WESTERN CAPE PROPERTY REVIEW

The combination of an above average economic growth rate and land scarcity makes Western Cape an above average performing market

FNB Property Barometer

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FNB HOME LOANS WESTERN CAPE REGION

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SUMMARY – WESTERN CAPE RESIDENTIAL AND COMMERCIAL PROPERTY OUTPERFORMING THE NATIONAL AVERAGE, BUT SLOWDOWN LOOKS IMMINENT

The Western Cape residential property sector appears to have outperformed the national residential market, having recorded average house price inflation of 13.8% year-on-year for the 2nd quarter of 2010. This rate is a further acceleration from the 8.7% achieved in the 1st quarter.

The best performing price segment has been the so-called affordable segment. The Affordable Areas House Price Index, with an average price of R396,932, showed estimated year-on-year price inflation of 18.2% in the 2nd quarter. By comparison, the Middle Income Area grouping (average price=R817,478) inflated by 14.5%, the High Income Area Index (average price=R1,233,840) rose by 10.7%, while the so-called Top End grouping (average price=R1,820,104) had the weakest inflation rate at 7.7%.

However, examining growth rates in house prices on a quarter-on-quarter basis, it would appear that the province's market is losing growth momentum, and the 2nd half of 2010 is expected to bring slowing price inflation back into single-digit year-on-year rates.

Indeed, the FNB Estate Agent Survey for the 2nd quarter has already indicated a slowing in demand activity, with the average demand activity rating (on a scale of 1 to 10) by a sample of agents having declined from 6.75 in the 1st quarter to 5.71 in the 2nd quarter.

The estimated average time of a property on the market rose sharply from 10 weeks and 1 day in the 1st quarter to 16 weeks and 4 days in the 2nd quarter, while the percentage of sellers being required to drop their asking price also rose.

The FNB Estate Agent Survey for the Western Cape also continues to show how fragile the household situation is, with 15.5% of total sellers still being those downscaling due to financial pressure. Although this percentage has improved, it remains high. In addition, the survey points to a very weak buy-to-let and holiday buying market, further reflection of high degrees of financial pressure, which puts non-essential property buying on the backburner.

We have anticipated a residential slowdown from around mid-2010 for a while, with the SARB Leading Business Cycle Indicator having pointed to a national economic slowdown in recent times, while there has been a lack of interest rate stimulus since August 2009, and the positive effect of the big rate cuts of 2009 must surely be wearing thin on the residential market by now.

While the FirstRand base case is for a mild slowdown in economic growth, but positive growth nevertheless continuing, we nevertheless believe that the risk of a so-called "double-dip" recession remains high, given the vulnerability of some highly-indebted developed economies as well as a high level of indebtedness in our own household sector. This implies that, at best, we see house price inflation continuing in the coming years, but receding back into single-digit territory towards 2011. This scenario would, however, assume no recession. Given the fragile nature of our household sector, due to having made little progress in reducing its high debt-to-disposable income ratio, along with an already unbalanced (demand versus supply) residential market, we believe that any recessionary conditions would bring about another bout of house price decline in the region.

On the commercial property side, we have yet to see any visible signs of slowdown in the market, after the recent min-recovery, either at a national or Western Cape level. Cap rates have declined mildly in recent quarters, and vacancy rates have also turned the corner for the better, according to FNB's Commercial Property Indices. However, the commercial sector follows a cycle not too dissimilar from that of the residential market, and we would expect a slowing economy to have the same cooling effect on this segment of the Western Cape market too.

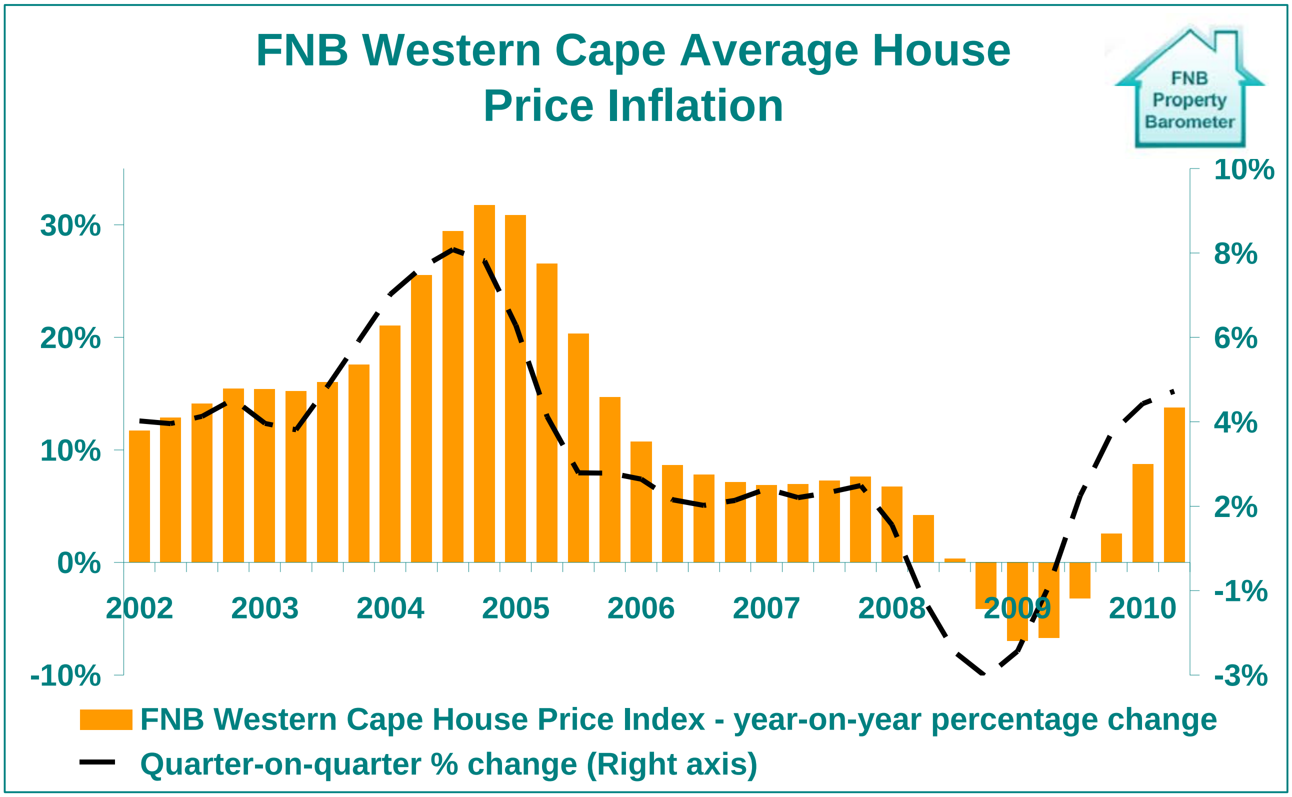
THE WESTERN CAPE RESIDENTIAL PROPERTY MARKET HAS OUTPERFORMED THE NATIONAL MARKET IN RECENT TIMES.

