EASTERN CAPE RESIDENTIAL PROPERTY REVIEW

- The Eastern Cape residential market is a more comfortable place these days, but the province needs an economy that can retain and attract more skills

FNB Property Barometer

FNB PROPERTY MARKET ANALYTICS

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SUMMARY

The Eastern Cape residential property market appears to have a more comfortable existence these days, after having seemingly battled its way back from a severe slump that co-incided with a severe recession. The province is more dependent on the highly-cyclical manufacturing sector than, for instance, the more services-driven economies of the Western Cape and Gauteng, and this was seemingly reflected in the severity of the slump in the province's house prices around 2008/9, because the manufacturing recession in South African was far more severe than was the case in other major economic sectors..

So, whereas the national FNB House Price Index declined by -3% in 2009, the FNB Eastern Cape House Price Index declined by -10.2% in the same year.

But with something of a lag when compared to the country as a whole, the Eastern Cape residential property market has battled its way back to greater stability, and in the 1st quarter of 2011, the province's house price index was still showing some acceleration in growth. The year-on-year rate of increase in the average house price was 8.6%, which was a further increase on the 7.1% of the previous quarter, and this represents the 4th consecutive quarter of positive year-on-year growth in the index.

Our FNB Valuers panel still, however, suggests that there is some work to be done in restoring the market balance to a healthy level, rating demand as still weak relative to the way it rates supply. In effect, the results of our FNB Estate Agent Survey for the Nelson Mandela Bay Metro support this view. The agents surveyed still suggest a somewhat unrealistically priced market in the province's largest city region, with 87% of sellers still having to drop their asking price in order to sell, as at the 1st quarter of 2011 (using a 2-quarter moving average), while the average time of a home on the market was 12.1 weeks, where an average of nearer to 2 months would arguably suggest a healthy market..

Nevertheless, our Estate Agent panel indicates significantly more 1st time buyers, less (though still very significant) financial stress-related selling, and higher rates of upgrade-related selling, than around 2008, all indicating that interest rate cutting since late-2008 has brought significantly greater comfort to the region's residential market.

However, the competitiveness of the Eastern Cape economy, relative to the 2 major provinces, may be a challenge at present. Agents point to a recent rise in the percentage of Mandela Bay sellers that sell in order to re-locate to elsewhere in South Africa to around 12%, significantly higher than the national re-location selling average of 8%. They also suggest that the main destination of those re-locating away from the region are Gauteng and the Western Cape.

We have done our own research using Deeds Office data to estimate the movements, between provinces, of repeat buyers, and this appears to support the views of the Mandela Bay estate agents that the region has a higher percentage of sellers re-locating to elsewhere in SA than is the case at least for the country's 2 major economic regions, Gauteng and the Western Cape. Our Deeds research also suggests that the Eastern Cape's "net outward migration rate" for repeat buyers (the difference between those repeat buyers coming into the province and those leaving) has been deteriorating over the past 2 years. This would suggest that, although the Eastern Cape has emerged from the 2008/9 recession, the recoveries of Gauteng and the Western Cape economies may have been a little stronger. This possible differential in the strength of economic recovery between regions may present a challenge for the Eastern Cape in terms of its ability to retain and attract skilled people to the region to drive its economy, and this competitive disadvantage may be being reflected in a worse net outbound migration rate of repeat sellers than is the case for Gauteng and especially the Western Cape. The province's net outward migration rate of repeat sellers, however, is by no means the worst of the 9 provinces.

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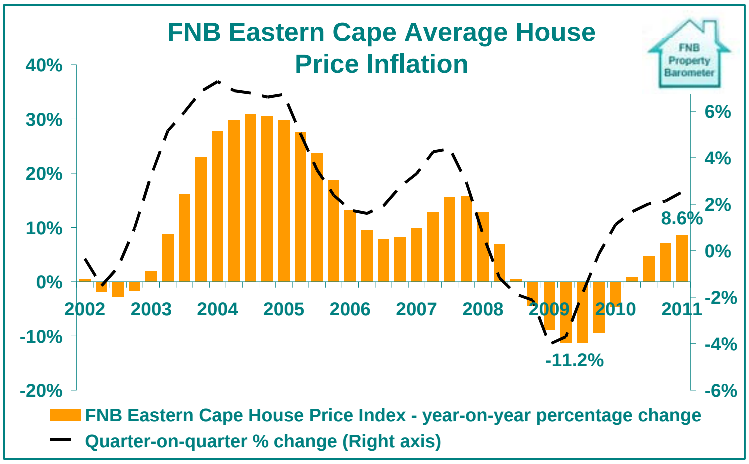
Finally, in 2011 we expect a flattening out in the residential buying market, given the expectation of no further interest rate cutting and possible interest rate hiking late in the year. However, simultaneously, we expect the region's rental market to continue its apparent strengthening trend through 2011, buoyed by a lack of buy-to-let buying constraining supply growth in properties available to rent, as well as the prospect of interest rate hikes making the rental option attractive for a certain group of would be future buyers.

