Residential Property Price Review

– The focus of demand remains on "basics" and affordability, and traditional measures of affordability continue to improve

FNB Property Barometer

FNB PROPERTY MARKET ANALYTICS

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1. SUMMARY – THE AFFORDABILITY AND "BACK TO BASICS" DRIVE STILL VISIBLE IN PRICE TRENDS

The FNB Estate Agent Survey for the 1st quarter of 2011 points to agents' perceptions of housing affordability, in terms of price levels relative to buyer income levels, having improved significantly.

We believe that this perception is to a large extent justified. As at the 1st quarter of 2011, it is very likely that housing affordability, as measured by the average house price/average remuneration ratio and by the instalment repayment/average remuneration ratio, continued to improve. This is due to anaemic house price growth of 0.82% year-on-year for the 1st quarter according to the FNB House Price Index, the likelihood of wage inflation being significantly stronger than house price growth, and a further decline in the average interest rate following a late-2010 interest rate cut.

However, affordability calculations are based on the wage growth of those employed, and after a major decline in formal sector jobs during the recession in 2008/9, recent employment growth remains very slow. Therefore, the household sector as a whole remains financially constrained, and despite the improvement in traditional measures of housing affordability, housing demand growth has not yet set the world alight.

Therefore, it is not surprising that, when house prices around major metros are measured on a value band basis, the affordable area segment has shown the best price growth in recent times. On a year-on-year basis, Affordable Area (average price = R377,864) average price growth measured +8.9% for the 1st quarter of 2011. Within the Affordable Segment, the Former Black Township component stands out as being the strongest, which may also reflect a lack of supply of stock relative to former suburban areas. The other 3 area value bands were grouped in a very narrow range of price growth, with Top End Areas (average price = R1.882m) showing +5.2% growth, Middle Income Areas (average price = R712,764) showing +4.6% increase, and High Income Areas (average price = R1.086m) rising by +3.8%.

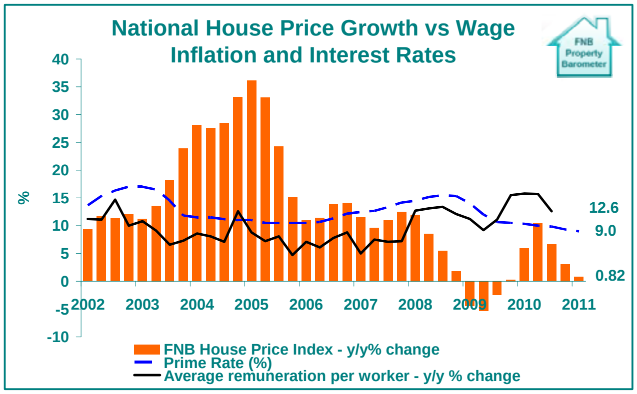
The household sector's financial constraints continue to keep it focused on basics, and this can be seen in coastal holiday town price estimates continuing to show significant deflation to the tune of -6.9% year-on-year.

However, despite some difference in the relative performances of segments, virtually all housing segments that we measure have shown further de-celeration in price growth during the 1st quarter.

The exception was the "Sectional Title Less than 2 Bedroom" segment. Whereas, the Sectional Title 3 Bedroom sub-segment recorded a meagre +0.3% year-on-year price growth in the 1st quarter, and the 2 Bedroom sub-segment +0.4%, the "Sectional Title Less than 2 Bedroom" sub-segment sub-segment showed a significantly better +6.6% growth, and was the only major segment in both the full title and sectional title markets to see its growth accelerate, from the previous quarter's +4.8%. One must bear in mind that the Less than 2 Bedroom sub-segment tends to be more cyclical than the others, and that it also saw the biggest price dip during 2008/9 of the key sectional title sub-segments, so its prices come off a lower base. This segment is believed to be a major target of 1st time buyers in the former white suburban areas, a source of demand that is more cyclical than overall residential demand. Its reliance on 1st time buyers may be starting to benefit it at present, because our FNB Estate Agent Survey shows an increase in 1st time buyers as a percentage of total buyers from 17% in the 4th quarter of 2010 to 22% in the 1st quarter of 2011.

2. THE NATIONAL PRICE AND AFFORDABILITY TREND

Low national house price growth in the 1st quarter means that housing affordability probably continued to improve



During the 1st quarter of 2011, year-on-year house price growth declined further to 0.82%, according to the FNB House Price Index, from the previous quarter's 3.1%. This was the 3rd quarter of slowing in year-on-year growth following the mini acceleration of both the economy and the housing market out of the extreme slump of 2008/9, with the effect of the most pronounced part of the interest rate cutting phase from December 2008 to August 2009 having worn off.

