PROPERTY BAROMETER

Quarterly Segment House Price and Market Strength Review.

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1. SUMMARY – AS THE ECONOMY WEAKENS, AFFORDABILITY WILL BE EVEN MORE CRUCIAL GOING FORWARD

There's no getting away from the trouble that some of the world's major developed economies are in, and the reality that it will affect South Africa.

Europe's debt woes have been well publicized. But arguably more significant is what is currently taking place in the world's largest economy, the USA. Indeed, that country did reach an agreement regarding the lifting of its government debt ceiling. However, the scale of its deficit spending and resultant borrowing has begun to cast doubt over its credit risk, and Standard and Poor has become the 1st rating agency to downgrade the US sovereign credit rating from its coveted AAA. This may hamper the US' ability to borrow as cheaply as it has in future, and there is a widespread realization that the US Government fiscal deficit must be reduced, and thus its borrowing needs.

That country's potential fiscal stimulus to its economy thus appears reduced, while with its policy interest rate at virtually zero there is no further scope for interest rate cuts. All the while, oil prices remain arguably too high for what is also the world's largest oil guzzling economy. Unsurprisingly, key global leading indicators point to a looming economic growth slowdown, with recession risk very significant.

In South Africa, we can be thankful that government and the Reserve Bank (SARB) have managed government finance and monetary policy far more prudently at a macro level than much of the developed world. A debt crisis thus seems unlikely here, while the SARB still has some ammunition, in the form of scope to cut interest rates further, should the need arise.

However, with our country's export value at near to one third of gross domestic product (GDP), we can't escape global events, and the SARB Leading Indicator, too, points to an economic growth slowdown. This economic pressure leads us to the belief that the low rate of house price growth seen in recent times will soon dissipate, and that the average house price for 2012 will be unchanged from the 2011 average house price level. This is assuming no interest rate hikes through the forecast period, with the SARB delaying any such moves due to slowing global growth and a resultant weakening of inflationary pressures.

In these weak economic times, it is small wonder that our analysis of segment house price trends continues to point back to affordability and basics as being the key priority. Segmented by major metro area value, our Affordable Area House Price Index followed by the Middle Income Area Index continue to outperform the High Income and Top End segments. Holiday towns, driven by this more non-essential form of buying, continued to show house price decline in the 2nd quarter, compared to major metros which still showed some small positive house price growth. Former Black Township house price growth, coming off the lowest base of all, continued to outperform all of the above segments. Split by Full Title versus Sectional Title, we find the Full Title segment mildly outperforming the Sectional Title segment. This, we believe is partly due to better value for money in the Full Title segment (i.e. the *average price of a 3 bedroom Full Title home remains cheaper than a Sectional Title 3 bedroom unit for instance), again an affordability matter.*

Splitting by size, we find the best price growth in the small-sized 20-80 square metre segment. Smaller is better not only from an average price point of view, but also from the point of view of lowering home running costs, crucial as municipalities and utilities pile on the rates and tariffs.

And finally there's the vacant land market, which FNB's valuers perceive as the weakest of all segments by far. Small wonder, when the cost of building a new home is significantly more expensive than an existing home, and the household sector remains under significant financial pressure.

Tough financial times have resulted in a major affordability drive by home buyers. The prospect of even tougher global economic times looming ahead suggests that it will be more of the same for the foreseeable future.

2. ECONOMIC ENVIRONMENT – CALL IT WHAT IT IS….. A TROUBLED WORLD

Over the past few weeks, it would appear that many of the global chickens have been coming home to roost, and this poses risks for South Africa, its economy and its property market. As a result of a high level "game of chicken" between US policy makers over lifting the legal government debt ceiling in that country, and the conditions that would be attached to such an agreement, that country came days away from defaulting on its government debt early this month.

The delay over reaching agreement on the lifting of the debt ceiling had global markets jittery, and the mood has barely improved even after agreement was finally reached. Why should it have? Standard and Poor has downgraded its US Sovereign credit rating, unhappy with a planned magnitude of government deficit reduction, saying that this is not going far enough to make a sufficient dent in the government's huge borrowing requirement. The job of reducing the fiscal deficit in the US in coming years will be made tough by an ageing population, the retirement of the Baby Boom generation, and steadily rising health care costs.

And all the while, many have ignored the fact that oil prices have been troublesomely high for what is also the world's largest oil consuming economy, and oil spikes usually cause some form of economic contraction in that country. Despite some softening in crude prices recently, at time of writing crude prices still seem somewhat on the high side for an embattled US economy, with the likes of Brent Crude remaining above $100 barrel. As it is, the US statistical agencies report that the economy has already been on a go slow for quite some time, with quarter-on-quarter annualized economic growth rates of only 0.4% and 1.3% for the 1st 2 quarters of 2011 respectively.

