1st QUARTER FNB BUY-TO-LET ESTATE AGENT SURVEY

- Buy-to-let buying still weak, implying slow supply growth in homes available to rent, and this is key to our expectations of further improvement in the rental market in 2011

FNB PROPERTY MARKET ANALYTICS

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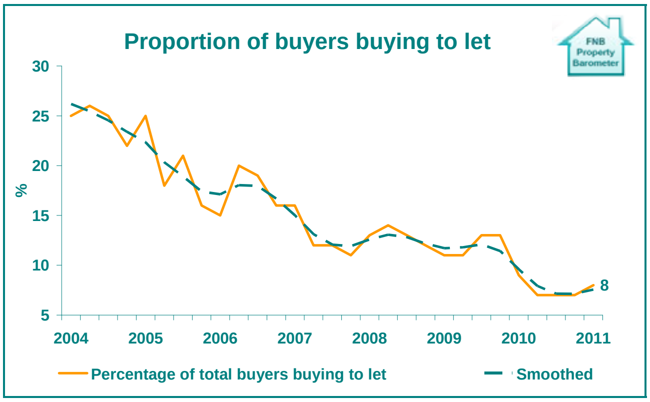
FUNDAMENTALS DRIVING THE COUNTRY'S RENTAL MARKET STILL APPEAR TO BE IMPROVING, WITH SUPPLY GROWTH CONSTRAINED

Such is the nature of the leads and lags in the property cycle, that it may sound ironic when we say that residential property may slowly be regaining some appeal as an investment asset class precisely because of a lack of investment in it in recent times.

While data availability for the South African rental market is somewhat sparse, those indicators available do suggest some improvement in the fundamentals driving the rental market, and we continue to expect further rental market strengthening in 2011.

In the 1st quarter of 2011, the FNB Estate Agent Survey continued to estimate very low rates of buy-to-let buying, although the percentage was admittedly slightly higher than that of the previous quarter. From a low of 7% of total buying in the previous quarter, the 1st quarter buy-to-let buying rate measured a slightly higher 8% of total estimated home buying, according to the group of estate agents surveyed.

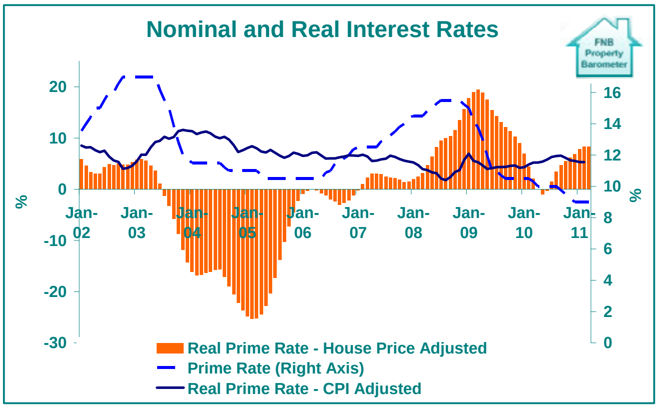


However, this percentage remains very weak compared to the double-digit percentages witnessed up until as recently as 2009. And while reflective of tough financial times, the buy-to-let weakness is seen as a positive from a rental market performance point of view, limiting the growth in supply of available property to rent, and thus boosting rental inflation.

One of the reasons for a low percentage of buy-to-let buying, we believe, is that many perhaps less sophisticated buy-to-let investors over the past decade may have been pinning their hopes on strong capital growth of property as a way to make a return, as opposed to many more seasoned investors who focus on income stream and the yield on property. The capital growth-focused buying was perhaps rational at the time, taking advantage of a low cost of borrowing relative to house price growth. With house price growth far outstripping the rate of interest around 2004/5, investors or speculators could profit relatively quickly by using cheap credit to buy property, even if the income stream which the property generated was weak.

It is not surprising, therefore, that back in 2004 when the Estate Agent Survey began, the percentage of buy-to-let buying was up at around 25% of total buying.

How the times have changed for the speculator, or capital growth-focused buy-to-let buyer, continues to be reflected in our alternative calculation of real prime interest rate. Whereas the normal way to calculate a real prime rate is to adjust prime rate with the consumer price index, to give one an idea of what the property investor/speculator is experiencing we adjust prime rate using the FNB House Price Index.