According to the FNB Western Cape House Price Index, the province outperformed the national average, showing an average year-on-year house price increase of 13.8% in the 2nd quarter, up from a rate of 8.7% in the 1st quarter.

This compares favourably with the 2nd quarter year-on-year house price inflation rate of 11.7% for the country as a whole.

This 2nd quarter growth acceleration is largely the lagged effect of the big interest rate cuts that took place from December 2008 to August 2009 feeding through.

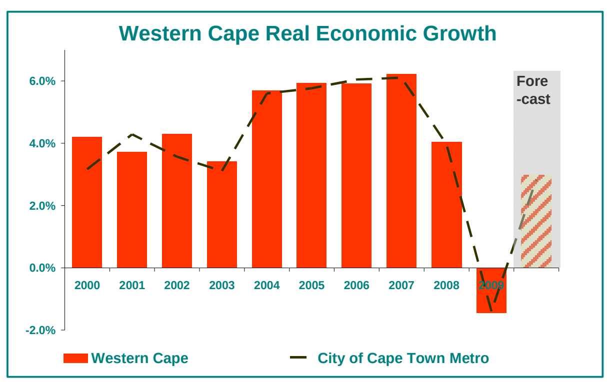
However, examining the house price growth on a quarter-on-quarter basis, we see signs that the pace of acceleration in house price growth may be starting to lose momentum. From 3.9% quarter-on-quarter growth in the 1st quarter, the growth rate only rose marginally to 4.2% in the 2nd quarter, following significantly faster growth accelerations in previous quarters. This may be a reflection that the positive impact from last year's big interest rate stimulus is starting to wear thin, and that the Western Cape housing market may be approaching its peak in this most recent "mini-cycle".



THE RECOVERY WAS ASSISTED BY A RECOVERY IN ECONOMIC GROWTH, AFTER LAST YEAR'S RECESSION.

No region could escape the 2008/9 recession unscathed. However, it is believed that the Western Cape's economy has moved back out of recession, and is expected to grow at around 3% in 2010. This supported the moderate recovery in the residential property market in the latter part of 2009 and early-2010, through assisting a recovery in real household disposable income growth.

This recovery was after a recession in which real economic growth had turned negative in the province, to the tune of -1.5% in 2009, according to Globalinsight estimates.



Data source: Globalinsight

How can we help you?

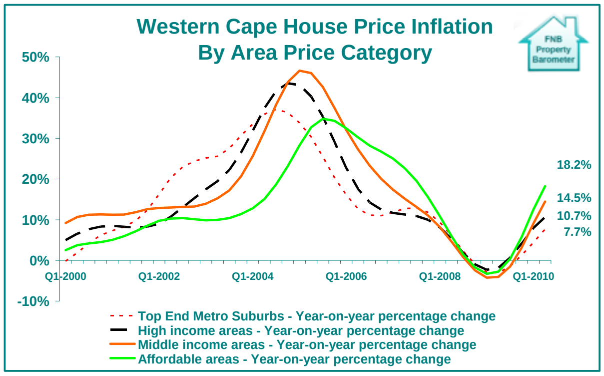
THE "LOWER END" APPEARS TO HAVE PERFORMED BEST IN THE WESTERN CAPE,...

