16 January 2012

FNB HOME BUYING ESTATE AGENT SURVEY – 4th QUARTER 2011

As we head into "Interest Rate" week, the residential property industry will not be wanting any nasty interest rate surprises, with estate agents still pointing to an unbalanced market late in 2011.

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ESTATE AGENTS DON'T APPEAR TO SUGGEST A MARKET IN "EQUILIBRIUM" YET

Last week, we were posed the question, based on some discussion in the media, as to whether or not the residential property market had reached "equilibrium, and whether now was THE time to buy property? The FNB Estate Agent Survey may help to provide an answer to this question.

It is surely safe to say that the residential property market has become more of a "buyers" market since early-2008, with prices having declined by around -17% in real terms since February of that year ("real prices" refer to average house prices adjusted for consumer price inflation).

But whether the market has yet reached "equilibrium" or not remains debatable in spite of a significant downward real price correction to date. Reaching equilibrium would imply that demand has finally caught up with supply after about 4 years in which the market could be deemed to have been oversupplied, a state which caused the downward real price correction in the market.

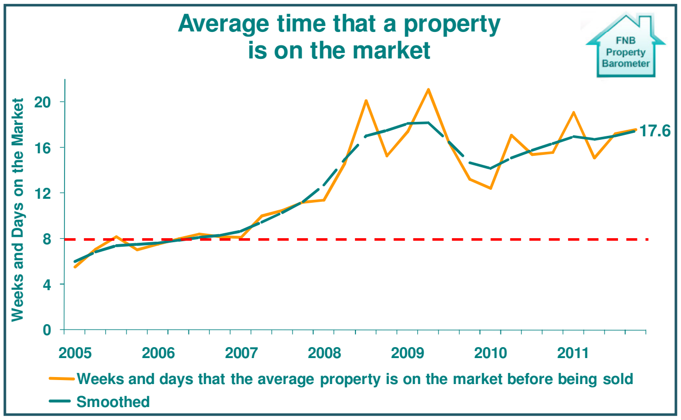
Reaching equilibrium would also imply no further real price decline to come, unless of course further economic deterioration in the near term caused the market equilibrium price level to decline further, because price levels required to reach market equilibrium, or (otherwise put) market balance, do change over time as economic conditions change.

However, we believe that indications emanating from the latest results of the FNB Estate Agent Survey suggest that the residential market still has some way to go before it reaches that "holy grail" where oversupplies disappear and the market can finally be said to be realistically priced and, yes, in equilibrium.

This means that as we head towards the first Reserve Bank Monetary Policy Committee (MPC) meeting later this week, the residential property sector would be hoping that there will be no unnecessary surprises in terms of an interest rate hike, because it remains in a fragile state.

The FNB Estate Agent Survey is a survey of a sample of estate agents predominantly from South Africa's 6 major metros, with a view to obtaining their perceptions of residential property market conditions. Estate agents provide useful insights, because they tend to "lead" the rest in terms of experiencing market changes first.

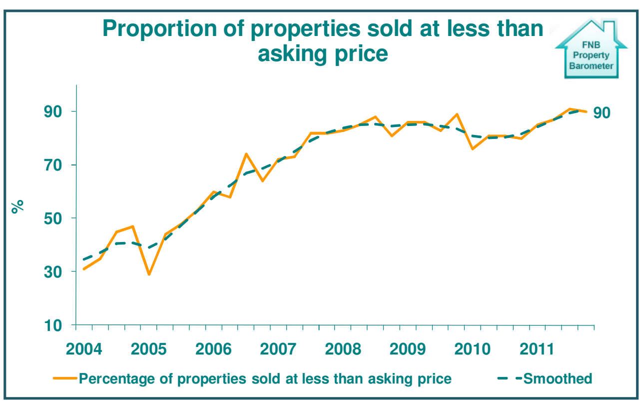
Amongst other things, we attempt to ascertain the level of price realism in the market through two questions, namely agents' estimates of the average time that a home is on the market prior to being sold, and the estimated percentage of sellers being required to drop their asking price in order to make the sale.