EASTERN CAPE HOUSING MARKET, ALTHOUGH STILL IN A MEDIOCRE STATE, SEEMS A MORE COMFORTABLE PLACE THESE DAYS COMPARED TO 2008/9

After a very deep slump through 2008/9, Eastern Cape house prices have seen some recovery, seemingly lagging the 2009/early-2010 national mini-recovery in the housing market. We have mentioned before that we are of the opinion that the Eastern Cape economy, and specifically Nelson Mandela Bay, may have been worse hit than the national economy during the recession of 2008/9, due to the high exposure of the region to the highly-cyclical manufacturing sector. Other more services driven metros such as City of Joburg and City of Cape Town seemed to come through the recession less affected. That is not to mention the lengthy drought that has affected parts of the Eastern Cape economy.

Nevertheless, big interest rate cuts have brought some relief to the Eastern Cape too, manufacturing has undergone something of a recovery, and the region's house prices moved back into positive year-on-year growth as at the 2^{nd} quarter of 2010. This was a little later than the national "mini-recovery", but whereas the national house price index has already shown declining growth since June 2010, as at the 1^{st} quarter of 2011 the FNB Eastern Cape House Price Index was still experiencing accelerating growth.

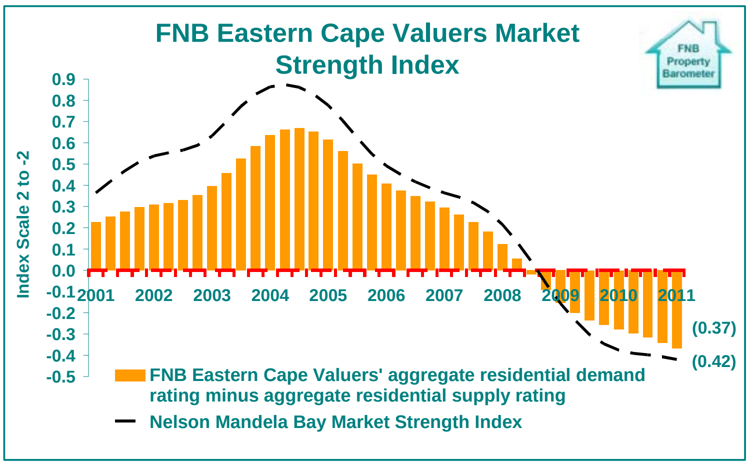


From 7.1% year-on-year growth in the 4^{th} quarter of 2010, the growth rate increased further to 8.6% in the 1^{st} quarter of 2011. And, although the quarter-on-quarter rate of increase looked to be flattening out, the 1^{st} quarter rate of 2.5% was still a little higher than the 2.1% rate of the previous quarter. So, it certainly isn't a boom, but the Eastern Cape market appears to have been doing a little better as of late in terms of price performance.

Data source: FNB

THE SUPPORT FOR THE PROVINCE'S MARKET APPEARS TO BE MORE FROM OUTSIDE OF MANDELA BAY

Having said that the average estimated price for the province as a whole still appears to be on an accelerating growth track, this appears to be driven more by the regions outside of Mandela Bay, with the East London-dominated Amatole District playing a key role. We say this partly based on what our panel of Valuers' tells us via its ratings of residential demand versus supply.



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 (+1)", "average (0)", and "weak (-1)". From all of these ratings we compile an aggregate demand and an aggregate supply rating, which are expressed on a scale of -1 to +1. After aggregating the individual demand and supply ratings, we subtract the aggregate supply rating from the demand rating to obtain the FNB Valuers' Residential Market Strength Index.