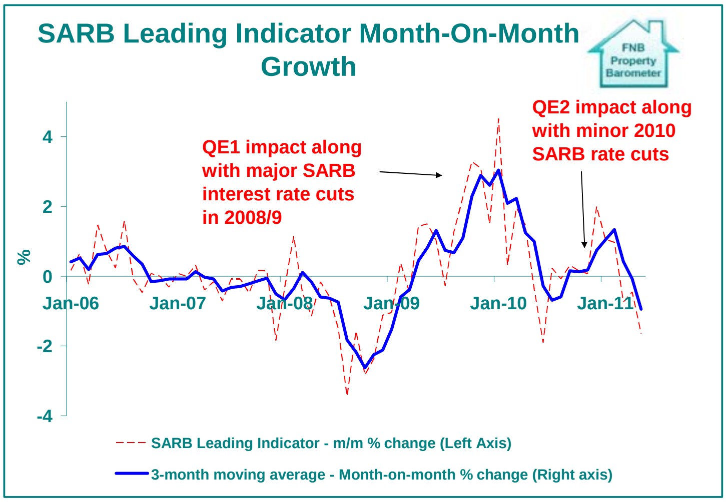
The dreaded "Double Dip", i.e. a second recession shortly after the previous one around 2008, is firmly back on the table as a distinct possibility, after many had over-hastily jumped to the conclusion that the troubles were over.

This time around, as opposed to 2008, the US authorities have less ammunition with which to stave off a recession. The Fed Funds Target Rate, the Fed's main policy interest rate, is already virtually zero, while there is a general acceptance that the US Government Fiscal Deficit has to be reduced by some magnitude. Two forms of stimulus gone, that leaves asset buy backs by the Federal Reserve, commonly known as "quantitative easing", left, but the 2nd round of quantitative easing (QE2) late in 2010 and earlier in 2011 had limited noticeable effect at best..

All of this and we haven't even begun to discuss Europe, which has a list of countries battling debt crises. There is little doubt that many of the Western developed economies, including the world's largest economy, are in deep trouble.

Unlike certain of those troubled developed economies, South Africa's fiscal and monetary authorities have been far more prudent in their macroeconomic management, not sharply ratcheting up the government debt burden and maintaining healthy positive real interest rates. This provides us with some ammunition with which to combat the global economic pressures mentioned above. It is still possible for the SARB to lower interest rates further, while government is not under as much pressure to reduce its fiscal deficit and borrowing requirement, as is the case in parts of Europe as well as the US.

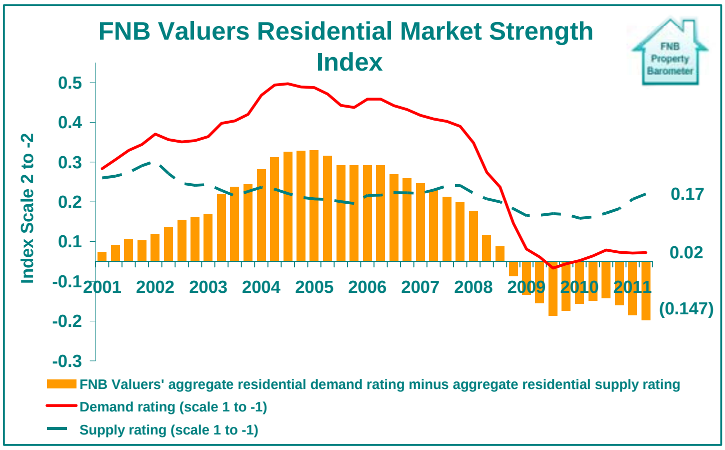
However, for an economy as open as the South African economy, with export value near to one third of gross domestic product (GDP), the above-mentioned global events still point to severe pressure for us in the near term.



And indeed, the SARB Leading Business Cycle Indicator has long since begun to show the mounting pressure, having shown 3 consecutive months of month-on-month decline up to and including May.

Other leading indicators that have shown signs of slowing growth include the value of new residential mortgage loans granted, which slid into year-on-year decline of -4.8% in the 1st quarter, after strongly positive growth through 2010, NAAMSA new vehicle sales have seen year-on-year growth gradually slowing from above 30% year-on-year at a stage of 2010 to 11% by July 2011, and the Manufacturing Purchasing Managers Index dropped to 44.2 in July (a level below 50 signaling an industry contraction).

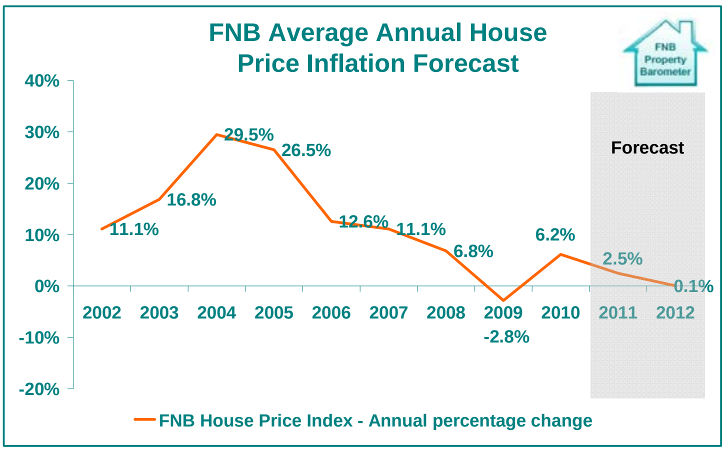
The signs are, therefore, for a very significant slowing in our country's economic growth, as usual tracking global economic trends.



These signs of economic weakening come at a time when the residential property market already has a very weak level of demand relative to supply, and resultantly low house price growth.