The insignificant pace of house price inflation, coupled with the likelihood of far stronger wage remuneration inflation (averaging +12.6% year-on-year as at the 3rd quarter of 2010, the most recent available figure), and a slightly lower average interest rate in the 1st quarter compared with the previous 2 quarters (with prime rate now at 9%), makes it very likely that the affordability of housing continued on its improving trend in the early stages of 2011.

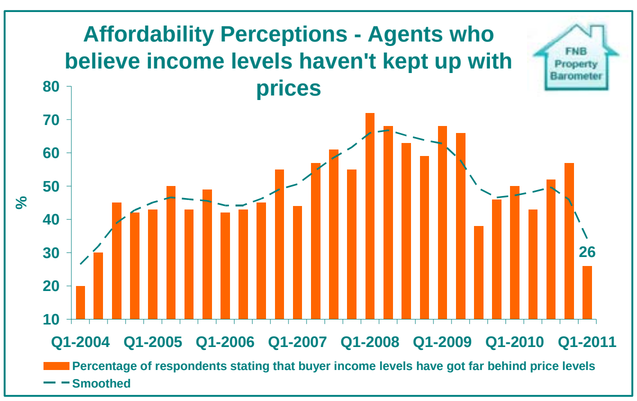
Certainly, in our 1st Quarter FNB Estate Agent Survey, the sample of agents surveyed showed a significant improvement in their perceptions of housing affordability. This follows on a few previous quarters of deterioration in this perception.

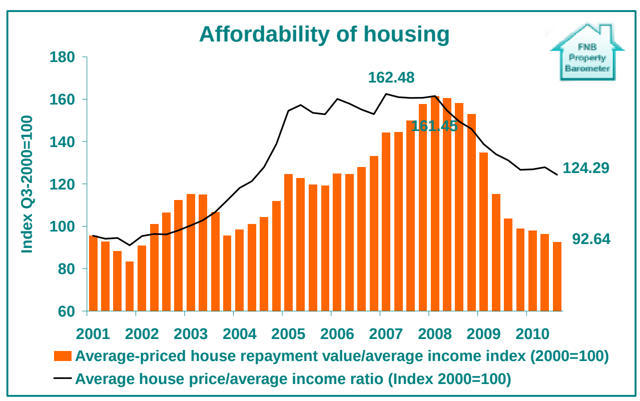
The question put to the panel is admittedly subjective, asking the panel whether average income levels have "kept up with house price levels", got "a little behind price levels" or have "got far behind price levels"? In the 1st quarter 2011 survey, we saw the percentage stating that income levels had got far behind price levels declining sharply from 57% in the final quarter of 2010 to 26%.

The 2 traditional measures of affordability that we periodically use are the "average house price/average labour remuneration ratio" and the "instalment value on a 100% loan on an average priced house/average remuneration ratio" (both ratios expressed in index form). Unfortunately, wage data runs somewhat behind, meaning that we can only calculate these indices up until the 3rd quarter of last year. The former index has declined (affordability improved) from a peak of 162.48, reached in the 1st quarter of 2007, to 124.29 by the third quarter of 2010, while the latter index had shown an even more significant improvement from a peak of 161.45 as at the 1st quarter of 2008 to 92.64 by the 3rd quarter of last year.

The price/remuneration index is at its lowest level since the 2nd quarter of 2004, while the repayment/average remuneration ratio index is the lowest since the 1st quarter of 2002.

The dramatic improvement in these 2 measures of home affordability were driven by the combination of average formal sector remuneration increases (+12.6% year-on-year as at 3rd quarter 2010 after being above 15% in 2 preceding quarters) far outstripping house price growth since early-2008, while 6.5 percentage points' worth of interest rate cuts from late-2008 to late-2010 gave the instalment/house price measure of affordability an additional boost.



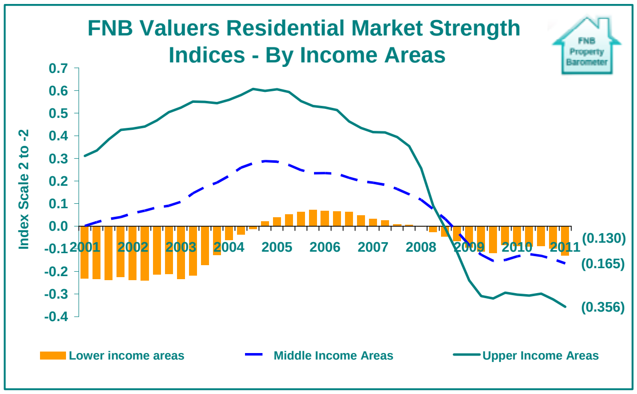


One word of caution must be issued, however. The traditional affordability measures, however, apply to those who are employed, and formal sector employment is still estimated to be significantly less compared with pre-2008 recession levels. The slow recovery in employment continues to place limits on the growth in numbers of people that can afford housing, constraining the pace at which residential oversupplies are mopped up. In the 3rd quarter of 2010,formal sector employment was estimated to have grown insignificantly by a +0.2% quarter on quarter annualised rate, only the 2nd successive quarter of positive employment growth following 6 successive quarters of decline.