One can see on the accompanying graph that the Mandela Bay Market Strength Index has been weaker than the index for the Eastern Cape as a whole since early-2009, and as at the 1^{st} quarter of 2011 was still recording a weaker reading of -0.42 compared to the entire province's -0.37. The property slowdown of 2008/9 therefore appeared to be more severe in the Mandela Bay Metro relative to the rest of the province, and our valuers still see it as having a weaker demand relative to supply.

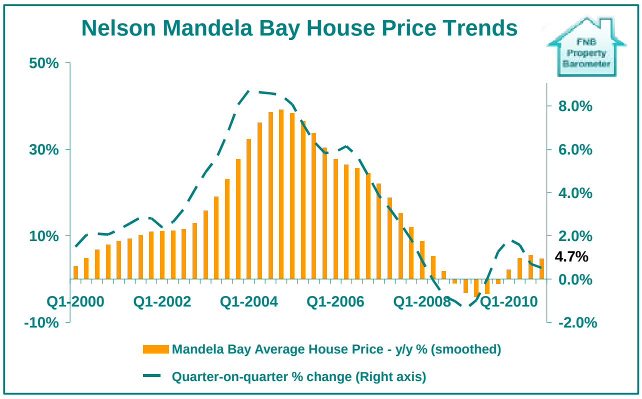
PRICE TRENDS OF THE EASTERN CAPE'S MAJOR URBAN CENTRES

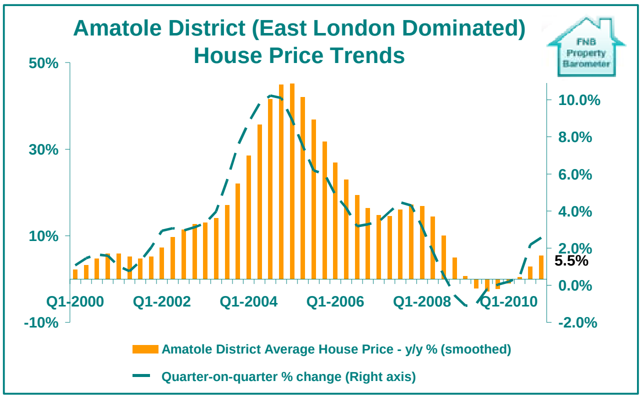
Using Deeds data property transactions by individuals in areas deemed to be residential dominant, we estimate average home price trends for the two major urban regions of the Eastern Cape, namely Nelson Mandela Bay and Amatole District (East London Dominated).

It would appear from this that Nelson Mandela Bay did experience a slightly bigger average price decline in 2008/9, responded a little quicker to the interest rate cuts which started late in 2008, and is seeing its price growth already starting to de-celerate to +4.7%, much like the national trend. Amatole District, by comparison, seemingly responded slower to better interest rate and economic times, and appears to still have been experiencing accelerating quarter-on-quarter as well as year-on-year growth as at the final quarter of 2010 (+5.5%).

It may thus be East London and surroundings that are currently more responsible for the still-accelerating Eastern Cape House Price growth, while Mandela Bay's price growth slows.

Note that this data is from a different source to our own FNB Eastern Cape House Price Index and is thus not entirely comparable.





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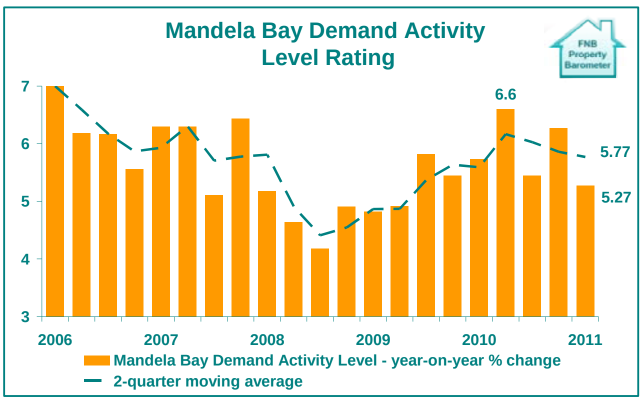
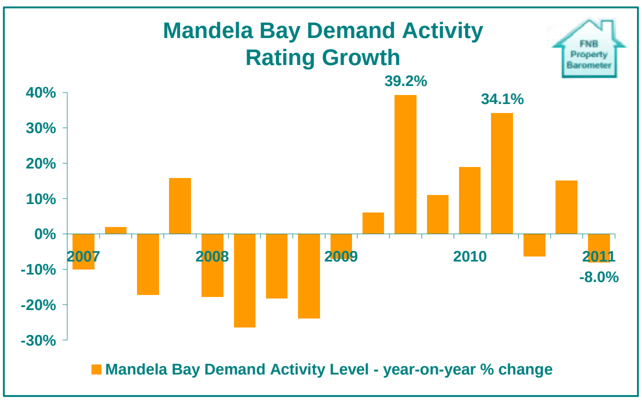
FNB ESTATE AGENT SURVEY SUGGESTS THAT THE PACE OF IMROVEMENT IN MANDELA BAY HAS INDEED FLATTENED OUT AT MORE COMFORTABLE LEVELS COMPARED TO 2008