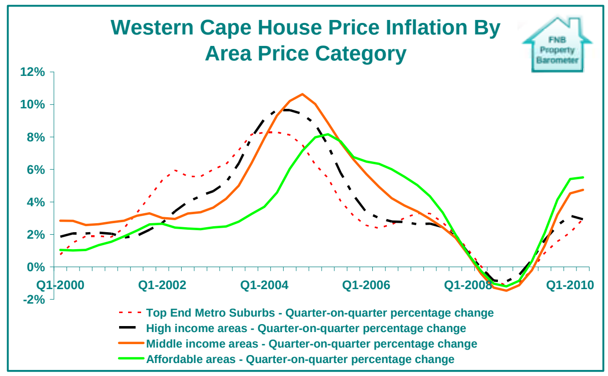
We have created 4 "area value band" indices for the Western Cape, where areas are grouped based on their average property price, based on transactions by individuals recorded in the Deeds Office.

We find that, during the 2009/10 "mini-recovery", it was the lower end which outperformed the higher priced echelons.

The so-called Affordable Areas House Price Index, with an average price of R396,932, showed estimated year-on-year price inflation of 18.2% in the 2nd quarter. By comparison, the Middle Income Area grouping (average price=R817,478) inflated by 14.5%, the High Income Area Index (average price=R1,233,840) rose by 10.7%, while the so-called Top End grouping (average price=R1,820,104) had the weakest inflation rate at 7.7%

However, examining growth rates on a quarter-on-quarter basis (a better way to ascertain short term momentum), we see that there was a broad flattening out in growth rates in the 2nd quarter, supporting the notion of the reaching of a peak in the cycle and the start of a slowing price inflation trend to come.

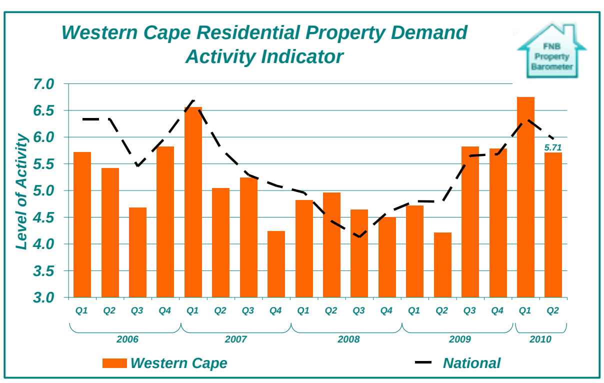




....BUT THE RESIDENTIAL MARKET MAY BE SHOWING EARLY SIGNS OF SLOWDOWN

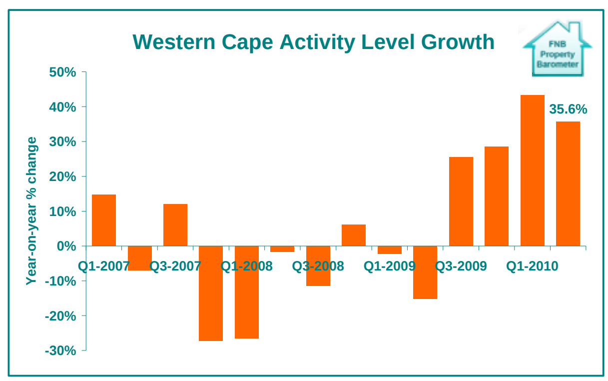
Besides the quarter-on-quarter house price growth rate pointing to slowing acceleration during the 2nd quarter, the 2nd quarter FNB Estate Agent Survey for the City of Cape Town Metro is pointing to signs of a slowing residential market in the region.

In the survey, the sample of estate agents is asked to rate demand activity, as they experience it, on a scale of 1 to 10. From a level of 6.75 in the 1st quarter of 2010, the activity rating slid to 5.71 in the 2nd quarter survey. This decline comes after a steady recovery through much of 2009.



Towards the winter months, it is always possibly that seasonal factors hamper residential demand. However, it would appear that the 2nd quarter demand activity rating decline was a little more than that.

In order to eliminate seasonal factors, we calculate a year-on-year rate of change on the activity ratings, in other words, the percentage change of the 2nd quarter activity level on the corresponding quarter of 2009. This year-on-year growth rate was still a very healthy 35.6%, but reflects a slowdown from the 1st quarter peak of 43%, following a sharp acceleration out of negative growth territory in 2008.



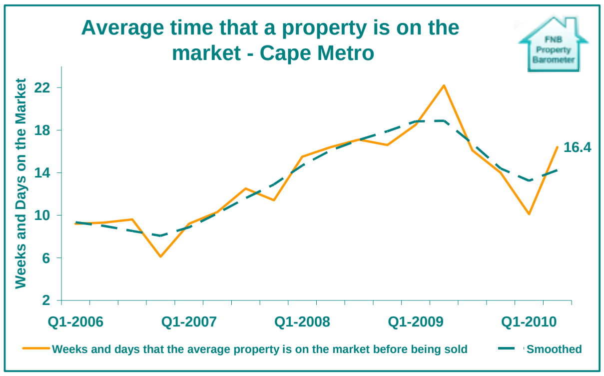
Admittedly, the year-on-year increase in the 2nd quarter was still strong despite having slowed, and some agents also suggest that the World Cup may have had something of a negative effect on demand through "distracting the nation". One must thus be cautious about drawing hard and fast conclusions at this stage.

However, we are of the opinion that this slowdown from quarter to quarter in demand activity does represent the start of a weakening trend in the residential market. This is due to the fact that there has been a lack of interest rate cutting since August 2009, with only one further cut in March this year. It could thus be possibly that the big stimulus of 5 percentage points' worth of interest rate cuts from December 2008 to August 2009 is starting to wear off. In addition, there are some signs that economic growth may once again be starting to slow down. More in this regard at a later stage.