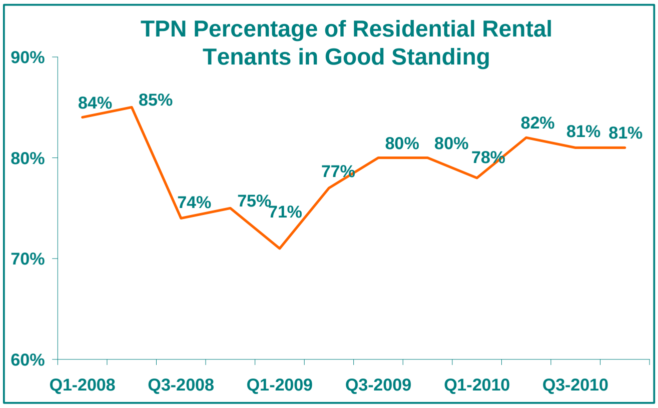


At its lowest rate in February 2005, this measure of real prime rate was a negative -25.3%, caused by rampant house price growth of 36.3% year-on-year at that time. There was no better time to borrow money and ride the capital growth trend.

Recently, as at March 2011, the real prime rate was a positive +8.3%. This is despite prime rate of only 9%, the lowest in decades, and is due to almost non-existent house price growth of +0.7% year-on-year.

The present time, therefore, remains one in which capital growth-focused investors experience very tight interest rate policy relative to house price growth, and will probably not be enticed into the market in significantly larger numbers for the time being.

The demand for rental property may also be a little better these days



It is difficult to determine the level of rental demand, but we believe that the current economic and financial times may have led to some improvement in the demand side of the rental market too.

Household sector financial pressure can be a positive factor for the rental market, because it can increase the short term appeal of renting for a certain group of financially stretched (but not distressed) households. However, there is a balance, and too much financial pressure would ultimately be bad.

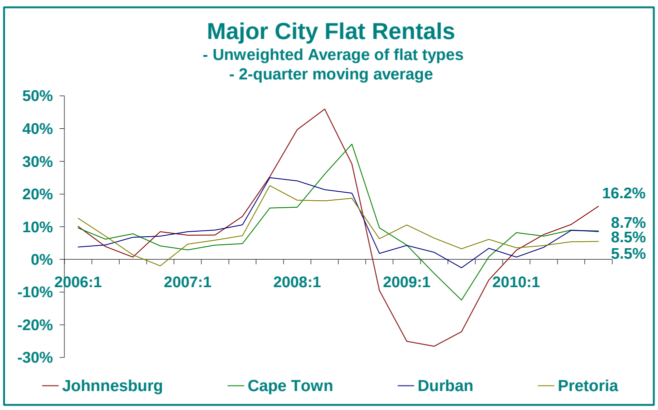
This balance may have been improved since 2009. According to credit bureau, TPN, as in the case of home owners 2009 was a torrid time financially for tenants and prospective tenants too.

As at the 1st quarter of 2009, only 71% of tenants on TPN's records were "in good standing" with regard to their rental payments. In 2010, while the statistics certainly don't suggest a strong financial position yet, the percentage in good standing had risen to a more respectable level above 80%.This would suggest that a lower percentage of tenants be required to exit the market due to non-payment of rent.

In addition, our home buying survey respondents suggest that, although having declined significantly since 2008/9, the percentage of home sellers selling in order to downscale due to financial pressure remains high at around 22%, and many of these sellers move into the rental market. The risks of interest rate hikes later in 2011 are also believed to be a positive for rental demand, as this can lead to some more cautious would-be home buyers adopting a "wait and see" approach, remaining in the rental market for longer and supporting rental demand.

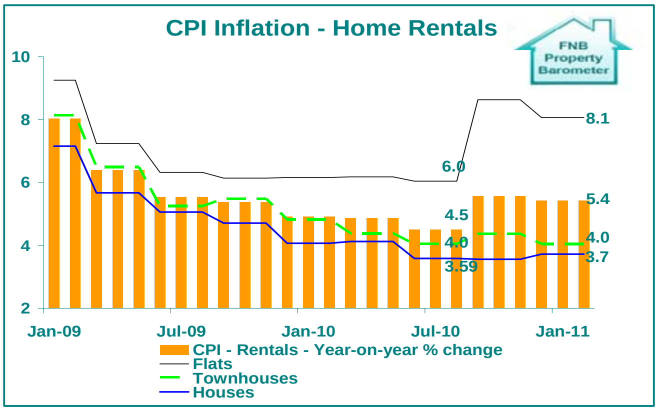
The constraint of rental stock supply relative to demand appeared to be having an effect in 2010

How much of the rental market's performance is due to supply factors and how much due to demand side forces is debatable. We believe that there are elements of both, particularly on the supply side due to weak buy-to-let buying in recent times. The net result, though, appears to be one of mild rental market strengthening through 2010.