In our FNB Estate Agent Survey, we ask a sample of estate agents to provide us with their subjective perception of demand levels on a scale of 1 to 10. The 1st Quarter FNB Estate Agent Survey for Nelson Mandela Bay indeed supports the notion that the best improvement in the housing market is possibly behind us in this metro, having taken place from late-2008 to the 2nd quarter of 2010. There was a noticeably uptick again in the final quarter of 2010, and renewed interest rate cutting by the Reserve Bank may well have played a role, but the 1st quarter demand activity rating declined again from 6.27 to 5.27 in the 1st quarter. Take note that in this region, a smaller sample size can make quarter-to-quarter movements volatile. As such, the demand activity rating graph for Mandela Bay also includes a 2-quarter moving average for smoothing purposes. This has shown something of a tapering off since a peak in the 2nd quarter of last year.

The Mandela Bay trend over the past few years seems to be broadly in line with the national trend, in which the demand rating also reached a peak early last year.





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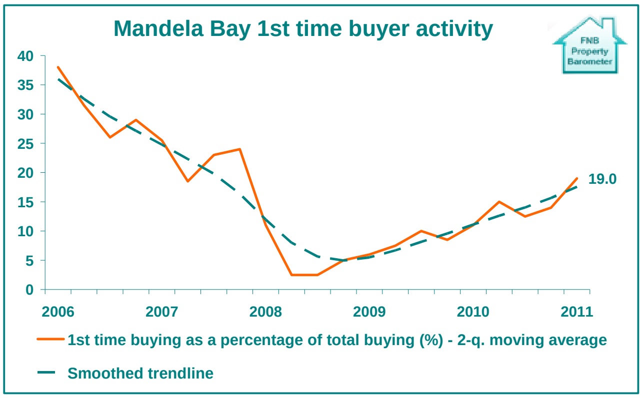
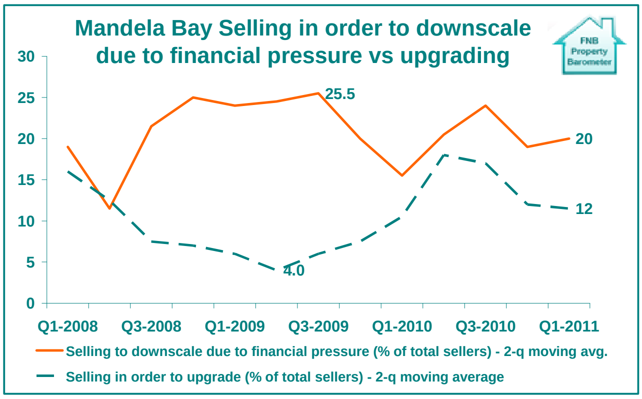
FNB ESTATE AGENT SURVEY SUGGESTS STRONGER 1ST TIME BUYING AND UPGRADING THESE DAYS, COUPLED WITH LOWER DOWNSCALING DUE TO FINANCIAL PRESSURE



Estimated 1st time buying in Mandela Bay has improved steadily since the depths of recession in 2008, from a low of 2.5% of total buying in the middle quarters of that year to 19% by the 1st quarter of 2011.

