January 2020

Q4 Property Barometer.

+3.5% y/y FNB HPI | **+0.1%** m/m FNB HPI | **3.6%** y/y FNB HPI (annual ave.) | **49.4** FNB Valuers' Market Strength Index

SA residential property market review and outlook

Muted house price growth in 2019; demand-supply gap narrowing

The FNB HPI was unchanged at 3.5% y/y in December, taking the average annual house price growth to 3.6% y/y for 2019, from 3.8% y/y in 2018. This is marginally above our forecast of an average annual growth of 3.5% y/y. After a slow start to the year, the combination of a mild improvement in demand, progressive mortgage lending as well as attractive market pricing supported the residential property market in 2H19. Nevertheless, depressed labour markets continue to weigh on household finances, which poses a threat to sustained demand growth. Market strength indicators continue to show a narrowing demand-supply gap, which may have provided support to house price growth in 2H19.

Area value bands suggest that pressure persists in the "affluent" areas, while low-income areas have remained resilient. This is due, in part, to the divergent demand-supply trends in the respective segments. In 3Q19 higher-priced areas (areas whose average purchase price corresponds to the top 20% of the price distribution) averaged -0.5% y/y, while low-income areas (areas whose average purchase price is in the bottom 20% of the price distribution) averaged 16.7% y/y. Sellers in the upper end have constantly had to reduce their asking prices to close the deal, while low-income areas are also supported by robust buy-to-let activity.

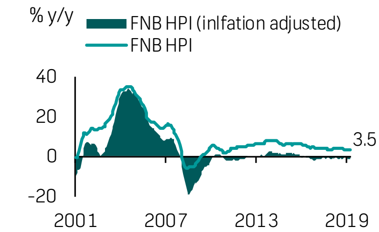
Below we summarise key themes that shaped market performance in 2019 and will likely continue to have an impact this year.

Five key themes that shaped market performance in 2019

1. Market activity in the bottom end

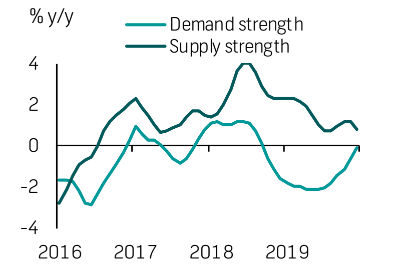
The FNB Estate Agents Survey shows market activity as relatively buoyant in the lower end of the market. Part of this activity is aided by significant cash transactions, as well as robust buy-to-let activity. The survey shows that in 2019 a property had an average of around 13 enquiries and approximately 6 weeks on the market before it was sold. By contrast, the "conventional" market averaged 9.5 viewers and approximately 15 weeks on market for sale. Stronger demand

Figure 1: FNB HPI



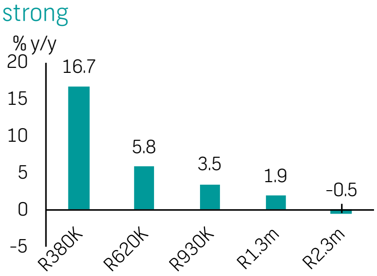
Source: FNB Economics

Figure 2: Narrowing demand-supply gap



Source: FNB Economics

Figure 3: 3Q19 – Bottom end still going strong



Source: FNB Economics

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was recorded in the R250k–R500k price bucket, with 16 viewers per showroom and a duration of 5 weeks and 6 days on the market. Part of this strong demand is due to robust buy-to-let activity, which is estimated to account for over 25% of total transactions. There are also strong cash transactions volumes in these segments, partly due to this strong investor participation. The combination of these factors propels property prices in these segments, and invariably erodes affordability of low-income earners.

2. Constructive lending and attractive prices propping the market: But for how long?

Despite the challenging macroeconomic environment, transactions volumes trended up in 2019, in line with the recent upswing in mortgage lending which outpaced house price growth. According to data from the SARB, mortgage advances grew at a progressively faster pace throughout 2019, reaching 5.0% y/y in November. Year-to-date (November is currently the latest data point) the value of mortgage advances has growth by 4.8% – the highest growth in a decade (since 2009). Furthermore, the loan-to-price (LTP) ratio increased to 91.2% in 3Q19, suggesting that lenders are progressively asking for smaller deposits from prospective buyers. A breakdown of the data shows that much of this upsurge, however, was more in the middle to upper segments, with lending to the lower end remaining relatively conservative. Anecdotal evidence also suggests that the intensified competition among lenders pushed mortgage interest rates lower.

As such, not only did buyers get discounts on market prices (due to the market favouring buyers), with over 95% of sales finalised at prices below initial asking price, but lenders also offered attractive interest rates on mortgages (due to increased competition) – thereby boosting affordability. However, sustainable long-term improvements in affordability (and demand) will have to be driven by income growth. Concerningly, our forecasts do not suggest a strong recovery in income growth. This threatens the sustainability of the support offered by constructive lending on the market.