A NOTICEABLE DETERIORATION IN PRICING REALISM HAS TAKEN PLACE IN THE 2ND QUARTER,...

Our FNB Estate Agent survey includes three different indicators of the level of pricing realism, or otherwise put, indicators of the balance between supply and demand.

The first one is the estimated average time on the market. Back in 2006, this average time on the market dipped below 2 months, a "benchmark" limit for a healthy market. During the 2009/early-2010 recovery, those healthy levels were never reached again, although a dramatic improvement took place from a weakest level of 22 weeks and 2 days as at the 2nd quarter of 2009 to 10 weeks and 1 day by the 1st quarter of 2010.

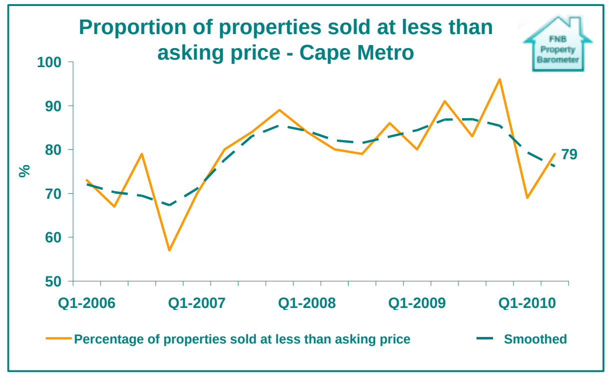


However, the 2nd quarter saw a sharp deterioration to 16 weeks and 4 days, reflecting the significant decline in demand in the quarter.

The 2nd measure, namely the estimated percentage of sellers having to drop their asking price in order to make the sale, also deteriorated in the 2nd quarter.

This average percentage rose from 69% of total sellers in the 1st quarter to 79% in the 2nd quarter. Admittedly, this indicator should be read with caution, as it is typically volatile from quarter to quarter, and the smoothed trend line has yet to turn upward.

The third indicator of pricing realism is the result of the survey question asking agents to estimate by how much the average price is dropped by, in those instances where sellers are required to drop their price.



In the Western Cape, the estimated drop increased from 9% in the 1st quarter to 11% in the 2nd quarter.

While data volatility can indeed be an issue from one quarter to the next, all three of the pricing realism indicators showed quarterly declines in the 2nd quarter.

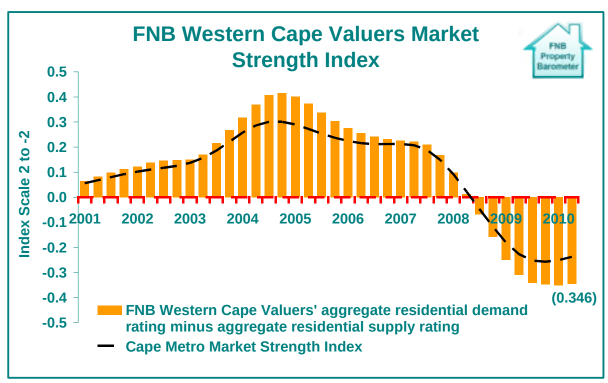
...WHILE FNB VALUERS SUGGEST THAT, RELATIVE TO SUPPLY, DEMAND HAD IMPROVED ONLY MARGINALLY AT BEST DURING THE RECOVERY

Each time an FNB valuer values a home, they are required to give an opinion of the strength of demand as well as the strength of supply. The answer is a simple "good", "average", or "bad" rating, which we convert into numbers of 1, 0 or -1 respectively.

We then subtract the average supply rating from the average demand rating, in order to gauge the valuers' view of demand levels relative to supply.

We call this the FNB Western Cape Valuers' Market Strength Index. It shows that, despite some small improvement in recent quarters, i.e. a narrowing in the amount by which the average supply rating exceeds that of the demand rating, the group of valuers is not overly impressed with the strength of the Western Cape residential recovery. In the 2nd quarter, the index level for the entire province was -0.346, still negative and only marginally improved from the -0.352 low point reached in the previous quarter.

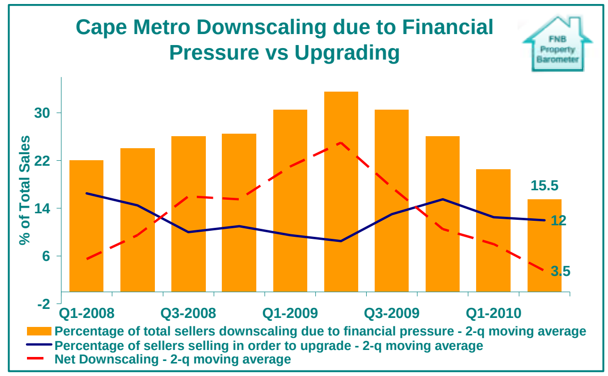
While this index tends to be a "lagging" indicator, confirming a trend already in place, the valuers tend to confirm what the agents are saying with their estimates of the average time on the market, i.e. that the market balance of the boom years was not nearly reached in the recent mild recovery. A poor market balance suggests that the market remains fragile, and that it would not take much to cause prices to decline once more after a reasonable recovery in late-2009/2010.