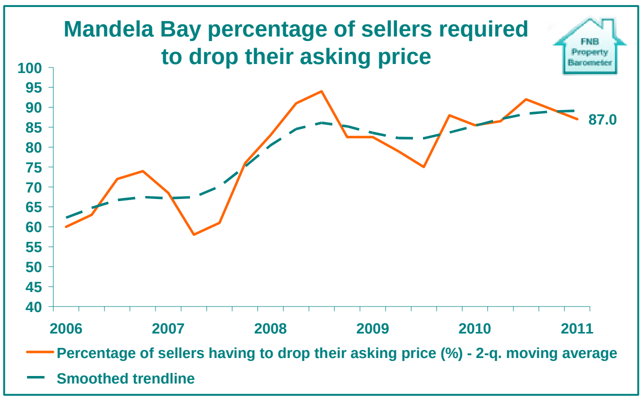
This partly reflects 1st time buyer flexibility, with this group often able to remain out of the market until economic and interest rate times suit them, but is also reflective of a more lenient banking sector credit stance compared to 2008. This group of buyers is on average a low saving group, so deposit requirements take their toll on 1st time buyers. The more common incidence of 100% loans has been crucial to helping a higher percentage of 1st time buyers into the market.



On the selling side, another important demand driver is that of selling in order to upgrade. This, according to the agents surveyed, measured 12% in the 1st quarter of 2011, using a 2-quarter moving average. This has tapered off somewhat from the 18% registered in the 3rd quarter of 2010, but is still well-higher than the 4% low of around mid-2009.

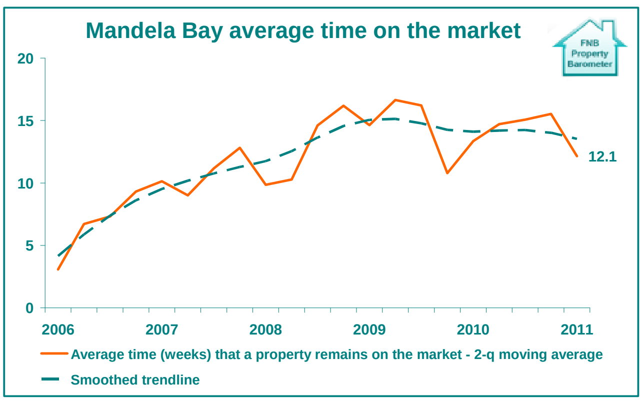
Selling in order to downscale due to financial pressure remains high at 20% for the 2 quarters to the 1st quarter of 2011, but is down on the 25.5% high reached in the 3rd quarter of 2009.

PRICING REALISM HAS IMPROVED EARLY IN 2011, ALTHOUGH STILL HAVING SOME WAY TO GO



It would appear that there has been some slight improvement in pricing realism early in 2011, although the market has some way to go before being deemed to be "realistically priced".

The Estate Agent Survey estimates that a still-high 87% of sellers were required to drop their asking price for the 2 quarters to the 1st quarter of 2011. This is slightly lower than the previous quarter's reading of 92%, but the smoothed trend line has not yet turned downward.



The previous indicator should be read in conjunction with the average time that a property is on the market prior to being sold. This average time has declined to 12.1 weeks in the 1st quarter, down from the previous quarter's 15.5 weeks. Once again, this decline in the estimated average time is a healthy improvement, but near to 3 months is probably still too long for a healthy market, with nearer to 2 months average time arguably a better benchmark for a strong market.

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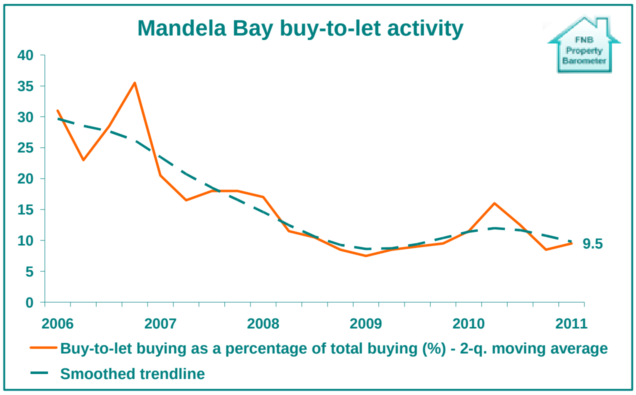
WEEK BUY-TO-LET BUYING HAS POSITIVE SPIN-OFFS FOR THE MANDELA BAY RENTAL MARKET