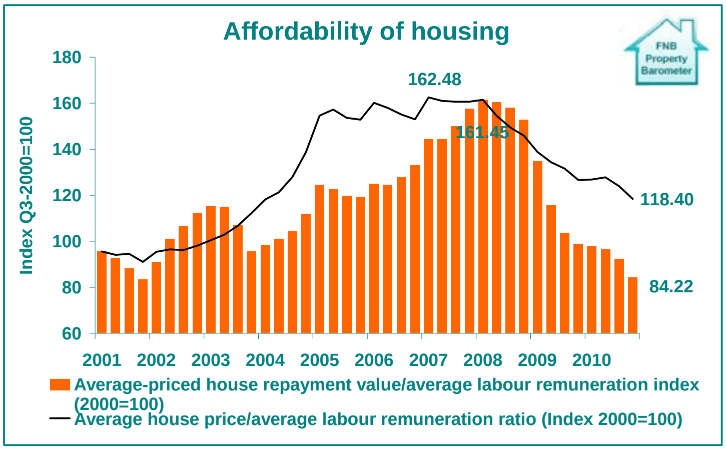
Our revised FNB Valuers Market Strength Index continued to return a negative value to the tune of -0.147 for the 2nd quarter, a deterioration on the previous quarter's value, the result of ongoing demand weakness along with a steadily strengthening supply rating.*

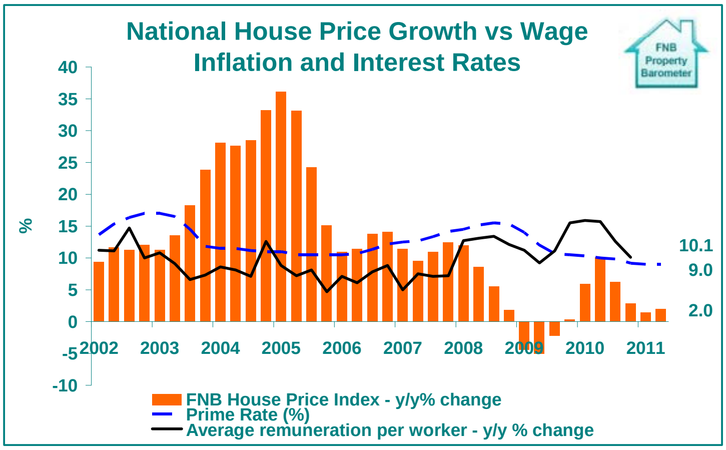
As such, looking ahead to end-2011 and into 2012, we continue to anticipate a very flat residential property market, with the FNB House Price Index annual average slowing to around zero growth in 2012 after projected mild growth of around 2.5% average for 2011.

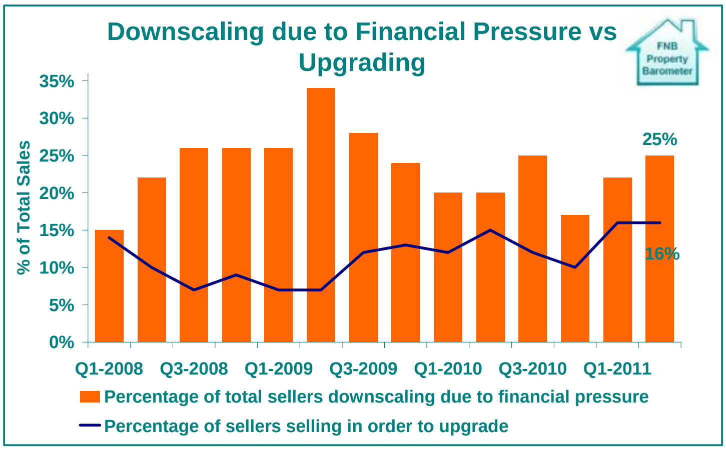


Given consumer price inflation expected to range between 4-5% for 2012, that would continue to translate into a real house price decline, and further effective downward adjustment in prices to align the residential market with far more troubled economic times than was the case prior to the 2008 recession.

3. AFFORDABILITY MEASURES IMPROVE FURTHER, BUT HOUSEHOLDS REMAIN FOCUSED ON REBUILDING BALANCE SHEETS FOR THE TIME BEING







Labour data runs a quarter behind most of SA's other quarterly economic data, and as such we only have average wage data up to the 4th quarter of 2010. As at that time, the two "traditional measures" of housing affordability showed yet further improvement on the previous quarter.

The average price/average employee remuneration ratio index declined further from 124 in the previous quarter to 118.4 in the final quarter of last year. This was due to average wage growth at 10.1% year-on-year still far outstripping house price growth of a mere 2.8% as at the same quarter. This ratio has now fallen by -27.1% since its high point reached in the 1st quarter of 2007.

The 2nd measure, i.e. the repayment instalment value on a 100% loan on the average priced house/average labour remuneration ratio (in index form), also declined further in the 4th quarter of 2010, aided in addition by a further 2 x 50 basis point interest rate cuts late last year. From 92.4 in the previous quarter, this index's value declined to 84.2 in the 4th quarter, cumulatively -47.8% down from its own peak reached in the 1st quarter of 2008.

So if affordability has improved so dramatically for the average wage earner, where is the residential demand that should accompany it? This time around, we cannot say that job losses are the reason, because official estimates suggest that late in 2010 the economy had once again been creating jobs. Rather, the answer probably lies in income and wealth distribution. Averages are not always reliable indicators of well-being. So, whereas our FNB Estate Agent Survey points towards an increased percentage of sellers selling in order to upgrade since lows of 2008, along with an increase in 1st time buyers entering the market, it also points towards ongoing high percentages of sellers selling in order to downscale due to financial pressure.