FINANCIAL STRESS-RELATED SELLING HAS CONTINUED TO IMPROVE IN THE 1ST HALF OF 2010, BUT UPGRADING STARTS TO TAPER

On the selling side, the 1st half of 2010 has yielded further improvement in the declining trend in "net downscaling" due to financial pressure. Net downscaling is the percentage points difference between the percentage of sellers selling in order to downscale due to financial pressure, and the percentage selling in order to upgrade. The difference declined to +3.5 percentage points, from +8 in the previous quarter, using a 2-quarter moving average. While the percentage downscaling declined from 20.5% in the 1st quarter to 15.5% in the 2nd quarter, those upgrading also declined, though by a smaller magnitude, from 12.5% to 12% over the 2 quarters, also using a 2-quarter moving average.

The estimated net downscaling of +3.5 is a dramatic improvement on the peak of 25 reached in the 2nd quarter of 2009, a time when financial stress was serious, and downscaling was estimated at 33.5% of total sales. However, at 15.5% of total sales in the 2nd quarter of 2010, financial stress-related selling still remains very significant.

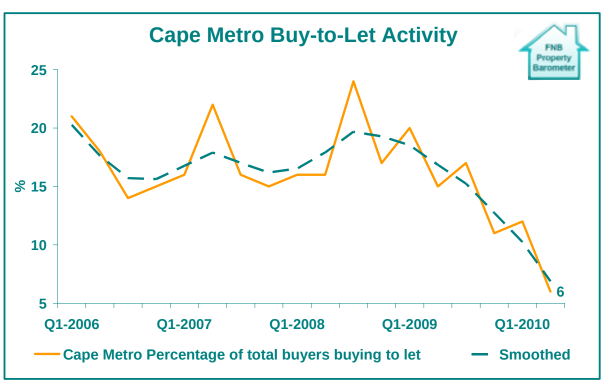


CAPE TOWN - REASONS FOR SELLING (AS % OF TOTAL SALES) - 2-quarter moving average	Q1-2008	Q2-2008	Q3-2008	Q4-2008	Q1-2009	Q2-2009	Q3-2009	Q4-2009	Q1-2010	Q2-2010
Downscaling due to financial pressure	**22.0**	**24.0**	**26.0**	**26.5**	**30.5**	**33.5**	**30.5**	**26.0**	**20.5**	**15.5**
Upgrading	**16.5**	**14.5**	**10.0**	**11.0**	**9.5**	**8.5**	**13.0**	**15.5**	**12.5**	**12.0**
Downscaling with life stage	16.0	15.0	14.5	13.5	23.5	21.5	20.5	27.0	18.5	15.0
Moving for safety and security reasons	10.0	9.0	9.5	8.5	6.5	7.0	7.0	7.0	11.5	13.0
Emigrating	**5.0**	**7.5**	**11.5**	**12.5**	**9.0**	**8.0**	**6.5**	**5.0**	**7.5**	**8.0**
Relocating within SA	10.5	11.0	9.5	8.0	5.5	7.5	7.0	4.0	5.5	6.0
Change in family structure	12.5	11.0	12.0	14.5	10.5	11.0	12.5	12.0	16.0	19.5
Moving to be closer to work or amenities	6.0	7.5	7.0	5.0	5.0	3.5	3.0	3.5	8.5	12.0

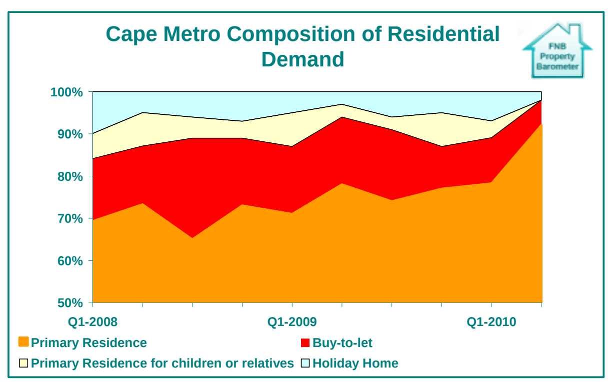
NON-ESSENTIAL BUYING ON THE BACKBURNER IN A FINANCIALLY PRESSURED HOUSEHOLD SECTOR, AS PRIMARY RESIDENTIAL BUYING DOMINATES

Buy-to-let activity in the City of Cape Town Metro remains poor. As a percentage of total buying, buy-to-let buying declined to a new low of 6% in the 2nd quarter of 2010, from 12% in the previous quarter.

This is the result of generally low yields, a mediocre rental market, and a household sector still financially pressured.



It isn't only buy-to-let that has suffered. Agents surveyed in the Cape Metro estimate primary residential demand to have risen to 93% of total buying, from 70% at the beginning of 2008. This has been at the expense of buy-to-let (which declined from 15% early in 2008 to 6%), holiday buying (down from 10% to 2% over the period), and buying primary residences for children and relatives (down from 6% of total buying in the 1st quarter of 2008 to 0%).



