BUY-TO-LET PROPERTY SURVEY

- Investment Property buying "bumping along the bottom" as fundamentals remain weak

FNB Property Barometer

FNB PROPERTY MARKET ANALYTICS

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SUMMARY – BUY-TO-LET MARKET SHOWS LITTLE SIGN OF CHANGE FOR BETTER OR FOR WORSE IN THE 3RD QUARTER SURVEY, AS IT WAITS FOR BETTER DAYS

According to the FNB Estate Agent Survey for the 3RD quarter of 2010, buy-to-let buying expressed as a percentage of total property buying remained unchanged from the previous quarter, at its record low point of 7%. Along with this weak survey reading, agent confidence in the near term prospects for this segment of the property market deteriorated further in the quarter.

After some mildly encouraging signs a quarter ago that the fundamentals behind buy-to-let buying were starting to improve, more recently there are hints that progress has stalled.

Agents pointed to a virtually unchanged average gross yield on rental properties of 7.8% in the 3rd quarter, which is insignificantly lower than the 7.9% of the previous quarter. However, this comes after two preceding quarters of significant rise in average yield, and while it could be the lagged result of accelerating house price growth prior to mid-year, it would also appear that the rental market remains mediocre.

As at the final quarter of 2010, Rode's flat rental data showed a return to low positive year-on-year rental inflation, but the 1st quarter of 2010 had shown no improvement on that. CPI data, which records actual rental paid (i.e. the combination of the impact of market rentals and escalations), continues to show a declining trend in overall home rental inflation, with the July year-on-year growth rate being a weak 4.5%.

In the mean time, household sector indebtedness remains high, and 2nd quarter economic growth estimates confirm what the SARB Leading Indicator has been showing for some time, i.e. that economic growth has started to soften. Slowing economic growth can place pressure on household disposable income growth, and thus on potential buy-to-let buying power..

Some mildly positive news for the buy-to-let market has surfaced over the past quarter, however, from TPN, whose report on rental tenants has shown an improvement in the average percentage of tenants that are " in good standing" with their landlords. From 79% in the previous quarter, the percentage of total tenants on the TPN system that are in good standing regarding rental payments rose to 82% in the 2nd quarter, according to the latest TPN report. This is further improvement in an upward trend spanning from the 1st quarter of 2009, at which time this percentage reached a lowly 71%. The improvement has arguably come largely as a result of a far lower interest rate environment since 2008, which can even assist rental tenants, who may have significant levels of debt elsewhere.

However, the improvement in the average performance of tenants has been insufficient to serve as a strong boost to the rental market to date, it would seem. So, while capital growth on property is uninspiring to those would-be buy-to-let investors who focus more on that, yields are un-enticing for the investor focused on a rental income stream, and so the long wait for an improved buy-to-let market continues.

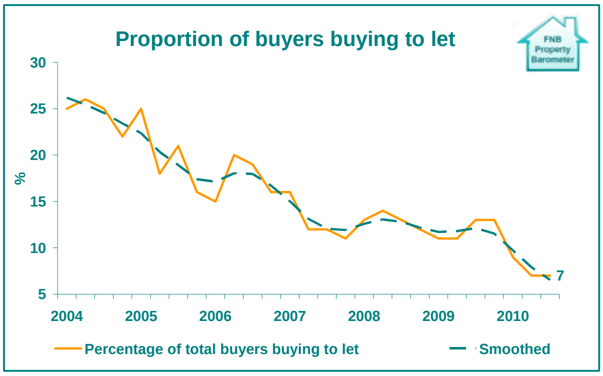
For the time being, though, many estate agents appear to have given up the wait in the sense that the survey shows a steady deterioration in their near term future expectations of buy-to-let buying. In the FNB Estate Agent Survey, we ask agents for their expectations regarding the near term expectation for the buy-to-let market, i.e. do they expect strengthening (a rating of 1), weakening (a rating of -1) or unchanged demand (a rating of zero). We combine their ratings into an index, which runs on a scale from 1 (most optimistic) to -1 (most pessimistic). For 4 consecutive quarters, we have seen a steady decline in the FNB Buy-to-let Confidence Indicator, from a 3rd quarter 2009 revised high of 0.149 down to a 3rd quarter 2010 level of 0.014.

THE FNB BUY-TO-LET ESTATE AGENT SURVEY

Estate Agent survey points towards buy-to-let buying remaining in the doldrums in the 3rd quarter

Given the ongoing pressure on the household sector's finances, as well as seemingly un-attractive average yields on residential property, it comes as little surprise that the latest FNB Estate Agent Survey for the 3rd quarter once again points to a very weak level of buy-to-let home buying.