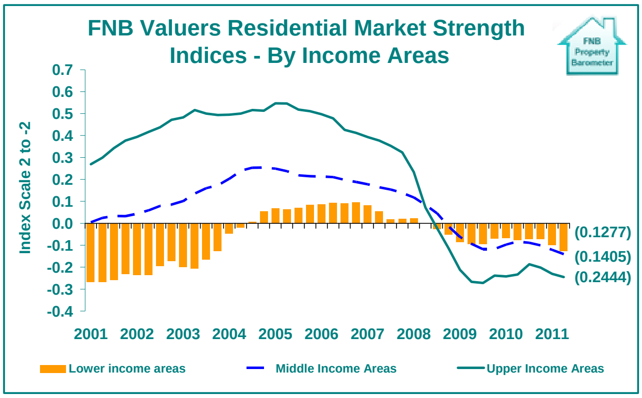
Other past spending "backlogs" also need to addressed by many, including deferred home maintenance and replacement of ageing motor vehicles (more pressing than ageing homes in many cases). On top of this, many may want to pay down debt faster with the memory of high interest rates still fresh, something we have seen on a group of our home loans since interest rates fell. And, of course, banks are more conservative compared with a few years ago.

Nevertheless, residential demand has increased since the lows of late-2008/early-2009, but insufficiently to yet make a dent in strong residential supply, and so the affordability measures continue to improve.

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

Area Value Band Indices still show lower end outperforming the higher priced Metro areas.

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 2nd 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.

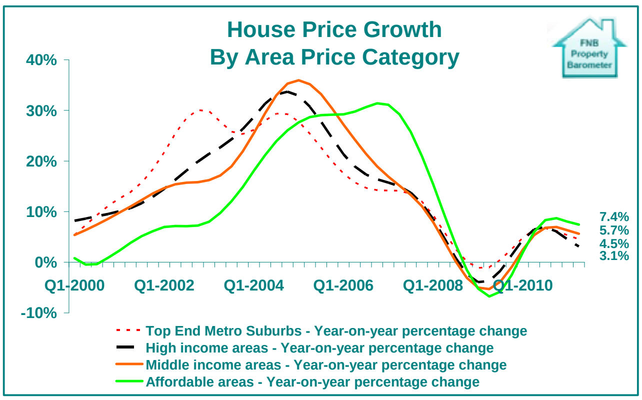


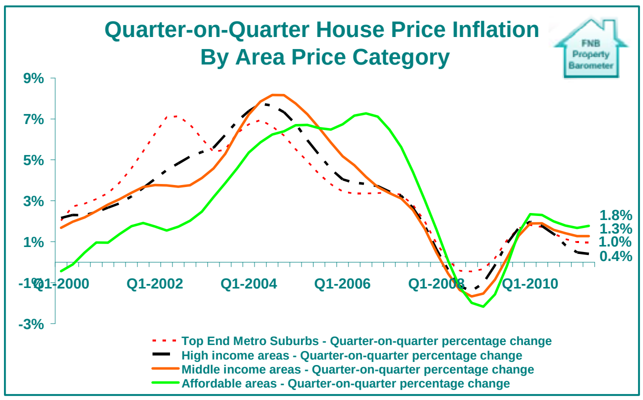
In recent years, our FNB Valuers panel has generally rated the level of demand relative to supply of residential stock as healthier in the lower income markets as opposed to the higher income segments. This is reflected in the FNB Valuers' Market Strength Indices by Income Areas. Valuers are required, 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. The valuers are asked to place their area into a particular income segment, so the categories are admittedly subjectively determined.

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

FNB has created its own 4 area value band indices for residential-dominated areas in the 6 major metros, grouped according to average prices of residential-dominated areas, and using Deeds data for transactions by individuals only, with which to estimate these.

Since the peak in the "relief rally" (or mini-recovery) that we saw in the 1st half of 2010, estimated year-on-year house price growth in all four of our Major Metro area value band indices has shown a tapering off.

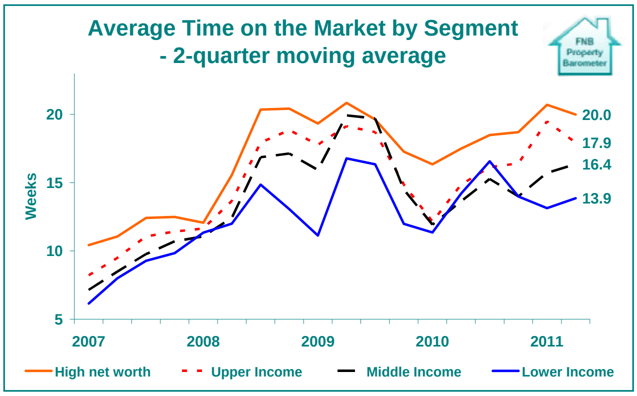




However, comparing segments against each other, the better price growth since early-2010 has been in the lower priced value bands with average area values below R1m. On a year-on-year basis, Affordable Areas' (average price = R376,974) average price grew by 7.4%, and Middle Income Areas' (average price = R724,136) average price by 5.7% in the 2nd quarter of 2011.