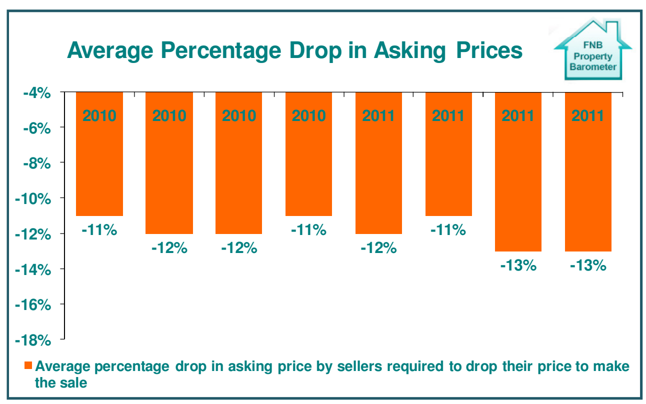


The estimated average time that a home remains on the market before being sold rose for the 2nd successive quarter in the 4th quarter of 2011, from a previous 17 weeks and 2 days to 17 weeks and 6 days.

This would suggest that the imbalance between demand and supply has deteriorated further recently. Ever since transaction volumes thinned out dramatically in 2008, this estimate has admittedly become volatile from quarter to quarter. However, the average time on the market has remained far above the 2 month level, and even above 3 months, a level which we would deem to reflect a market with a "healthy balance between supply and demand". In addition, there has been a broad trend of increase (deterioration) in the average time on the market since early-2010, as reflected by the smoothed trend line on the accompanying graph, after something of an improvement in 2009 on the back of major interest rate cuts.

The second indicator of pricing realism, namely the estimated percentage of sellers being required to drop their asking price to make the sale, has also shown the resumption of a broadly rising trend from late-2010 through 2011, and currently hovers around 90% of total sellers. Whilst one would always expect a significant percentage of sellers to "open the bidding" on the high side, the current percentage would appear to be extremely high when looking back to the lower percentage of sellers dropping their asking prices in years prior to the 2008 recession. In addition, 2011 showed further increase in this percentage, which is not what one would expect to see in a market getting nearer to equilibrium and price realism. While an additional survey question, regarding the average estimated percentage drop in price by sellers being required to do so, has only been asked for 2 years, we have seen a mild increase in the average estimated price drop from -11% early in 2010 to -13% by the end of 2011.





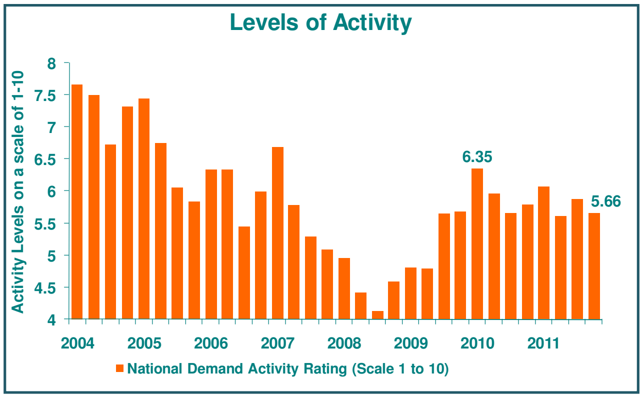
Therefore, the sample of estate agents surveyed during the 4th quarter of 2011 would not appear to believe that the residential property is yet realistically price given the level of demand, or otherwise put, they appear to imply that the market is not yet in equilibrium or "balance between demand and supply". Admittedly, the appropriate average time on the market is debatable, but we believe that above 17 weeks is inappropriately long. This, we believe, requires either further real house price decline, or alternatively residential demand needs to strengthen considerably to catch up with supply.