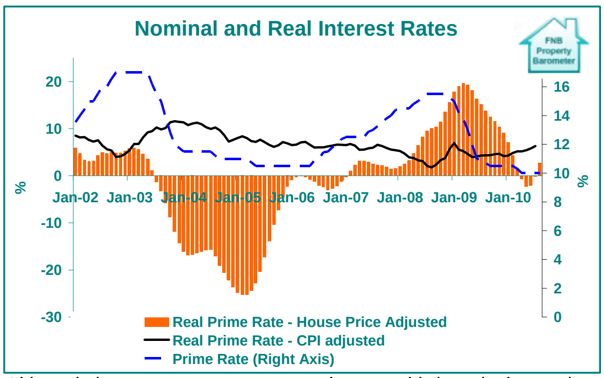
Expressed as a percentage of total home buying, the panel of agents estimated buy-to-let buying to make up a meagre 7%, which is unchanged from the previous quarter's historic low point.



This is in line with ongoing weakness in other non-essential forms of demand such as holiday property buying as well as the buying of property to be used as a primary residence for relatives.

The level of buy-to-let buying remains a far cry from the 25% level estimated back at the height of the property boom, at a time when much of the buy-to-let buying was probably more speculative by nature, with many buyers looking for rapid capital growth and very short term gains.

The SARB continues to maintain a highly speculator-unfriendly monetary stance



Although interest rates are currently at multi-decade lows, they don't necessarily encourage a wave of buy-to-let buying, or at least that component of buy-to-let buying more focused on capital growth as opposed to an income stream. Back in 2004/5, real interest rates for property speculators, as measured by the difference between prime rate and average house price inflation, reached an extreme negative rate of around -25%, which is hugely attractive for a speculator using credit. As at August 2010, this real prime rate measure once again turned positive to the tune of +2.8%, after a very brief recent return to mildly negative territory. This return to a positive real rate is due to steadily declining average house price inflation in recent months, as last year's interest rate stimulus for property demand starts to wear thin.

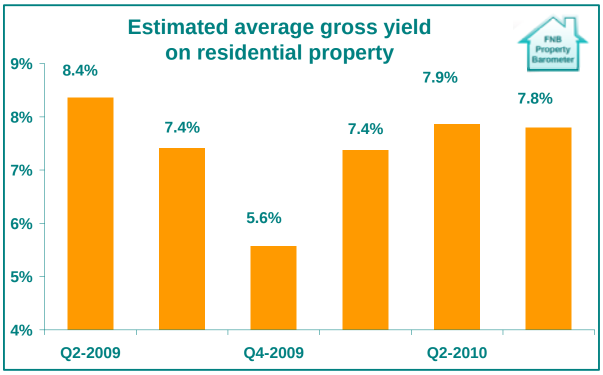
The SARB, therefore, is effectively ensuring that there is little place in the market for investors looking to use credit to buy property and make a short term profit through capital growth exceeding interest payments.

Given the declining rate of house price inflation, it is unlikely that last week's further interest rate reduction will cause the house price-related measure of real prime rate to turn negative. (FNB house price growth was 7.2% year-on-year in August and declining steadily)

Investors searching for an income stream also appear to be finding only limited joy at present, with yields still mediocre.

In previous quarters' surveys, we saw some improvement in gross income yields on residential property, as estimated by our estate agent survey respondents. Unfortunately, though, the combination of a seemingly mediocre rental market and still-accelerating house price growth until recently, may have temporarily halted the move to more attractive yields on property.

After a 2 quarter rise in gross yields, from a 5.6% low in the final quarter of 2009 to 7.9% in the 2nd quarter of 2010, the survey recorded an almost unchanged 7.8% in the current quarter.

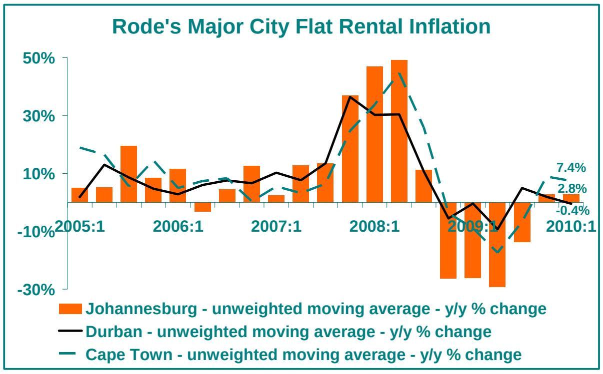


While the difference between the 2nd quarter and 3rd quarter average estimated yield is insignificant, the lack of further increase in yields may nevertheless be a reflection of a mediocre rental market which is battling to overtake an also-mediocre house price inflation rate.

While rental data is hard to come by, we do know that Rode's flat rental data had shown a recovery of sorts late in 2009, but that it still remained anaemic during the 1st quarter of 2010.