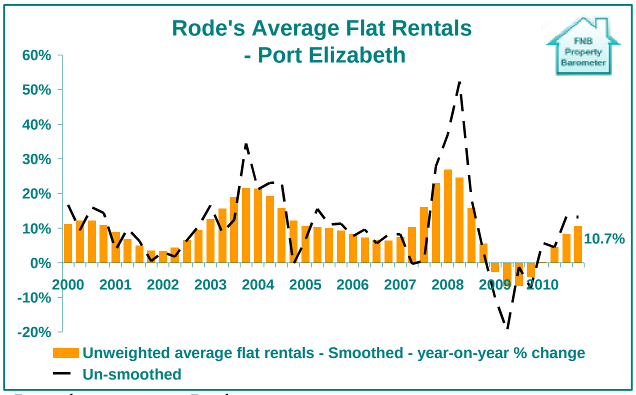


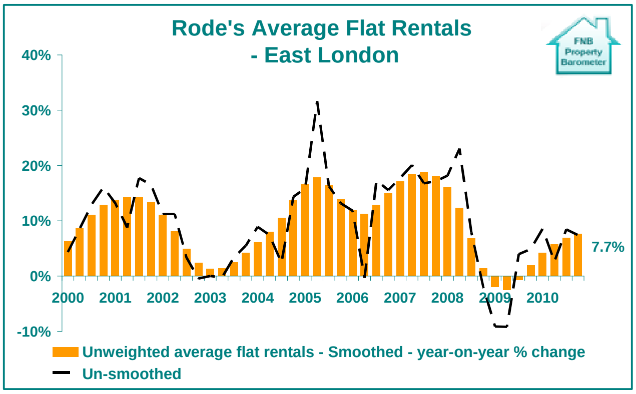
While not being overly-optimistic about any major strengthening in the home buying market from current levels in the near term, the rental market may be a different story. Here, weak buy-to-let buying in recent years means a supply growth constraint in available properties for rental.

Again, using a 2-quarter moving average, the estimated percentage of total home buyers that were deemed to be buy-to-let buyers was 9.5% in Mandela Bay, which is still a lowly percentage and only marginally higher than the 8.5% recorded in the previous quarter.

Weak supply, coupled to our belief that rental demand may prove to be quite solid in the near term, due to significant household sector financial pressure (making rental often a more attractive option than buying) along with prospects for interest rate hikes later in 2011 (also adding to the temporary attractiveness of the rental option for would be buyers), leads to the expectation that Port Elizabeth rental inflation can accelerate further than what the Rode data suggests that it already had by end-2010.

Indeed, a strengthening rental market in Port Elizabeth (the dominant town in Mandela Bay) already appears to have been the order of the day. Our smoothed version of the un-weighted average Port Elizabeth flat rental (using Rode flat rentals data) had accelerated into double-digit year-on-year growth of 10.7% in the 4th quarter of 2010, from 8.4% in the previous quarter. In East London (the dominant town in Amatole district), a similar rental market improvement appears to have been taking place, with smoothed flat inflation of 7.7% as at the 4th quarter of 2010.

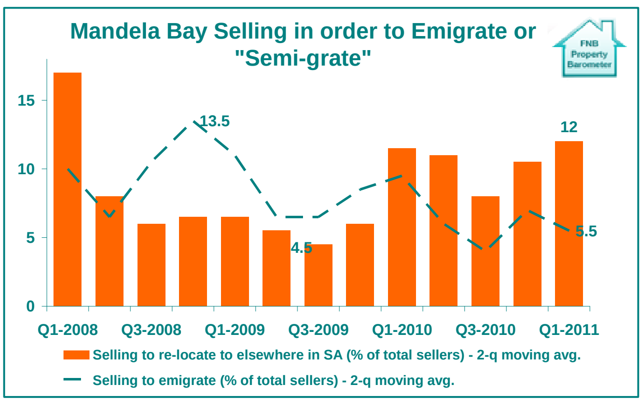




Raw data source: Rode

THE EASTERN CAPE ECONOMY NEEDS MORE "PULLING POWER" TO RETAIN AND ATTRACT SKILLED RESIDENTS

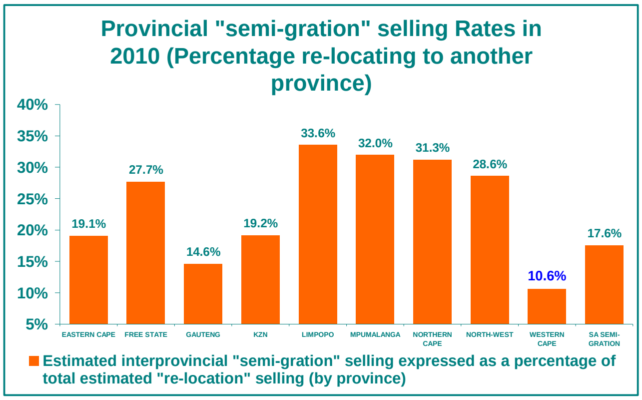
Over the past year, our sample of estate agents has been reporting a relatively low percentage of sellers selling in order to emigrate, i.e. 5.5% as at the 1st quarter of 2011. This is well-lower than the estimated 2-quarter average high of 13.5% reached in the 4th quarter of 2008. Lower rates of emigration selling these days suggest that long term sentiment amongst Mandela Bay residents towards the country is not too bad currently.



