index (Q1 2001 = 100) had dropped as low as 75.98 (thus -24.02% down on its 1st quarter 2001 level), having never really risen in the boom years of 2000-2007.

Thus, over the boom years, housing lost major ground on consumer goods and services in terms of relative affordability, and never fully "recovered". This "loss of ground" over time is in part addressed by the longer term move towards building smaller-sized residential units on smaller-sized stands.

So, when we use the PCE (Private Consumption Expenditure) Deflator to deflate house prices into real terms (with Q1 2001=100 for the Real House Price Index), we see that the Real FNB House Price Index is still a massive 59.45% higher than in early-2001, as at the 4th quarter of 2017.

Since the 4th quarter 2015 post-boom (referring to pre-2008 boom) high point in real house prices, we have seen some real price decline, cumulatively to the tune of -3.2%. However, the declining real price trend has stalled in recent quarters, with consumer price inflation also very low in recent times, and the 4th quarter real house price level actually rose slightly by +0.2% quarter-on-quarter (when using the PCE Deflator measure of consumer prices).

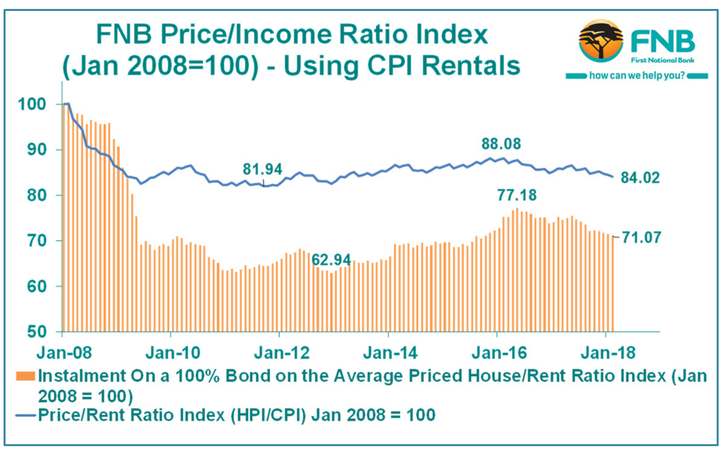
House Price-Rent Ratio off its late-2015 high.

The House Price-Rent Ratio is one important ratio in determining how costly the home buying option is relative to the competing option, i.e rental.

Analysts often become concerned when the Price-Rent Ratio is very high, as it can begin to make the rental option very appealing, contributing at some stage into a drop in home buying and a fall in house prices.

House price booms, or strong market periods at least, typically take this ratio higher.

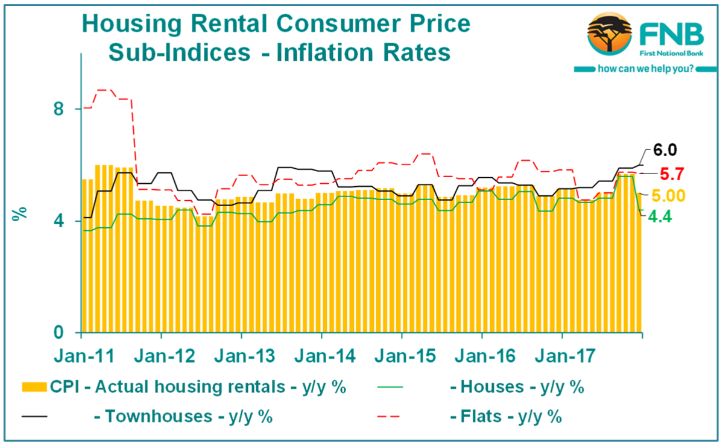
To this effect, we use the FNB House Price Index and the CPI for Actual rentals to monitor this ratio. We show it in index form (because the CPI is an index), with January 2008=100.



Since around the start of a slowing in the residential market late in 2015/early in 2016, there has been some noticeable progress in the lowering of the Price-Rent Ratio Index. From a post-2008/9 recession high of 88.08, reached in February 2016, the index has declined cumulatively by -4.6% to an 84.02 level in February 2018.

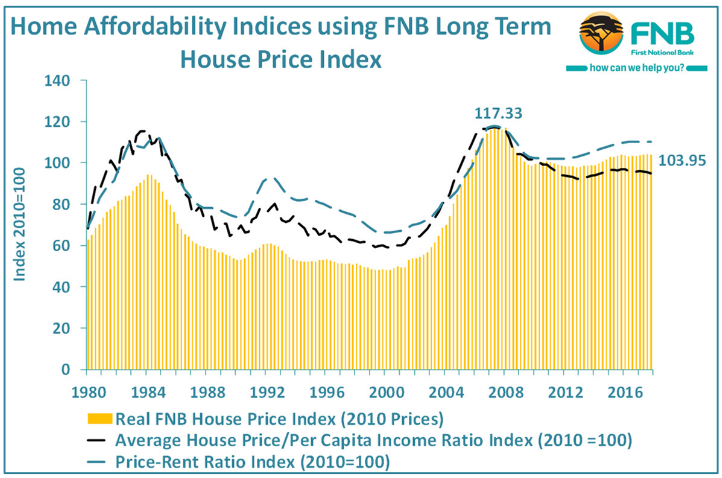
While 84.02 is believed to still be a high number, albeit -16.98% down on January 2008, the other important ratio, i.e. the Instalment on a 100% bond on the average-priced house/Rent Ratio Index, remains somewhat lower of late, at a level of 71.07 (January 2008 = 100), -28.93% down on January 2008, assisted by significantly lower lending rate levels than those in 2008. Since its post-2008/9 recession high of 77.18 reached in May 2016, this index has also made some progress, declining cumulatively by -7.9%, helped lower not only by weak house price growth but also by a 25 basis point interest rate reduction in July 2017.