3. REVIEW OF KEY RESIDENTIAL MARKET SEGMENTS' PRICE TRENDS AND MARKET STRENGTH

The Affordable Segment still appears to show superior performance, being a less oversupplied segment, but all segments' price growth continued to flatten out in the 1st quarter following the 2009/10 "mini-recovery"

In terms of trends, little has changed over the past quarter in terms of market direction. All major metropolitan value bands continued to show some price growth during the 1st quarter, but at a de-celerating rate, while holiday towns continued to show price decline. The Affordable end of the market continued to outperform the rest.



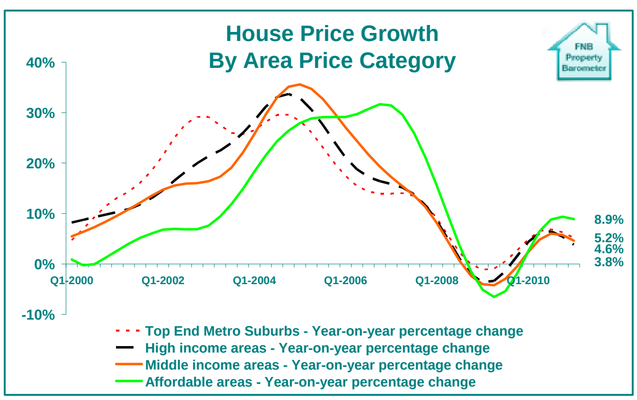
In recent years, our FNB Valuers panel has generally rated the level of demand relative to supply of residential stock as healthier in the lower income markets as opposed to the higher income segments. This is reflected in the FNB Valuers' Market Strength Indices by Income Areas. Valuers are required, when valuing a home, to rate the strength of demand in the area either as "Strong"(+1), Average(0) or Weak(-1), before rating the supply of homes on the market on exactly the same basis. We then subtract the average supply rating from the average demand rating for the 3 income bands to obtain the Market Strength Indices by income area.

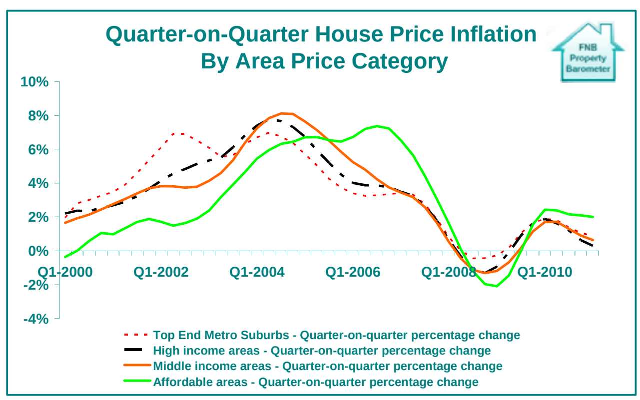
While it is not an exact science, the 3 indices do show valuers in Low Income Areas" as generally providing the strongest market strength ratings, followed by "middle income" areas, while "Upper Income Areas" are weakest.

From this, it would come as little surprise to learn that our calculations of house price trends by area value bands in the 6 major metro areas (Tshwane, Joburg, Ekurhuleni, Cape Town, Ethekwini and Nelson Mandela Bay), show Affordable Areas to have continued to mildly outperform the higher area value bands in terms of average price increase during the 1st quarter of 2011. For these area value band calculations, we use Deeds Office data for property transactions by individuals in areas that we believe to be residential-dominated, in order to estimate price trends.

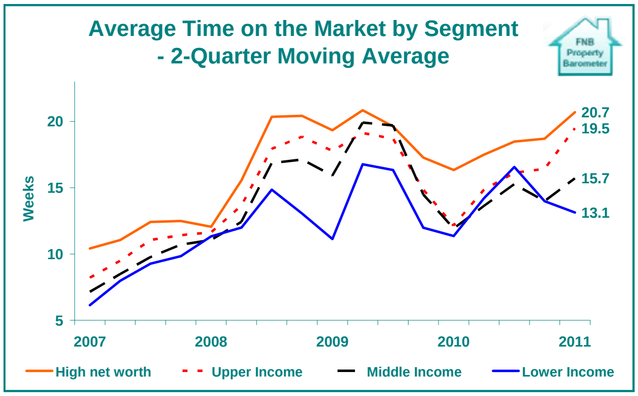
On a year-on-year basis, Affordable Area (average price = R377,864) average price growth measured +8.9% for the 1st quarter of 2011. Whilst being the strongest price growth of the 4 area value bands, this growth rate nevertheless represented a slowing from the previous quarter's +9.4%. The other 3 area value bands were grouped in a very narrow range of price growth, with Top End Areas (average price = R1.882m) showing +5.2% growth, Middle Income Areas (average price = R712,764) showing +4.6% increase, and High Income Areas (average price = R1.086m) rising by +3.8%.