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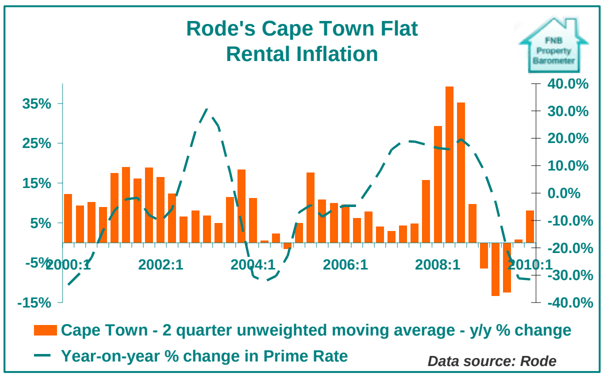
BUT A LACK OF NEW BUY-TO-LET SUPPLY HAS PROBABLY DONE THE RENTAL MARKET SOME MODERATE GOOD.

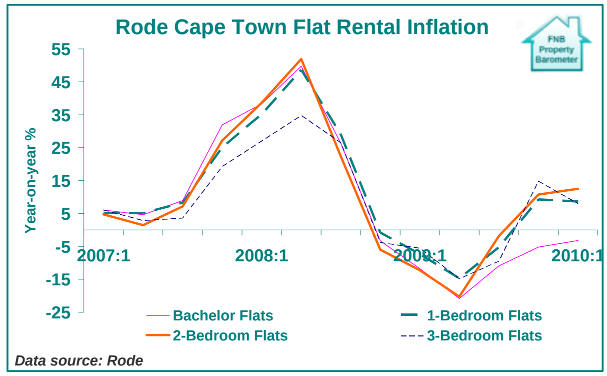
A lengthy process is well under way to take the buy-to-let market back to good health. With the household sector still under significant financial pressure, which impacts negatively on non-essential buying such as buying to let, curbing the growth in new rental stock coming onto the market has been easily achieved.

Now, the wait for demand for rental property to catch up to supply is on. Indeed, there appears to have some progress in this regard, and rental inflation at least in the flats market has resumed after a period of deflation in 2009.

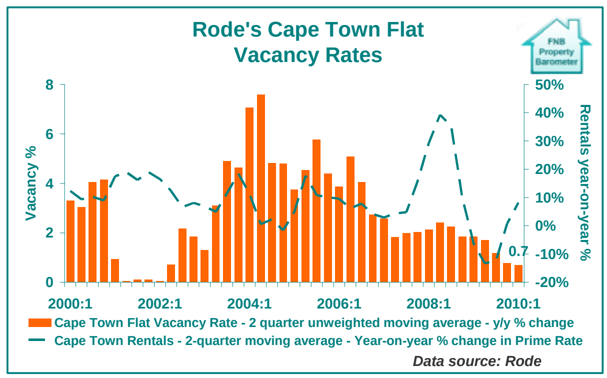
Using a 2-quarter un-weighted average, the Cape Town flat rental market returned to year-on-year inflation in the 1st quarter of 2010, to the tune of 8.2%.



The flat rental inflation is broad-based across all of the various flat size categories, with the exception of bachelor flats, which still languished in deflation as at the 1st quarter.



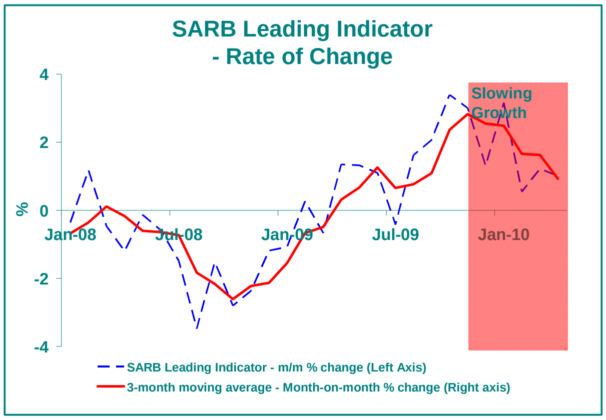
Examining vacancy rates, The interest rate hiking phase from mid-2006 to mid-2008, accompanied by significant household sector financial stress, has steadily whittled away at the city's average vacancy rate to 0.7% by end-2009. This is a vast improvement on the peak of 7.6% reached around mid-2004, which was the peak of the residential buying boom.



How can we help you?

We are of the opinion that the reported slowing in activity, by the sample of estate agents surveyed, is more than just a "once-off", and is start of a slowing trend that is expected to last at least into 2011.

The SARB Leading Business Cycle Indicator has been showing slowing month-on-month growth throughout early-2010.



Given that residential property is a leading economic sector, it is reasonable to expect that the start of a slowing growth trend would follow not too long after a slowing trend in Leading Indicator growth.

This slowing growth in the Leading Indicator is probably driven by the combination of major global leading indicators whose growth rates are also slowing, along with the fact that there has been a lack of further interest rate stimulus following the aggressive 500 basis points' worth of cuts by the SARB between December 2008 and August 2009 (with only one further 50 basis point cut in March 2010.