However, the agents are reporting a very significant percentage of people, i.e. 12%, selling in order to re-locate to other parts of South Africa. This is significantly above the 8% national survey average. When asked to indicate the key re-location destinations, Gauteng and the Western Cape feature very strongly amongst Mandela Bay agents.

The survey results, which suggest that the Eastern Cape has a higher percentage of sellers leaving for other parts of the country than do the bigger metro regions, appear to find some support in our own analysis of migration patterns between provinces using Deeds Office data.

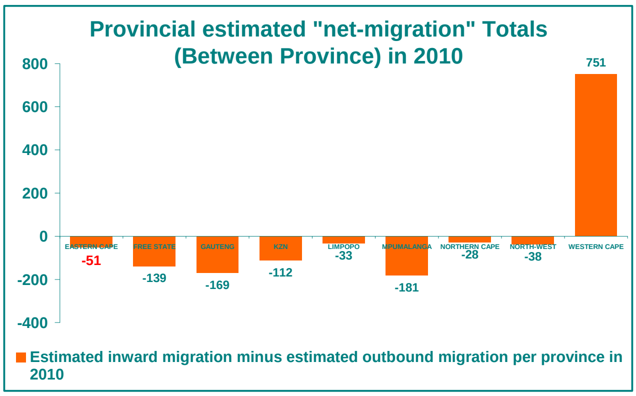
Deeds data offers us the opportunity to try to quantify the migration of people between regions, in this case between provinces. For this purpose, we identify all purchases by individuals where there is a corresponding sale by the same individual within 12 months either side of the purchase. The bulk of these "repeat buying" transactions are within the same province, but in 2010, nationally, 17.6% of these purchases were in a province other than where the corresponding sale took place, and this figure is our estimate of the year's inter-provincial re-location rate or, alternatively put, the" semi-gration" rate of repeat buyers. It isn't an exact science, as a portion of holiday buying may "infiltrate the numbers", while 1st time buyers who have re-located do not get included into this figure. Nevertheless, we believe it to be a good indicator of repeat buyers semi-gration flows.

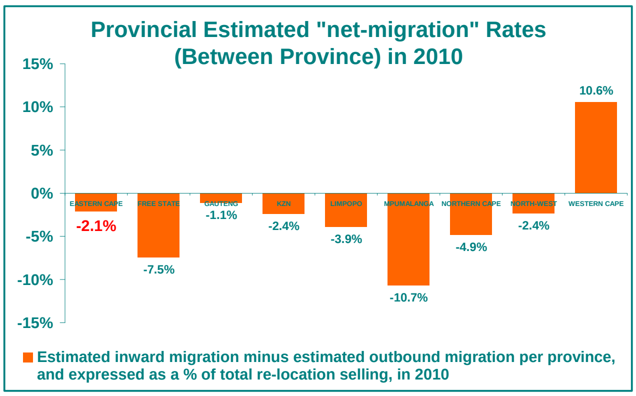


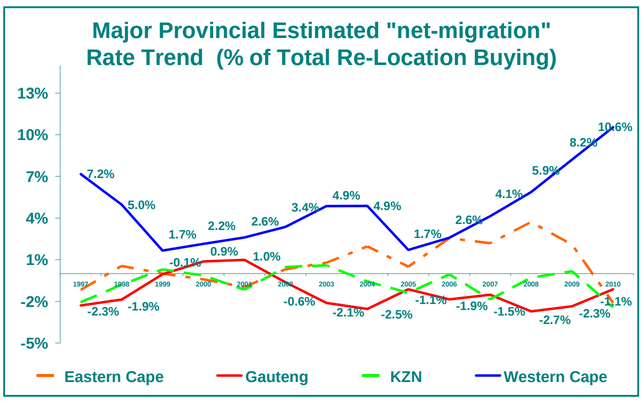
Breaking it down by province, at 19.1% of total repeat buyers in 2010, the Eastern Cape province did not have the highest rate of outbound migration of "repeat buyers". The smaller provinces have far higher percentages in this regard.