On a quarter-on-quarter basis, a better indicator of short term momentum than the year-on-year calculation, the right hand graph below shows all 4 segments showing a slowing rate of growth, but with the Affordable Areas Index holding up best to date.



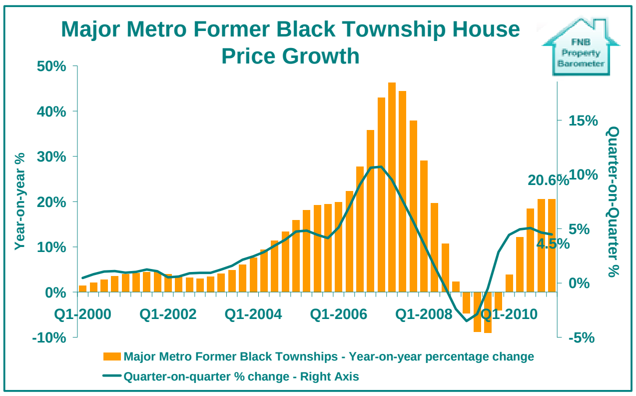


The Top End Area Index, showing slightly higher growth than the High and Middle Income Areas, could perhaps appear to be an anomaly to some, given what has been said about oversupplies being more acute at the higher end of the market. However, it may well be that the Top End of the market has the financial means to sit and wait it out for their price, implying more resilient prices but a longer time on the market.

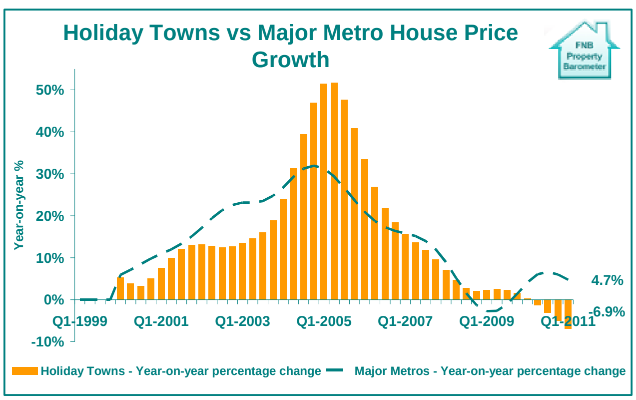


This is possibly being reflected in the FNB Estate Agent Survey, where the estate agent self-defined Upper Income (average price = R2.01m) and High Net Worth Areas (average price = R2.8m) have both seen marked increases in the average estimated time that a home is on the market, with the former reaching 19.5 weeks in the 1st quarter (using a 2-quarter moving average) and the latter reaching 20.7 weeks. The Middle Income Areas (average price = R1.17m) have seen a more moderate rise in average time on the market to 15.7 weeks, while Lower Income Areas (average price = R582k) have experienced a decline in average time on the market to 13.1 weeks.

In short, the gap in average time on the market between the high end and the low end has widened in recent quarters, according to our Estate Agent Survey, suggesting that much of the weakness in the market in our Top End segment is reflected less in price trends and more in average time on the market.



Within the Affordable Area Value Band, the key source of strength appears to be in the Former Black Township Market around the major metros. In the 1st quarter of 2011, the Major Metro Former Black Township Index (average price = R269,420) showed average price growth of +20.6%. This, too, looked to have been peaking, however, with a quarter-on-quarter growth rate of +4.5% being slightly slower than the previous quarter's +4.7%.



Finally, when using Deeds data to compare major metro price trends with those of our grouping of towns that we deem to be holiday towns, the trends continue to reflect the financially pressured state of the household sector, which translates into very weak non-essential buying such as holiday property buying.

Whereas our Major Metro Price Index (average price = R1.095m) showed +4.7% year-on-year growth in the 1st quarter, the Holiday Towns Price Index (average price = R793,869) showed a -6.9% decline for the same period.

By early-2011, the price growth differential between the Sectional Title and Full Title market segments had been virtually wiped out.

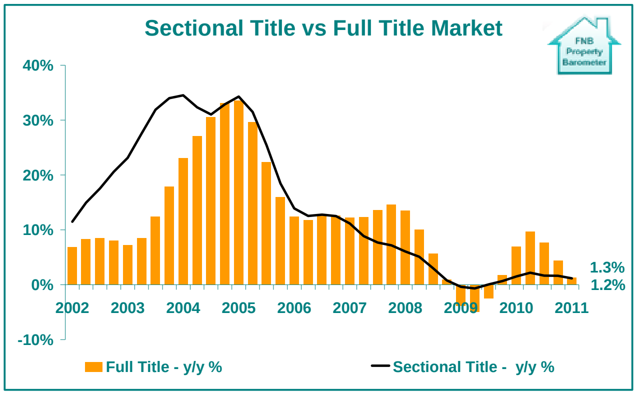
Examining trends in some of the key market segments, utilising FNB's own price data, it would appear that the Sectional Title Market remained a lot flatter through 2010, when compared to the Full Title Segment through the 2009/10 "mini-recovery.