The Price-Rent and Instalment-Rent Ratio Indices have thus also made some improvement over the past 2 years or so.



Recently, average year-on-year house price growth has been running noticeably slower than 5% year-on-year rental inflation as at February 2018 (as measured by StatsSA), sustaining the lowering of the Price-Rent Ratio.

In order to give a longer term perspective of the level of the Price-Rent Ratio, we have used 2 different quarterly series, namely our FNB Long Term House Price Index (compiled from Deeds data) and a long term rental estimate using SARB Household Consumption data for actual and imputed rentals.

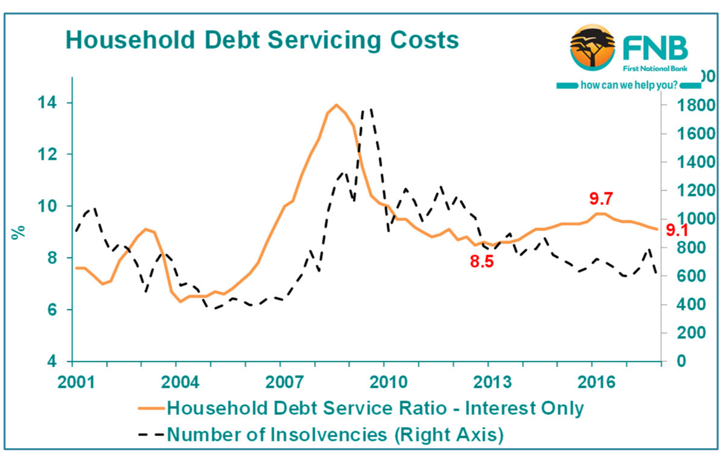


A multi-decade high was reached late in 2007 at the back end of the boom period, and while the most recent level of this index is -6.6% down on the 2nd quarter 2007 multi-decade high point, it remains relatively high by historic standards at +66.4% higher than the multi-decade low point reached in the final quarter of 1999. We thus still see the Price-Rent Ratio Index as relatively high.

The affordability of servicing existing debt

Finally, there is the matter of credit affordability, which is a function of the value of credit outstanding, the level of disposable income, and the prevailing level of interest rates.

The best measure of the affordability of Household Credit is the Debt-Service Ratio (The cost of servicing total household sector debt, expressed as a percentage of Household Disposable Income).



In the 4th quarter of 2017, we saw a Debt-Service Ratio of 9.1 being slightly lower than the previous quarter's 9.2, but more significantly lower than the 9.7 multi-year high reached in the 2nd quarter of 2016, just after the last interest rate hiking cycle had peaked.

The decline (improvement) in the Debt-Service Ratio since 2016 was due in part to a lone 25 basis point interest rate cut in July 2017, but more significantly due to further decline in the level of Household Sector indebtedness as measured by the Debt-to-Disposable Income Ratio. This ratio has been declining gradually for 10 years, from an all-time high of 87.8 as at the 1st quarter of 2008 to 71.2 by the final quarter of 2017

CONCLUSION

FNB's 2 major Housing Market affordability Indices continued to show improvement (decline) in the final quarter of 2018, assisted by weak national average house price growth. Average house price growth for 2017 as a whole was only 3.8%, underperforming Per Capita Income growth significantly.

Moving into 2018, we believe that the home affordability improving trend of the past 2 years or so is likely to have continued, with average house price growth for the 1st quarter of 2018 being a mere 2.7%. Then, in March, came a further 25 basis point interest rate cut by the SARB, which should assist affordability improvement mildly further in the 2nd quarter of this year.

However, it is conceivable that the improved home affordability trend could stall in the 2nd half of this year. We are of this view because the signs have been emerging recently of significantly improved domestic sentiment, and a noticeable rise in our FNB Estate Agent Survey Activity Rating in the 1st quarter, especially in the major Gauteng region. This could translate into faster house price growth, possibly even slightly above 5%, which would be close to Per Capita Income growth, Such an even would virtually stop the declining trend in the 2 home affordability indices, while our forecast of no further interest rate cuts from here on would not assist the Instalment/Per Capita Income Ratio Index's decline any further either.