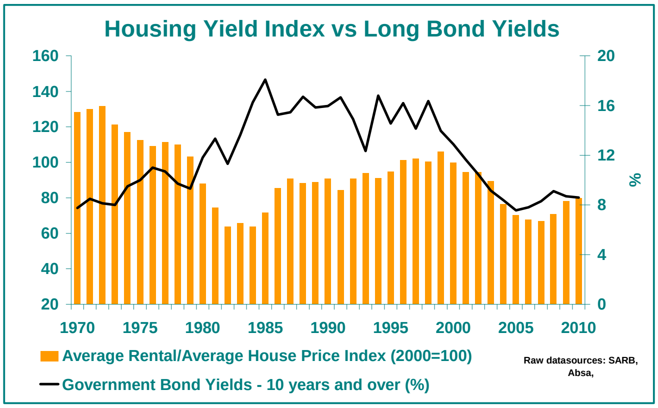
Using data from Rode and Associates regarding flat rentals, it would appear that at least the flats component of the rental market had indeed responded. By major city, while one saw no fireworks yet, our calculations of flat rental averages per major city (un-weighted by flat category) showed a broad increase in market rental inflation rates since the 2009 slump. The 2-quarter moving average for Johannesburg showed the most impressive increase of 16.2% year-on-year as at the 4th quarter of 2010, while Pretoria showed the slowest rate of increase of 5.5%.

How can we help you?



The StatsSA CPI survey also yielded some improvement in actual rental growth late in 2010. Whereas its June survey showed 4.5% rental growth for the overall rental market, following a declining trend through 2009/early-2010, the September and December surveys showed slightly higher rental growth, with the most recent rate being 5.4%. With affordability being key in financially tough times, it is perhaps not surprising that this strengthening took place largely in the area of flat rentals, as opposed to townhouses and houses, with flats showing the strongest rental growth of 8.1% in the latest StatsSA rental survey.

Using SARB data, it would appear that yields rose further in 2010



Data constraints make yield calculations for the residential property sector far from an exact science. However, given very weak house price growth in recent times, coupled to signs of accelerating rental inflation, it is possible that 2010 saw a further rise in gross income yields (gross operating income as a percentage of home value).

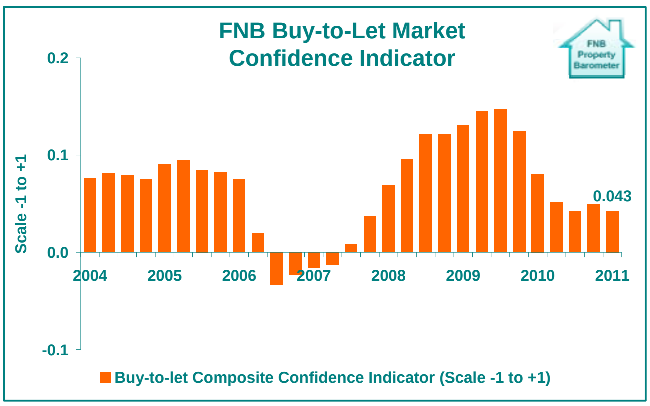
Using Reserve Bank actual rental data as published in the household consumption figures, we calculate a further increase in the average rental/average house price ratio, expressed in index form, for 2010. This was the 3rd consecutive year of increase according to this index, partly the result of a few years of very weak house price growth, and in 2010 perhaps also partly due to some rental market improvement.

At a level of 80, the index is far from suggesting impressive yields on residential property yet, if one compares it to 1999 peak of 106.2. However, the improvement is significant, especially at a time when yields on certain other asset classes are far from attractive. Government bond yields for bonds 10 years and over actually declined in 2009 and 2010 (averaging 8.6% in 2010), and are a far cry from the double-digit levels of the late-1990s, while short term interest rates at multi-decade lows provide little attractiveness for the cash saver. ***Residential property's investment attractiveness relative to other asset classes may thus be slowly on the mend.***

Conclusion – Residential property's attractiveness may be slowly improving, but don't expect buy-to-let fireworks soon

It may seem something of an irony that a lack of investor demand for residential property at present is key to improving the attractiveness of residential property as an investment asset class, and some signs are there that an improving rental market, along with flat house prices, may well have been leading to some rise in residential yields, thus indeed taking the market towards improved attractiveness in future.

However, any such improvement that may have taken place is not expected to lead to a significant increase in buy-to-let buying just yet. Financial pressure in the household sector remains widespread, while there is a significant group of would-be investors that would wish to see improved capital growth first (initiated by stronger primary residential demand). In addition, increased talk of interest rate hiking is expected to keep households cautious in their spending, especially on non-essential items such as buy-to-let residential buying.



We would therefore expect a significant improvement in buy-to-let investment only at the next interest rate cutting cycle a few years from now. By that time, we believe that further rental market strengthening and yield increase would have improved residential property's attractiveness significantly from where it is now.

Our Estate Agent Survey appears to support our view of weak buy-to-let buying in the near term. A slight decrease in the portion of the sample of agents expecting a near term improvement in buy-to-let buying, kept 1st quarter 2011 buy-to-let confidence in the doldrums. After a very slight improvement in the FNB Buy-to-Let Confidence Indicator to a revised 0.049 in the 4th quarter of 2010, the level (scale +1 to -1) dropped back again to a lowly 0.043.