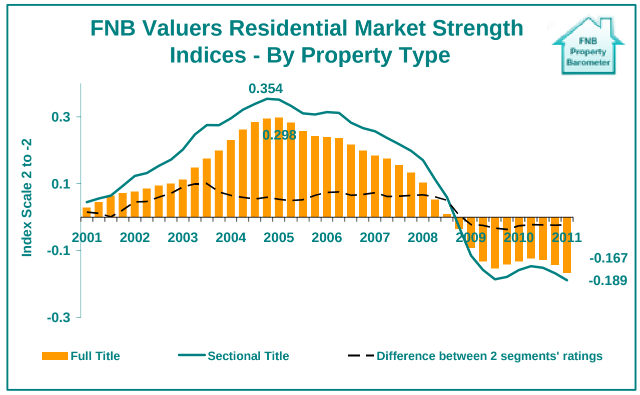
However, by early-2011, the price inflation gap between the Full and Sectional Title Segments had been virtually wiped out, with the Full Title Segment's growth having shown a more pronounced slowdown in the latter half of 2010.

The year-on-year growth rate in the Full Title Price Index for the 1st quarter of 2011 was a weak 1.3%, whereas the Sectional Title Index grew slightly slower at +1.2% over the period.

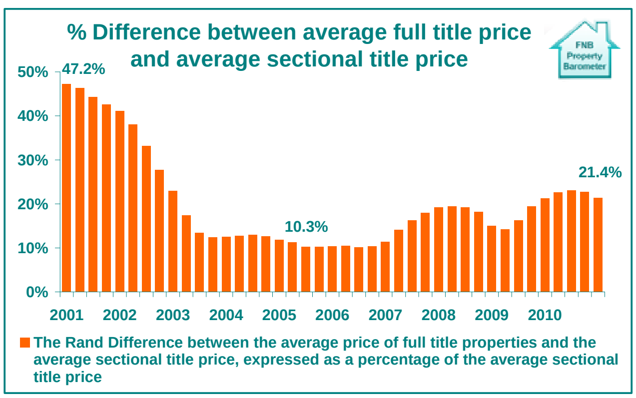
Further supporting both the recent absolute and relative price trend evidence are the readings of the FNB Valuers' Market Strength Indices. In the 1st quarter, the 2 ratings, i.e. the Market Strength ratings, for the Full Title and Sectional Title segments both showed a weakening on the previous quarter's readings, the Full Title reading from -0.144 to -0.167, and the weaker Sectional Title reading from -0.168 to -0.189.

However, since late-2009, the gap between the 2 market balance indices has narrowed mildly, and this is arguably being reflected in a narrowing of the price growth gap between the 2 segments too.



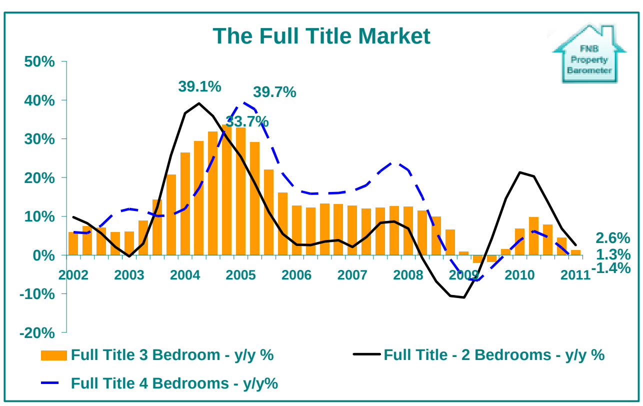


Our belief remains that within the Full Title Segment, the "suburban" 3 bedroom family market is a very solid and stable component, because it was arguably less of a first time buyer and buy-to-let target during last decade's boom than the Sectional Title Market. This, we believe, was important in keeping the Full Title Market a little more solid through the bad part of the cycle (2008/early-09), because established family demand is more steady than 1st time buyer and buy-to-let demand. However, one must also acknowledge the role of the 2 bedroom full title market in boosting the average price growth of this segment last year during the "mini-recovery" (2009/10). The 2-Bedroom Full Title Segment is believed to be driven heavily by the Affordable Housing Segment, which has been less oversupplied than the suburban markets in recent years, as well as being more credit-dependent and thus interest rate sensitive, and as a result had a better price rebound during the 2009/10 "mini-recovery". However, that rebound has also started to wear thin as the effect of the stimulus of the major part of the interest rate cutting cycle to August 2009 wears off.