However, of the major 4 provinces, the Eastern Cape's estimated percentage of outbound repeat buyers is significantly higher than the 10.6% and 14.6% rates of the Western Cape and Gauteng respectively.

On a net migration basis, however, the Eastern Cape appears less unlike the Gauteng Province, although all provinces fare poorly in this regard relative to the Western Cape (which was the only province with an estimated positive net inbound migration rate of repeat buyers). But the Eastern Cape did nevertheless experience a slightly worse net migration rate than Gauteng too, i.e. repeat buyers entering a province minus those departing, to the tune of -2.1% of total repeat buying in 2010 by the province's inhabitants.







However, while the net outbound migration rate from the Eastern Cape would not appear to bad, two factors should be considered. Firstly, our migration estimates do not include 1st time buyers, and we suspect that the province may lose a significant portion of its skilled would be 1st time buyers to the bigger economic regions elsewhere in SA. Secondly, the accompanying graph shows that, whereas the Western Cape and Gauteng net migration rates improved in 2009 and 2010, the Eastern Cape showed a significant deterioration in its rate in those 2 years. The trend has thus been "going the wrong way" as of late.

Our suspicion is that the 2 major provinces have come through the tough economic times of recent years in better shape, due to less dependence on manufacturing and more dependence on a more

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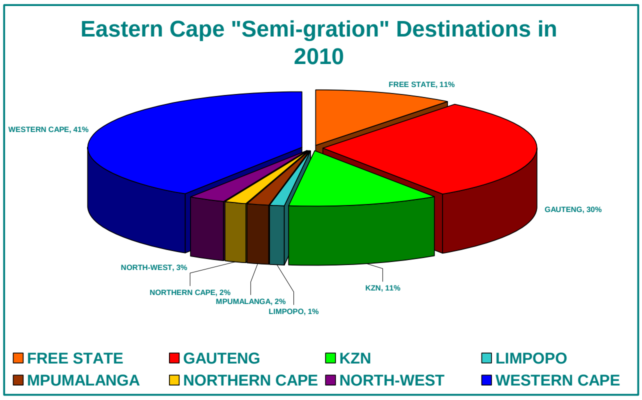
stable services component of the economy. In addition, many corporates centralize more functions to head office during tough economic times, and we suspect that Gauteng and the Western Cape would have benefited mostly through such restructurings.

In short, therefore, while the Eastern Cape has by no means the worst net outbound migration rate of what essentially is its skilled labour base, it does lag the country's 2 largest economic regions in this regard and its net migration appears to be trending worse.

This presents the province with its key challenge in the coming years, i.e. to raise its economy to a level sufficient to provide a significantly greater part of its home grown skilled labour force with long term career prospects that are sufficiently attractive as to keep greater numbers in the province, while simultaneously attracting a greater portion of other provinces' skills. Improving the net migration rate is not only good for long term economic growth, but also supportive of a stronger property market.



Finally, our research suggests that, in 2010, the most popular Eastern Cape inter-provincial "semi-gration" destination was Western Cape, followed by Gauteng, which is broadly supportive of what our agent panel is saying.

IN CONCLUSION.

The Eastern Cape residential market continued to show accelerating house price growth in the 1st quarter of 2011, having seemingly lagged the country as a whole in the recovery process following the 2008/9 recession. Nelson Mandela Bay, the province's largest urban market, appears to have been a little more oversupplied than the province as a whole, and has already seen tapering house price growth. The Amatole District by comparison, the other major city region in the province, was still seeing accelerating house price growth as at the end of 2010.

Our FNB Valuers panel still suggests that there is some work to be done in restoring the market balance to a healthy level across the province, rating demand as still weak relative to the way it rates supply. In effect, our FNB Estate Agent Survey for Nelson Mandela Bay Metro supports this view, with the agents still suggesting a somewhat unrealistically priced market in the province's largest city region. An estimated 87% of sellers still had to drop their asking price in order to sell, as at the 1st quarter of 2011 (using a 2-quarter moving average), while the average time of a home on the market was 12.1 weeks, where an average of nearer to 2 months would arguably suggest a healthy market.

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