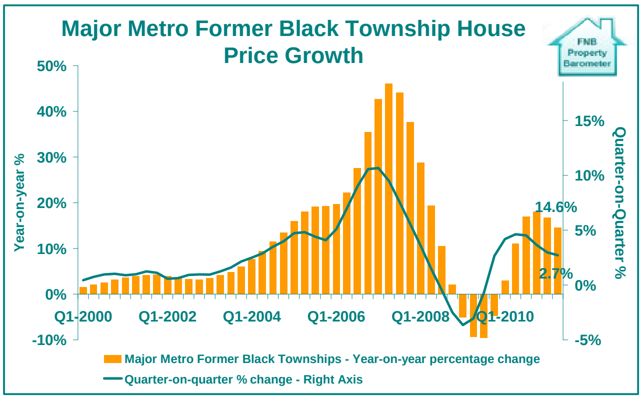
By comparison, the two higher priced area value bands registered slower price growth, with Upper Income Areas (average price = R1.092m) showing 3.1% year-on-year growth and the Top End areas (average price = R1.889m) showing 4.5% increase.

Comment: *The slightly "odd band out" was the Upper Income Area Band, in the sense that it showed price growth slightly weaker than the Top End, partly breaking the pattern of "the higher the weaker". Raw data volatility can always play a role in any index, so one must allow some "leeway". However, it may point towards this market segment's supply improving more significantly than others in recent times. If one examines the average time on the market by segment, as defined by our panel of agents in the FNB Estate Agent Survey, one sees a noticeable increase in the past 2 quarters, in the average time of what estate agents term the "Middle Income" segment in their own classification for the survey. This segment, according to the agents, has an average price of R1.21m and is thus reasonably comparable with our own-defined High Income area value band (average price = R1.092m), narrowing the gap between itself and the higher segments' declining average times, with a rise to 16.4 weeks in the 2nd quarter. This is a possible explanation, but a few more quarters' survey results and deeds data are probably required before drawing conclusions.*



Former Black Townships continue to outperform even the overall affordable area segment.

Within the Affordable Area Value Band, the key source of relative strength appears to be the Former Black Township Market around the major metros. In the 2nd quarter of 2011, the Former Black Township Index (avg. price = R263,931) showed year-on-year growth of +14.6%. While far more impressive than any of the 4 area value band indices' growth rates, this, too, represents the 2nd successive quarter of slowing year-on-year price growth in the township index.

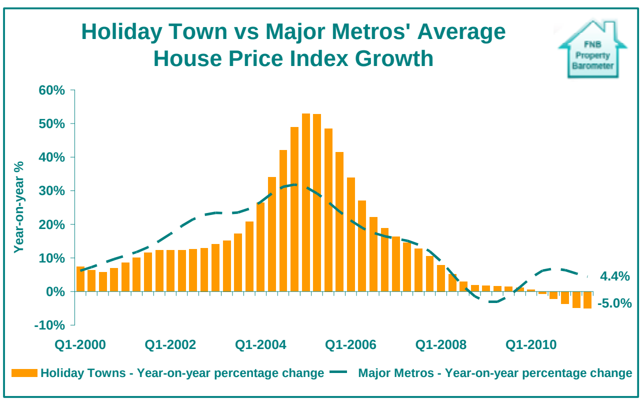


On a quarter-on-quarter basis, growth has slowed for 4 consecutive quarters to +2.7% rate as at the 2nd quarter. So, despite affordability being key in tough economic times, thus making these "most affordable" former Black Townships a popular option for market entrants from the so-called Black population group, a lack of new interest rate stimulus along with a weakening economy also appears to be taking its toll on the price growth of these areas too.

High growth rates in townships should be interpreted with caution. New affordable developments often come at a higher price than existing homes. These could make up a significant portion of township transactions, driving up the average prices. That would reflect more of an activity shift as opposed to genuine capital growth on homes.

Holiday towns still appear to be the weakest link

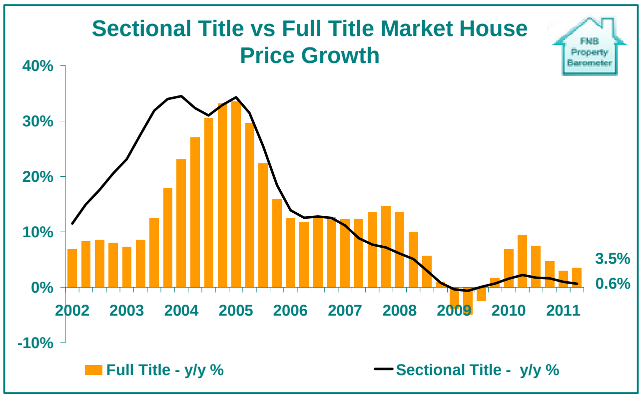
When using Deeds data to compare major metro price trends with that of our grouping of towns that we deem to be holiday towns, the trends continue to reflect the financially pressured state of the household sector, which translates into very weak non-essential buying such as holiday property buying.

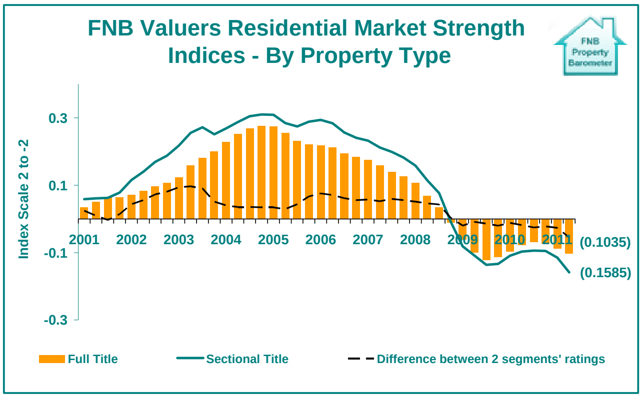


Whereas our Major Metro Price Index (average price = R1.102m) showed +4.4% year-on-year growth in the 2nd quarter, the Holiday Towns Price Index (average price = R807,721) showed a -5% decline for the same period.