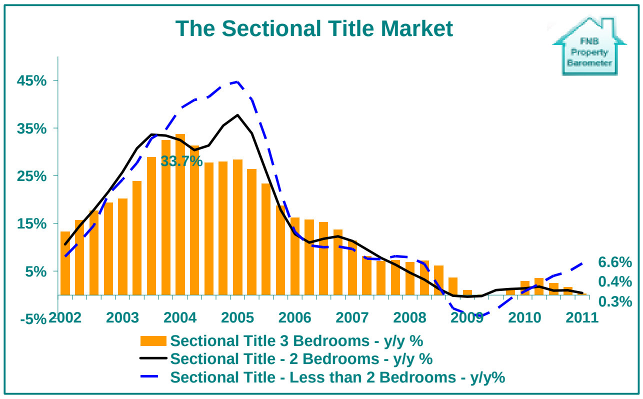
Over the past 2 quarters, as the price growth recovery in the Full Title Segment peters out, the differential between the average Full Title price and the average Sectional Title price has started to narrow once more, from a peak of 23.1% in the 3rd quarter of 2010 to 21.4% by the 1st quarter of 2011.

All key sub-segments' price growth have weakened in the 1st quarter of 2011, with the exception of the Less the One Bedroom Sectional Title Segment which may be benefiting slightly from increased numbers of 1st time buyers.



Examining trends in the key sub-segments of the Full Title Market, all 3 sub-segments have shown further de-celeration in year-on-year price growth. In the 1st quarter, the largest slowdown off the highest growth base came from the 2 bedroom segment with this sub-segment's average price growth measuring +2.6%, compared to the +6.8% recorded in the previous quarter. The 3 Bedroom sub-segment showed slight price growth of +1.3%, down from a previous +4.5%, while the 4 Bedroom sub-segment entered negative price growth to the tune of -1.4%, compared with a previous quarter's +1.8%.

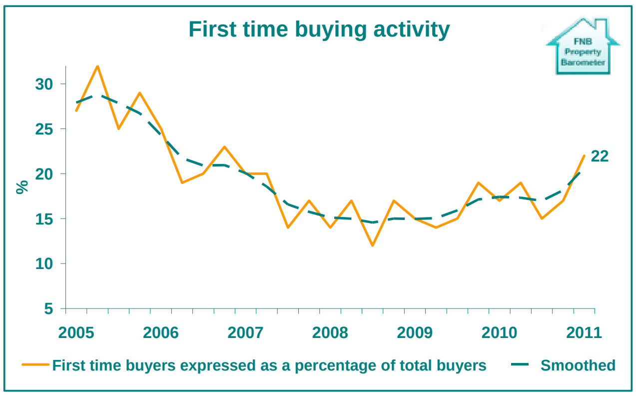
On the sectional title side, the 3 Bedroom sub-segment recorded a meagre +0.3% year-on-year price growth in the 1st quarter, slightly

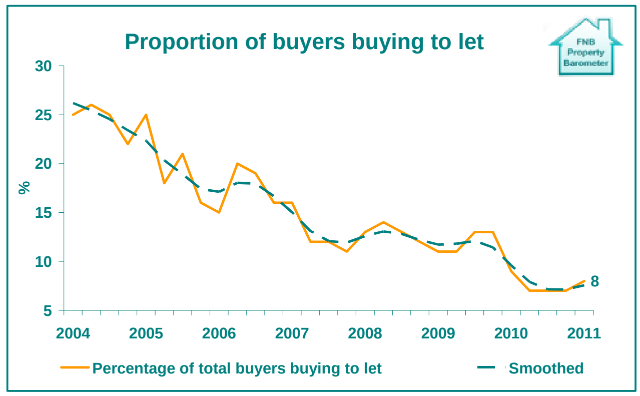


down from +1.6% previous, while the major 2 Bedroom sub-segment rose by +0.4%, down from +1% in the previous quarter. The Less than 2 Bedroom sub-segment of the sectional title segment was the exception to the norm, showing some acceleration in average price growth to +6.6%, from a previous quarter's +4.8%.

One must bear in mind that the Less than 2 Bedroom sub-segment tends to be more cyclical than the others, and that it also saw the biggest price dip during 2008/9 of the key sectional title sub-segments, so its prices come off a lower base. This segment is believed to be a major target of 1st time buyers in the former white suburban areas, a source of demand that is more cyclical than overall residential demand. Its reliance on 1st time buyers may be benefiting it at present, because our FNB Estate Agent Survey shows an increase in 1st time buyers as a percentage of total buyers from 17% in the 4th quarter of 2010 to 22% in the 1st quarter of 2011.