3. Holiday home buying rising in Durban

Data from the FNB Estate Agents Survey shows that while holiday home buying remained relatively muted in 2019, Durban received increased interest. Data shows holiday home buying to have nudged up to 2.5% (of the total property transactions, nationally) in 4Q19, after a recent low of 2.3% in 1Q19. The marginal improvement could also have been supported by easier lending standards, particularly in 2H19. Nevertheless, this is still below the historical average of 2.7% (since 2007) as well as the recent peak of 3.5% in 1Q18. Interestingly, holiday home buying appears to be migrating away from Cape Town and towards Durban. This could be attributed to the relatively better price points relative to Cape Town. Notwithstanding, holiday home buying in Cape Town remains robust, assisted by the recent downward price adjustment in the affluent regions.

4. Supply of new stock adjusting lower (but emigration-related sales still robust)

Stats SA data shows a massive surge in the supply of new residential units in 2019, particularly of sectional title units. Year-to-October, volume of new units was 67% higher than the corresponding period in 2018. Furthermore, there has been a noticeable shift from freehold properties to more sectional titles in the last two to three years, with the latter now accounting for around 60% of new build units. This is significantly above the 30% historical average since 2000. This is mainly driven by changes in consumer preferences (i.e., SA buyers across all income groups have become more security conscious) as well as increased densification. A disaggregation of the data shows the upsurge in supply to be mainly concentrated in Gauteng. Some of what is reported in the Stats SA numbers, however, could be attributed to a suspected backlog in the approval process in the City of Johannesburg. However, anecdotal evidence, particularly the rising flat vacancy rates and muted rental inflation (more on this below), suggests that the balance of demand-supply is indeed tilted towards oversupply.

Looking ahead, pipeline supply (volume of new residential units in the planning stage) has retreated, presumably in reaction to subdued demand. This gives tentative signs that actual supply of new stock will likely decline in the coming months, which should help the overall market stabilise.

5. Rental market reflects subdued demand in the economy

Data up to 3Q19 showed muted rental CPI, which has helped put a lid on overall inflation. Lower rental escalations were recorded across all major provinces in 3Q19, except in KZN. Data further reveals that rental inflation is still the highest in the Western Cape, at 6.6% y/y in 3Q19 versus 1.8% in Gauteng. We believe the Western Cape rental market is being supported by the lower price segments in Cape Town, while pressure persists in the upper end. This pressure will likely continue filtering down, which should see rental inflation in Cape Town (and consequently the Western Cape) continue trending lower. This should help contain overall rental inflation in the coming quarters.

Overall the downward trend in rental CPI reflects muted demand as well as the surge in the supply of new flats, which, according to our market strength index, are currently in excess supply. This is evidenced by high (by historical standards) vacancy rates, which averaged 5.5% in 4Q19, according to Rode and Associates' data.

We maintain our view that rental inflation will trend lower in the near term, and will likely start improving in the second half of 2020, in line with a soft uptick in growth as well as our expectations of supply adjustments (new build stock). Nevertheless, given the uninspiring outlook on employment growth, we expect rental inflation to remain relatively low throughout the forecast horizon.

Outlook for 2020

South African economic growth is expected to remain muted over the forecast horizon, weighed on by the weak fiscal position, weak labour markets impacting negatively on income growth and therefore consumers' spending power, as well as fragile business confidence. Concerningly for households, and as hinted in the October mini-budget statement, higher taxes could be on the cards. These could come in the form of bracket creep or higher tax rates, or a combination of both. This could exert further pressure on disposable income, and thereby consumer demand. Positively, however, inflation is expected to be relatively benign, with a possibility of one more 25bps rate cut by the SARB on the horizon. This should provide marginal support to consumers' discretionary income. Our expectation is for real GDP growth to lift slightly to 0.9% in 2020, from a low 0.3% estimated for 2019.

For the residential property market, we expect broader economic developments, especially employment growth, to continue dictating the longer-term trends. Positively, demand (for mortgages) has shown mild signs of improvement across all price segments. At the same time, some sellers withdrew their properties on the market for resale amid unfavourable selling conditions. This has somewhat curtailed the pace of supply. Nevertheless, there is still robust supply of new stock, as well as emigration-related sales. On the other hand, inbound demand (i.e. from foreigners buying property in South Africa as well as from South African expats buying property locally) remains comparatively subdued. As mentioned above, supply of new stock is expected to continue correcting, and adjusting to lower demand levels.

More positively, mortgage advances have been progressive in recent months and LTPs have been rising. This has helped inject liquidity in the market. However, these benefits have mainly accrued to the higher-priced segments, with lending in the lower end remaining broadly conservative. Given our expectation of muted disposable income growth, this support will likely wane as 2020 progresses. We forecast average annual house price growth of 3.7% for 2020, which is still below our inflation forecast of 4.3% in the same period. House prices will be weighed on mainly by tepid disposable income growth, as well as low sentiment levels. Marginal support will come mainly from lower interest rates as well as the ongoing readjustment in supply of new build stock.