Note: the metro area value band price indices, former black township and holiday town indices are compiled using deeds office price data for property transactions by individuals only, in areas deemed to be residential dominant.

The Sectional Title Market still appears weaker than the Full Title Market Segment





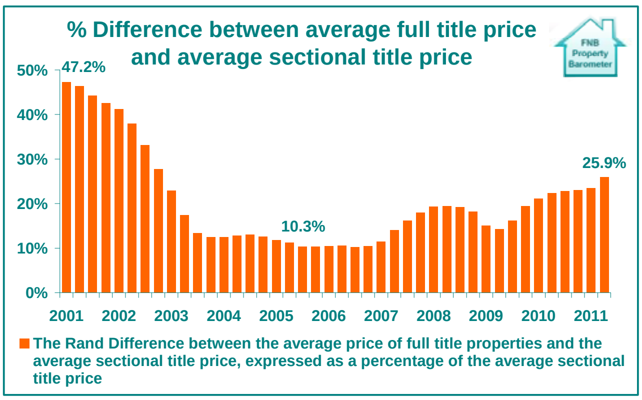
Although the price growth differential between the Sectional Title and Full Title market segments had narrowed late in 2010 and early-2011, the Full Title Market segment continues to outperform the Sectional Title Segment by a narrow margin.

The year-on-year growth rate in the Full Title Price Index for the 2nd quarter of 2011 was a moderate 3.5%, slightly up from the previous quarter's 3% whereas the Sectional Title Index grew at a slower 0.6%, down from 1% in the previous quarter. The Full Title segment would thus appear to have been responsible for the slight overall price growth improvement towards mid-year, which we believe was the lagged impact of some slight improvement in residential demand in the summer quarters as a result of late-2010 interest rate cuts.

Further supporting the recent relative price trend evidence are the readings of the FNB Valuers' Market Strength Indices. In the 2nd quarter, the 2 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 a revised -0.088 to -0.104, and the weaker Sectional Title reading from a revised -0.115 to -0.159. However, the Full Title reading remains stronger than the Sectional Title one.

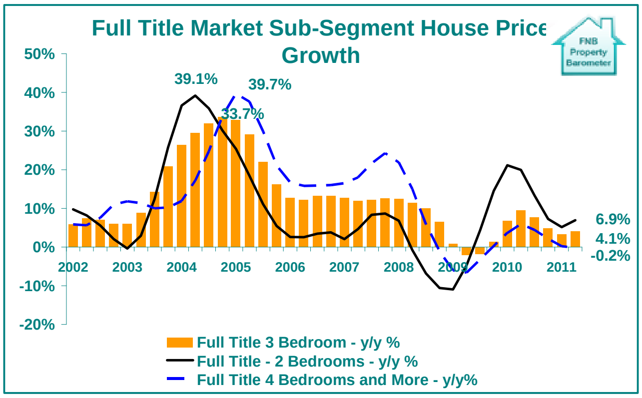
Our belief remains that within the Full Title Segment, especially the "suburban" 3 bedroom family market (the largest segment of the Full Title Market) is a very solid and stable component, because it was arguably less of a first time buyer and buy-to-let target during last decade's boom than the Sectional 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. The Full Title segment also appeared to have less "over-building" during the boom and thus less of an oversupply than did the Sectional Title segment.

However, the 2 bedroom full title market also heavily supported 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.

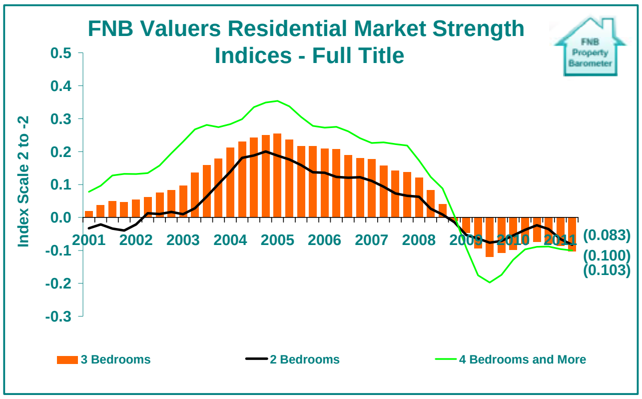


In the 2nd quarter, a slight acceleration in Full Title price growth caused a further noticeable increase in the differential between the average Full Title price and the average Sectional Title price to 25.9%, now significantly widened from the 10.3% reached at a stage of 2005.

The 3 and 2 Bedroom Full Title Segments see price growth rise slightly in the 2nd quarter



Of the 3 key sub-segments within the Full Title Market, the 2 and 3 bedroom sub-segments showed a slight increase in year-on-year price growth in the 2nd quarter of 2011. The 2 Bedroom sub-segment (average price = R436,614), saw year-on-year price growth rise from +5.2% in the previous quarter to +6.9% in the 2nd quarter, while the 3 Bedroom sub-segment's (average price = R911,060) growth rose from +3.3% to +4.1%. The 4 Bedroom and More sub-segment (average price = R1.473m), which has shown the weakest growth of the 3 since the 2nd half of 2008, with its already stagnant growth deteriorating from +0.2% in the 1st quarter to -0.2% year-on-year in the 2nd quarter.