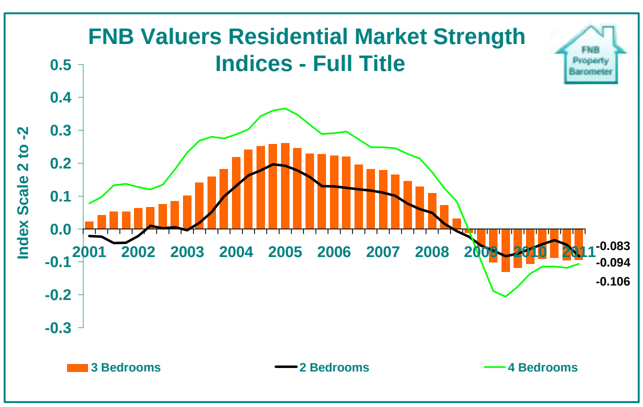
This sub-segment was also believed to be a target of buy-to-let buying during the boom years. This source of demand still remains weak, however, having only increased very slightly from 7% of total buying to 8% over the past 2 quarters according to Estate Agents surveyed.

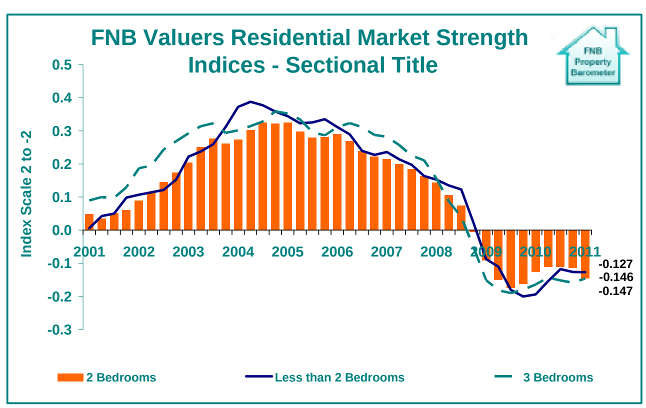




The FNB Valuers' Market Strength Indices appear to more-or-less support the recent price trend findings. Of the 3 main sub-segments for the Full Title Segment , the 2 Bedroom sub-segment still showed the strongest reading at -0.083, but also showed the most noticeable weakening in the reading from the previous quarter. The 3 Bedroom sub-segment had a slightly weaker reading of -0.094, with the 4 Bedroom market weakest at -0.106. This ties in with the order of price inflation rates of these 3 sub-segments currently.

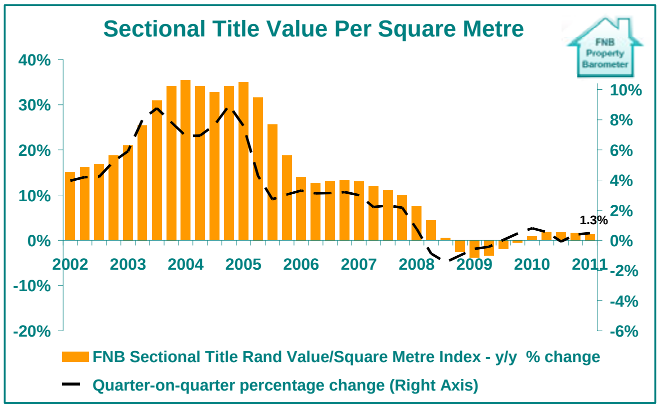
In the Sectional Title segment, the Less than 2 Bedroom sub-segment now has the strongest market strength reading of the three, at -0.127, followed by the "Less the 2 Bedroom" sub-segment with -0.146, while the 3 Bedroom segment now has the weakest reading of -0.147. These relative positions of the Sectional Title sub-segments' market strength readings tie in with the relative positions in their price growth rates.





How can we help you?

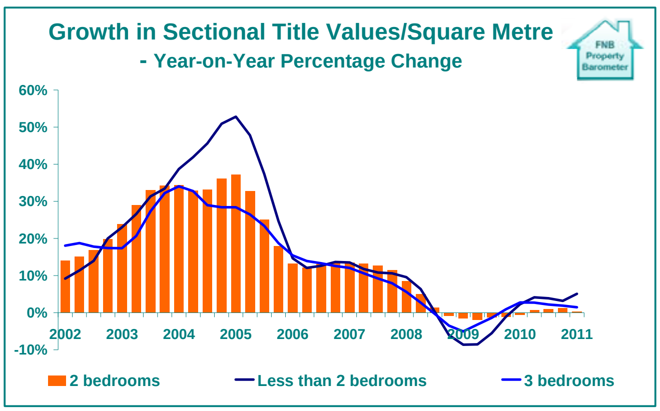
The per square metre Sectional Title Value Indices