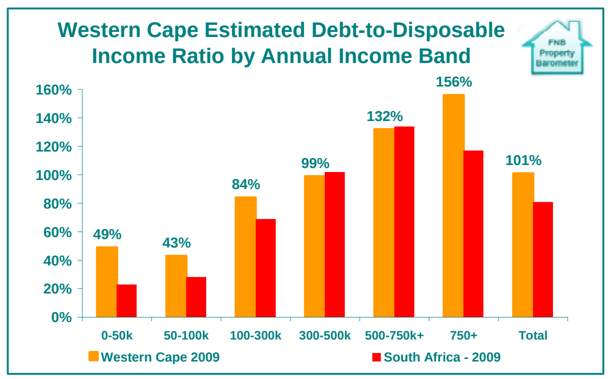
Crunch time has come to the global economy. Huge fiscal and monetary stimulus packages were put in place in many developed economies, most importantly the US, and the time has come for these to be withdrawn in the interests of fiscal sustainability.

As the US begins to wind down its fiscal deficit (no sign of interest rate hiking from near zero just yet), it faces huge risks in doing so, with consumer confidence low and the unemployment rate not far below the recent 10.1% peak of October 2009, levels last seen following the early-80s oil price shock.

Nationally, the Kagiso Manufacturing Purchasing Managers' Index has declined for the past 4 months, dipping to below the key level of 50 (the dividing line between expansion and contraction in manufacturing output). This suggests more weakness on the way for this major economic sector, and a sector which is usually a good indicator of the direction of overall economic growth.

Therefore, we believe that the Western Cape residential market has started on a weakening trend, which is expected to last well into 2011.How low do we go? Well, it must be said that the risk of a "double-dip" recession for the global and domestic economy is high, with very high levels of indebtedness both in some developed countries, notably the US, as well as in the domestic household sector, making us highly vulnerable.

Western Cape household indebtedness estimates are high, estimated at 101% of disposable income for the household sector as a whole according to the Bureau of Market Research. While not proving to be a crisis, this high indebtedness severely curbed the household sector's ability to grow its credit in response to the big interest rate cuts of 2008/9, making the 2009/10 residential recovery a very mild one, and one which we believe has run out of steam quite quickly.



Source: Bureau of Market Research

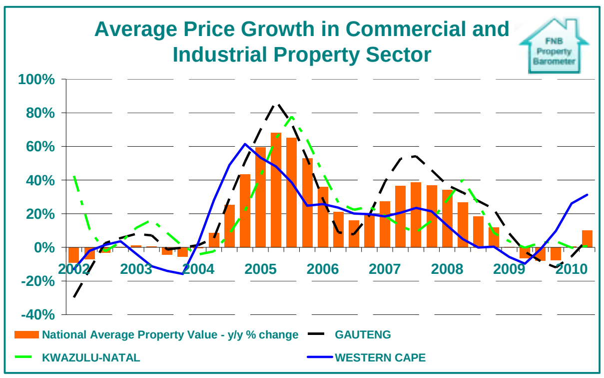
Therefore, we expect Western Cape house price growth to recede back into single-digit territory by year-end, and remain there through 2011 as the country and the region goes through a slower economic growth period.

WESTERN CAPE APPEARS TO BE THE STRONGEST COMMERCIAL PROPERTY MARKET, BUT COMMERCIAL PROPERTY EXPECTED TO FOLLOW THE SAME CYCLE AS RESIDENTIAL

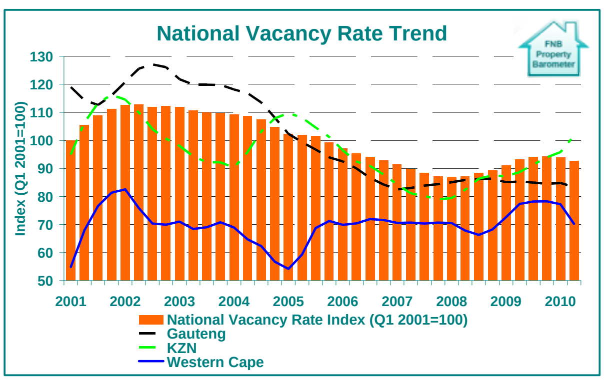
FNB's "All Commercial" Property Indices point to the Western Cape Province being the strongest commercial property market of the 3 major provinces. The indices are short on detail, incorporating all 3 major commercial property sectors, namely office, industrial and retail, but provide some up to date insight as to the recent direction of the commercial property sector.

For the country as a whole, the average price of commercial properties was estimated to have risen by 9.9% year-on-year in the 2nd quarter, an acceleration from the 0.5% in the previous quarter. Like the residential market, the commercial sector saw price deflation through most of 2009.

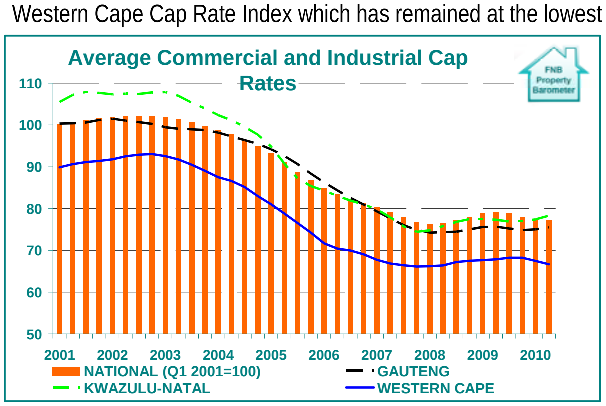
The Western Cape Index, by comparison, rose year-on-year by 31.3%, compared to Gauteng's 4.6% and KZN's 0.8%.