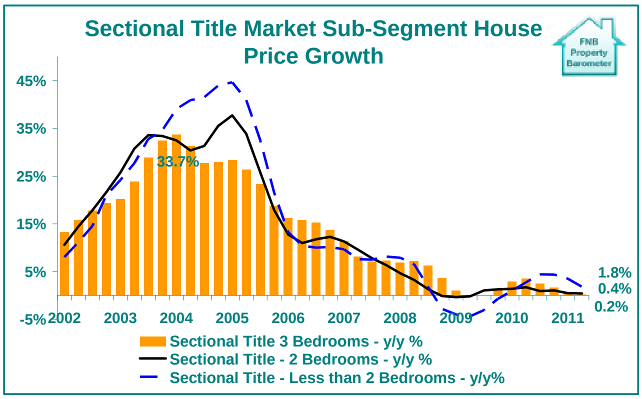


Of significance, though, is that the 2nd quarter saw the 4 Bedroom and More sub-segment no longer being rated by valuers as having the weakest market balance. This comes after this sub-segment consistently had the weakest Market Strength Index reading throughout 2009 and 2010.

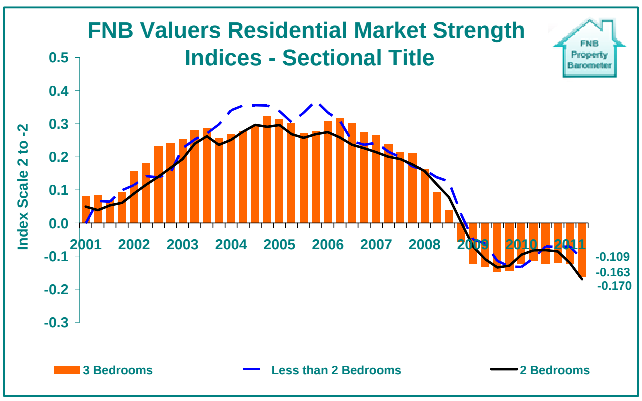
Its Market Strength reading of -1.00 in the 2nd quarter was slightly weaker than its previous quarter's reading, but the 3 Bedroom (-0.103) and the 2 Bedroom (0.083) Market Strength Indices have showed faster deteriorations to all but close the gap with the 4 Bedroom sub-segment.

This may suggest that the superior price growth performances of the 3 and 2 Bedroom sub-segments may be short-lived.

All Sectional Title sub-segments now showing slowing year-on-year price growth



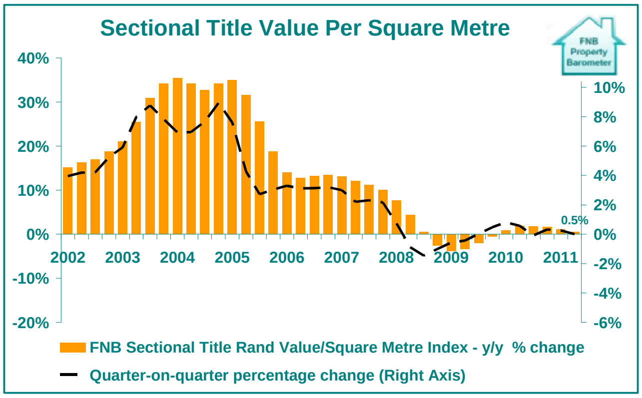
Within the Sectional Title Market, the Less than 2 Bedroom sub-segment (average price = R463,968) showed the best year-on-year price growth of +1.8% in the 2nd quarter. This, however, is down from +3.5% in the previous quarter. We believe that its mildly superior performance, compared to the 2 and 3 bedroom sub-segments in recent quarters, may be due to a higher dependence of 1st time buyers than the larger units, and 1st time buyers are believed to have increased in significance over the past year or so. By comparison, the larger 2 Bedroom sub-segment (average price = R631,825) showed meagre price growth of +0.4%, and the 3 Bedroom sub-segment (average price = R945,646) +0.2%.



The Sectional Title Valuers' Market Strength Indices appear to explain the better price performance of the Less than 2 Bedroom sub-segment. All 3 sub-segments' indices have showed a recent weakening, but the Less than 2 Bedroom sub-segment had the best reading of the 3 in the 2nd quarter at -0.109, while the 2 Bedroom (-0.163) and 3 Bedroom (-0.170) Indices are noticeably weaker and running very close to each other.

Sectional Title price trends on a per square metre basis

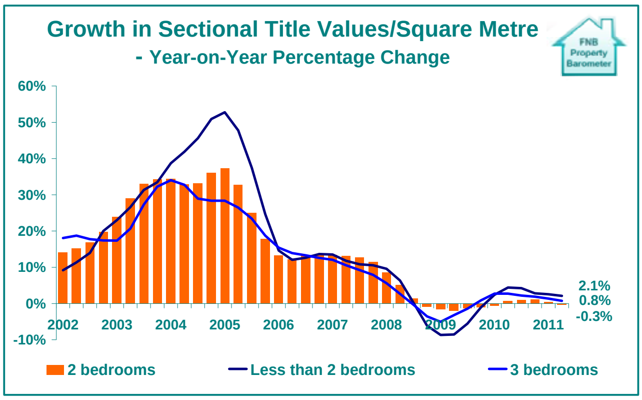
The FNB Sectional Title Value Per Square Metre Index, which estimates the average value of sectional title property on a per square metre basis, is an attempt to reduce the effect of a change in the size composition of property transactions on property indices over time, thereby getting a more accurate 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.