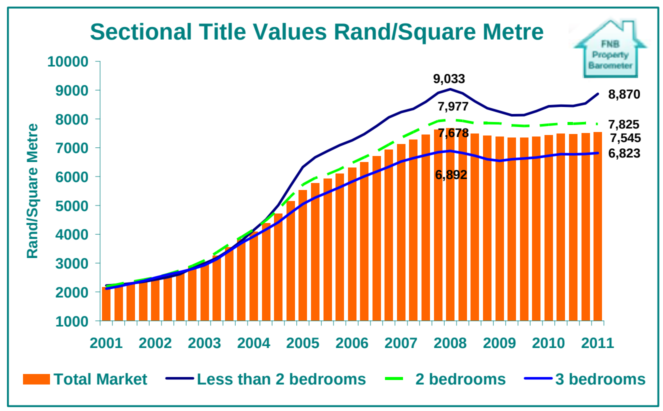


The FNB Sectional Title Value Per Square Metre Index, which estimates the average value of sectional title property on a per square metre basis, is an attempt to reduce the effect of a change in the size composition of property transactions on property indices over time, thereby getting a more accurate reflection of true property value trends in this property category. The index is a fixed-weighted average of the 4 Sectional Title Market sub-segments, i.e. the "Less than 2 Bedroom Segment, the 2 Bedroom Segment, the 3 Bedroom Segment and the 4 Bedroom Segment". The 2 Bedroom sub-segment is by far the largest of the Sectional Title Market, accounting for almost half of the overall index.

On a per square metre basis, the average value of sectional title properties rose by +1.3% year-on-year for the 1st quarter, down from the previous quarter's +1.7% revised figure. On a quarter-on-quarter basis, the average value registered very mild positive growth of +0.5%.

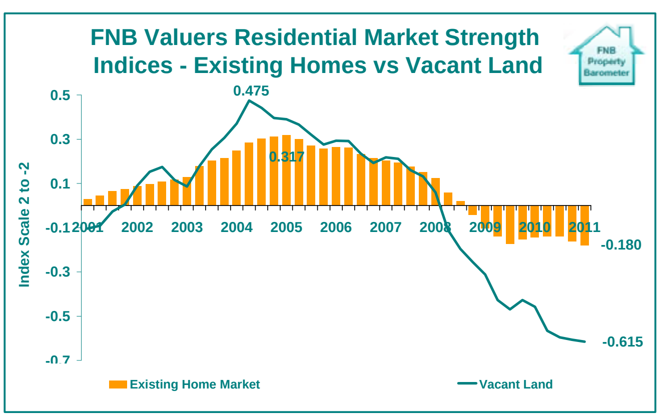
Segmenting the Sectional Title Market into its 3 key segments, the smaller the size in terms of bedroom number the higher the per square metre value. The "Less than 2 Bedroom Segment" showed an average value of R8,870/square metre in the 1st quarter of 2011, the 2 Bedroom Segment averaged R7,825/square metre, and the 3 Bedroom Segment R6,823/square metre. The Overall index averaged R7,825/square metre.





All segments are still at lower average per square metre values than their 1st Quarter 2008 peak values despite making up some of the recession-driven losses more recently. The "Less than 2 Bedroom" sub-segment was the most negatively affected during the 2008/9 slump but after a recent catch-up sees its average/square metre value now only -1.8% below the early-2008 peak. The 2 Bedroom segment is -1.9% down from peak while the 3 Bedroom sub-segment is a mere -1% lower.

The vacant land market remains firmly in the doldrums



The oversupplied nature of the residential market in recent years, and the resultant building slump, has had a dramatic impact on the vacant land sub-segment, now the weakest property sub-segment. Whereas the FNB Market Strength reading for the entire existing home market was -0.18, the vacant land index reading was a far weaker -0.615, and no sign of strengthening was visible. This would continue to suggest another weak year on the property development front in 2011.

4. CONCLUSION

As at the 1st quarter, it is very likely that housing affordability, as measured by the average house price/average remuneration ratio and by the instalment repayment/average remuneration ratio, continued to improve. This is due to anaemic house price growth, the likelihood of wage inflation being significantly stronger than house price growth, and a further decline in the average interest rate following a late-2010 interest rate cut.

However, affordability calculations are based on the wage growth of those employed, and after a major decline in formal sector jobs during the recession in 2008/9, recent employment growth remains very slow, and the household sector as a whole remains financially pressured. This pressure continues to be reflected in relative segment price performances. Most noticeable in this regard is that, when measured on a value band basis, the affordable area segment has shown the best price growth in recent times. The household sector also continues to be focused on basics, with coastal holiday town price estimates continuing to show significant deflation.

However, despite some difference in the relative performances of segments, virtually all housing segments that we measure have shown further de-celeration in price growth during the 1st quarter. The exception is that of the “Sectional Title Less than 2 Bedroom” segment, which may have been buoyed slightly by the arrival of an increased number of 1st time buyers in recent times.