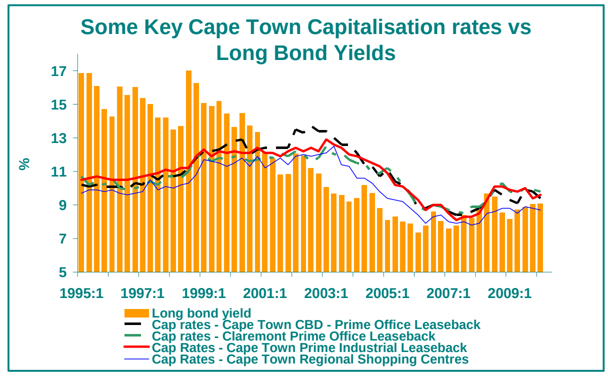
During the 1st 2 quarters of 2010, the national vacancy rates turned the corner for the better, after a moderate rise through 2009. Once again, we estimate the Western Cape vacancy index to have remained the lowest of the major provinces throughout the weakening and "mini-recovery cycle.



In response to the combination of a resumption of declining vacancy rates, along with a sharp drop in the cost of finance since the big 2009 interest rate cuts, cap rates returned to a mild declining trend from the latter half of 2009. Once again it is the Western Cape Cap Rate Index which has remained at the lowest

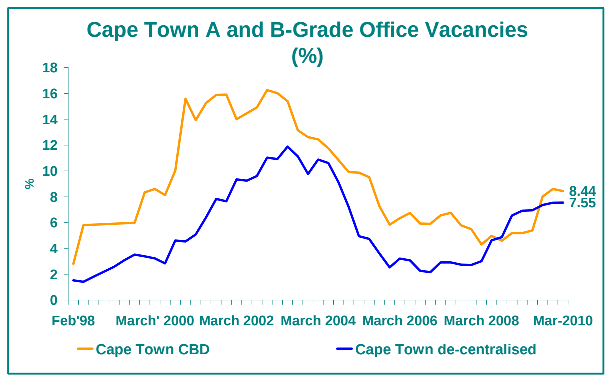


The Rode data points to a similar picture, with cap rates having rise mildly across all Cape Town commercial property classes during 2008, but having since experienced mild declines through 2009 to early-2010 after the cost of funding declined and vacancies showed some improvement.



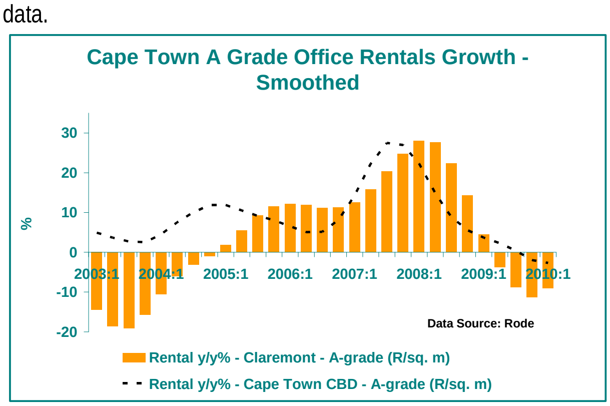
Data source: Rode

In the office segment, SAPOA vacancy rates point to high single-digits in both the Cape Town CBD (8.44%) as well as decentralised nodes (7.55%), with the CBD being slightly higher, and the de-centralised nodes' vacancy trend having appeared to flatten out earlier after a significant rising trend.

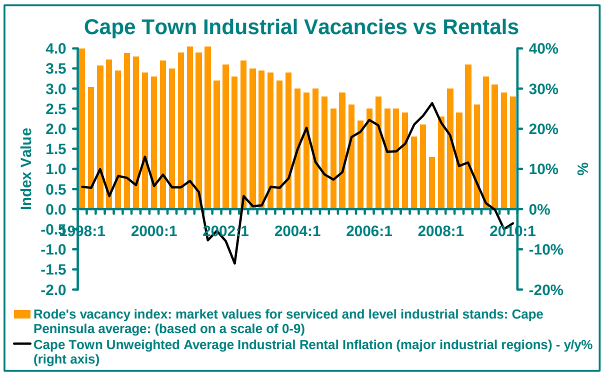


Data source: Sapoa

This would probably explain why we have seen year-on-year office rental deflation starting to diminish in the de-centralised nodes during the 1st quarter (using a 4-quarter moving average), while such an improvement has yet to be seen in the CBD rental data.



As at the 1st quarter of 2010, the 4-quarter moving average for industrial rentals for Cape Town continued to show deflation year-on-year, although this had just started to diminish in response to a renewed declining trend in vacancy rates for the region.



Data source" Rode

The return of the manufacturing sector to positive growth after a deep recession has arguably helped matters in the industrial property sector to early-2010.

OUTLOOK FOR COMMERCIAL IS ALSO THE EXPECTATION OF A WEAKENING "MINI-CYCLE"

Using quarter-on-quarter average property price growth as a short term momentum indicator, we have yet to see any signs of slowing, unlike the residential case where 2nd quarter quarter-on-quarter momentum has shown clear signs of slowing.

From 3.3% in the 1st quarter, average capital growth accelerated further to 5.1% in the 2nd quarter.

However, the commercial market follows a cycle not too different from that of the residential market, and a slowing economy coupled to a lack of interest rate cuts is expected to have the same cooling effect on commercial property in the 2nd half of the year.