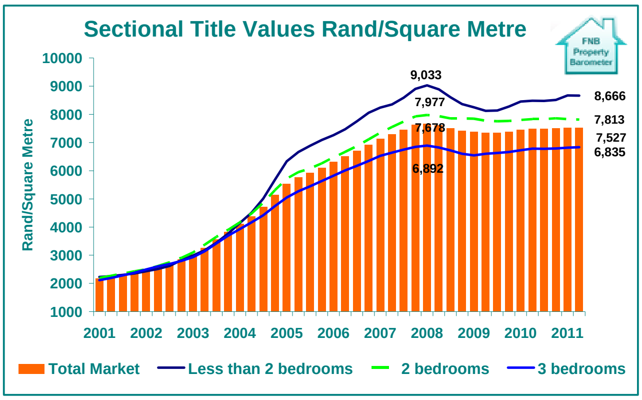


On a per square metre basis, the average value of sectional title properties rose by +0.5% year-on-year for the 2nd quarter, down from the previous quarter's +1.1% revised figure. On a quarter-on-quarter basis, the average value registered zero growth.

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 R8,666/square metre in the 2nd quarter of 2011, the 2 Bedroom Segment averaged R7,813/square metre, and the 3 Bedroom Segment R6,835/square metre. The Overall index averaged R7,527/square metre.

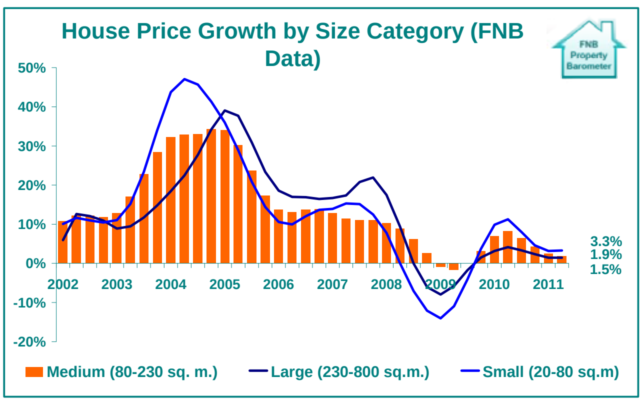
All segments are still at lower average per square metre values than their 1st Quarter 2008 peak values despite making up some of the recession-driven losses more recently. The "Less than 2 Bedroom" sub-segment was the most negatively affected during the 2008/9 slump and even after a recent catch-up sees its revised average/square metre value now -4.1% below the early-2008 peak. The 2 Bedroom sub-segment is-2.1% down from the peak while the 3 Bedroom sub-segment is a mere -0.8% lower.



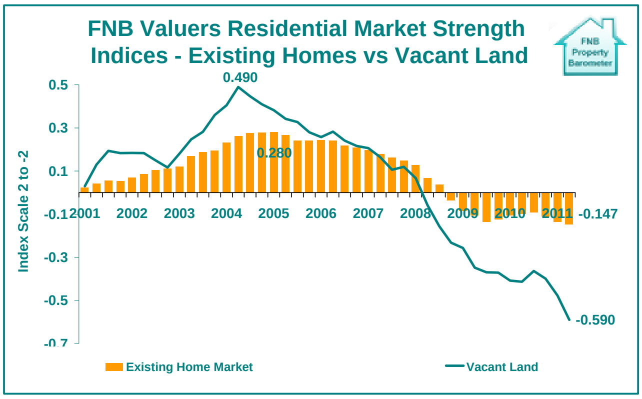


Price Trends by Size of Home – Smaller is Better

In these times of significant financial pressure and skyrocketing rates and tariff bills related to property, it comes as no surprise that smaller size properties have been doing a little better in terms of average price growth in recent years. Of the 3 size categories, the 20-80 square metre Small Sized category (average price = R412,994) showed the best year-on-year price growth of +3.3% in the 2nd quarter. This segment's growth has outperformed the other 2 since the end of 2009. The 80-230 square metre Medium Size category (average price = R843,953) was next best with +1.9% growth, while the 230-800 square metre Large Size category (average price = R1.573m) saw the weakest rise of +1.5%.



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 -0.147, the vacant land index reading was a far weaker -0.59. This represents a further weakening on the revised figure of the previous quarter, and would continue to suggest ongoing weakness in the property development sector for the foreseeable future.

5. CONCLUSION

At present, one can't ignore the reality of a world economy under increasing pressure, and the potential impact that it can have on an already-mediocre South African economy. This is expected to slow household disposable income growth, and thus home purchasing power. As a result, we anticipate a virtually unchanged national average house price in 2012 compared with the average price for 2011.

The relative segment price performances, as outlined above, continue to point to an "affordability and basics" focus by home buyers in general. It comes as little surprise to see a continuation of this trend, and weaker global and domestic economic times ahead would point to more of the same going forward. We would thus expect the smaller-sized, more affordable segments to moderately outperform the higher priced segments through the remainder of 2011 and through 2012. Primary residential demand-driven markets also look set to continue to outperform markets driven more by non-essential forms of buying such as holiday property buying.