By the 4th quarter of last year, all of the major cities' un-weighted average flat rental growth rates had just managed to reach single-digit positive growth territory, after spending the previous 4 quarters in negative growth territory.

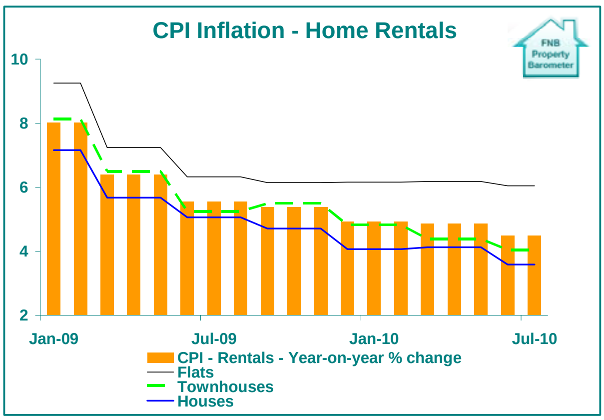
In the 1st quarter of 2010 (the most recent data available), the un-weighted average flat rental for Cape Town showed +7.4% year-on-year growth, for Durban the rate was slightly negative to the tune of -0.4%, and for Johannesburg a mildly positive +2.8%, with none-of these growth rates being an improvement on the previous quarter.



Data source: Rode

Consumer price inflation data, published by StatsSA, also points to a listless rental market. This data reflects a survey of actual rentals, and is thus the combination of market rentals and escalations.

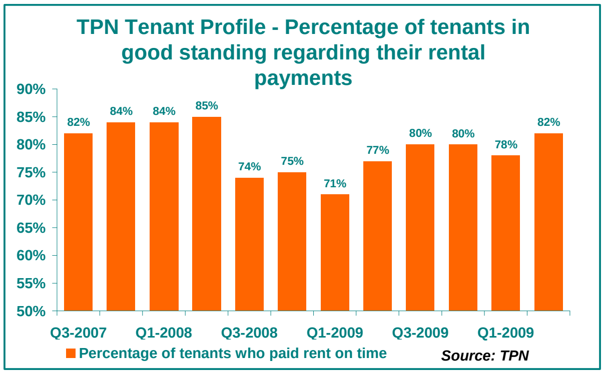
By July 2010, the actual home rentals year-on-year inflation rate had declined to 4.5%, down from a significantly higher 8% at the beginning of 2009, good for interest rate cuts, but hardly a performance to bring the buy-to-let investors in their droves yet.



One improvement from a landlord point of view has been a gradual improvement in tenant payment records, according to TPN,.....

While the rental market is not yet setting the world alight, a low interest rate environment appears to have eased financial pressure amongst tenants, and TPN reports a significantly increased percentage of tenants who are in good standing regarding their rental payments.

From a low point of 71% as at the beginning of 2009, an overhang from the high interest rate period of 2008, TPN data shows a gradual rise to 82% of tenants being in good standing by the 2nd quarter of 2010, a response to lower interest rates and a more stable economy following the recession.



Data source: Rode

.....but this was insufficient to prevent a further decline in the FNB Buy-to-Let Market Confidence Indicator.

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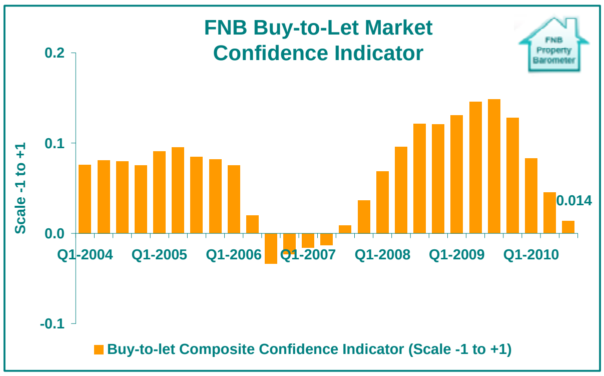
For 4 consecutive quarters, we have seen a steady decline in the FNB Buy-to-let Confidence Indicator, from a 3rd quarter 2009 revised high of 0.149 down to a 3rd quarter 2010 level of 0.014.



CONCLUSION

The 3rd quarter FNB Estate Agent Survey shows no improvement in buy-to-let buying as a percentage of total buying (7%), from its lowest levels since the survey commenced back in 2004.

This result comes as little surprise, given that the household sector remains under financial pressure in a weak economy, most recent rental market data continues to point to an anaemic rental market, and that estate agents continue to point to low yields on residential property on average.

We believe that estate agents have been disappointed, after having shown increasing confidence in near term buy-to-let market prospects through 2008 to mid-2009. As a result, they have steadily adjusted their expectations downward over the past 4 quarters, to levels more in line with a weak actual reality.