Monthly FNB House Price Index (%y/y)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2001		-1.7	-0.7	-0.4	-0.5	0.7	3.0	5.9	8.6	10.6	11.6	11.8
2002	11.6	12.0	12.8	13.8	14.2	14.0	13.6	13.1	13.2	13.5	13.8	13.8
2003	14.0	14.5	15.3	16.2	17.1	18.2	19.3	20.3	21.4	22.9	24.7	27.0
2004	29.4	31.3	32.4	33.2	33.7	33.9	34.5	35.1	35.3	35.2	35.3	35.4
2005	34.8	33.8	32.9	31.8	30.7	29.7	28.8	27.9	26.9	25.7	23.9	21.7
2006	19.9	18.5	17.6	17.3	17.3	17.2	16.9	16.5	15.8	15.1	14.4	14.0
2007	14.0	14.3	14.9	15.7	16.3	16.6	16.3	15.5	14.5	13.2	12.0	11.0
2008	9.7	8.0	5.5	2.5	-0.4	-2.9	-4.7	-5.6	-5.8	-5.6	-5.1	-5.1
2009	-5.0	-5.0	-4.5	-3.8	-2.8	-1.8	-0.7	0.0	0.5	0.9	1.2	2.0
2010	3.0	3.9	4.6	5.2	5.6	5.5	5.0	4.7	4.5	4.1	3.7	3.1
2011	2.4	2.1	2.0	2.2	2.5	2.8	3.3	3.6	3.8	3.9	4.1	4.4
2012	4.7	4.8	4.8	4.7	4.6	4.7	4.9	5.2	5.6	5.7	5.8	5.8
2013	5.9	6.0	6.1	6.1	6.1	6.3	6.5	6.4	6.3	6.5	7.0	7.7
2014	8.2	8.3	8.2	8.3	8.4	8.3	8.0	7.8	7.6	7.2	6.8	6.2
2015	5.8	5.9	6.3	6.5	6.6	6.4	6.3	6.2	6.1	6.2	6.3	6.3
2016	6.3	6.2	6.1	6.0	5.9	5.8	5.7	5.6	5.4	5.1	4.8	4.8
2017	4.9	4.9	4.7	4.4	4.2	4.1	4.1	4.2	4.2	4.2	4.2	3.9
2018	3.3	3.1	3.3	3.6	3.9	4.1	4.1	4.0	4.1	4.2	4.2	4.2
2019	3.9	3.3	3.4	3.4	3.3	3.5	3.6	3.7	3.8	3.7	3.5	3.5

Forecast

FNB SA Economic Forecast

Economic Indicator	2016	2017	2018	2019f	2020f	2021f
Household consumption expenditure %y/y	0.6	2.1	1.8	1.2	1.4	1.7
Government consumption expenditure %y/y	2.2	0.2	1.9	1.1	1.1	1.2
Gross fixed capital formation %y/y	-3.5	1.0	-1.4	-1.4	0.4	0.9
Real GDP %y/y	0.4	1.4	0.7	0.3	0.9	1.2
Total exports %y/y	0.4	-0.7	2.6	2.1	1.4	2.2
Total imports %y/y	-3.9	1.0	3.3	2.0	2.0	2.0
Current account (% of GDP)	-2.8	-2.5	-3.5	-3.3	-3.6	-3.7
CPI (average) %y/y	6.3	5.3	4.6	4.1	4.3	4.5
CPI (year end) %y/y	6.7	4.7	4.5	4.1	4.4	4.4
Repo rate (year end) %p.a.	7.00	6.75	6.75	6.50	6.25	6.25
Prime (year end) %p.a.	10.50	10.25	10.25	10.00	9.75	9.75
USD/ZAR (average)	14.70	13.30	13.25	14.50	14.90	15.50

Source: FNB

ADDENDUM - NOTES:

Note on The FNB House Price Index:

The FNB Repeat Sales House Price Index has been one of our repertoire of national house price indices for some years, and is based on the well-known Case-Shiller methodology which is used to compile the Standard & Poor's Case-Shiller Home Price Indices in the United States.

This "repeat sales approach" is based on measuring the rate of change in the prices of individual houses between 2 points in time, based on when the individual homes are transacted. This means that each house price in any month's sample is compared with its own previous transaction value. The various price inflation rates of individual homes are then utilized to compile the average price inflation rate of the index over time.

The index is compiled from FNB's own valuations database, thus based on the residential properties financed by FNB over the past 18 years.

We apply certain "filters" and cut-offs to eliminate "outliers" in the data. They main ones are as follows:

- The maximum price cut-off is R15m, and the lower price cut-off is R20 000.
- The top 5% of repeat sales price growth rates, and the bottom 5% of growth rates are excluded fromthe data set.
- Repeat transactions that took place longer than 10 years after the previous transaction on the same home are excluded, as are repeat transactions that took place less than 6 months after the previoustransaction on the same home.
- 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.