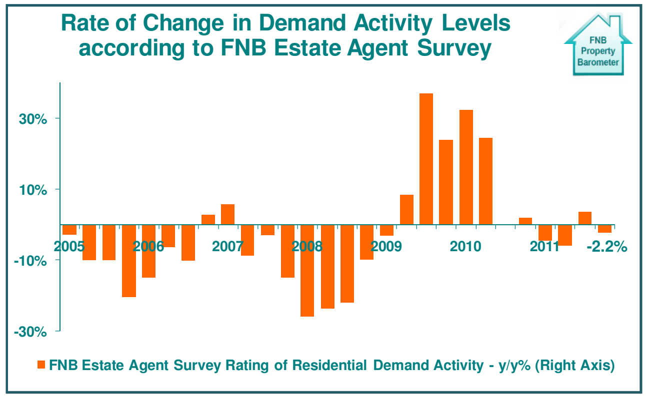
ON THE DEMAND SIDE, AGENTS POINTED TO A MILD WEAKENING LATE IN 2011,……

A key question posed to estate agents in the survey is with regard to their perception of residential demand strength, done on a scale of 1 to 10 with 10 being the strongest possible level. After a mild strengthening in the demand rating in the 3rd quarter of 2011 to 5.87, the 4th quarter (normally a seasonally stronger quarter) saw a mild decline to 5.66.

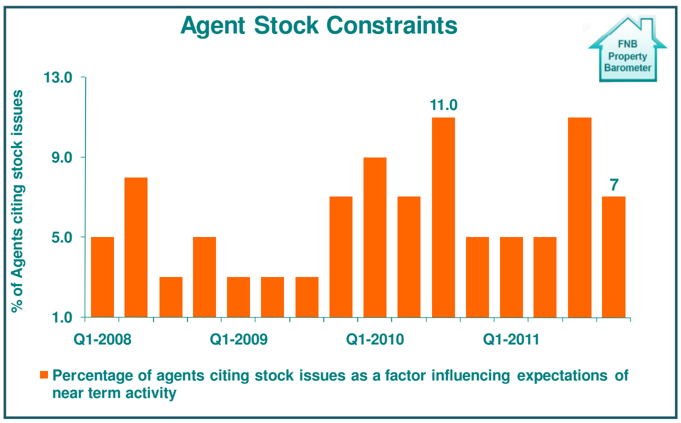
With seasonal factors always playing a role from quarter to quarter, we like to view the demand rating results in terms of year-on-year percentage change. Viewed in this way, we find that after brief positive year-on-year rise in the 3rd quarter, of +3.7%, the 4th quarter saw a return to negative growth in the demand rating, measuring a -2.2% decline.

Since the 2nd half of 2010, therefore, agents have not perceived demand to have made any progress in terms of strengthening, following a significant surge from mid-2009 to mid-2010. This shouldn't be surprising, given that since late-2009, there has been very little further interest rate reduction, and little support from a very mediocre economy.





......WHILE FEWER CITED SUPPLY SIDE, OR "STOCK" ISSUES IN THE 4TH QUARTER



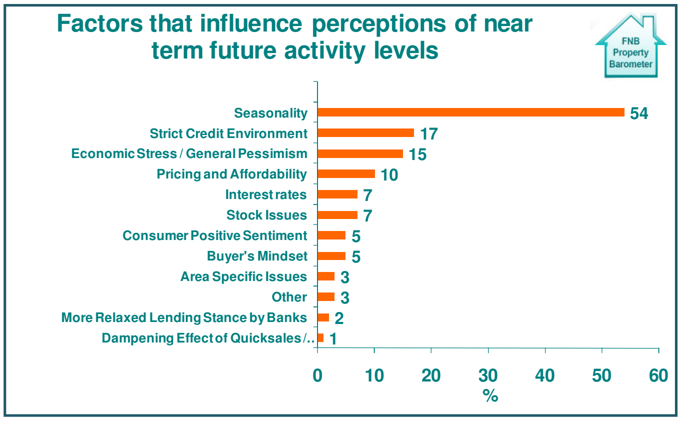
Trying to gauge the strength of supply of residential stock through asking survey respondents for their opinion is admittedly a tall order. All we can say on the matter is that when asking agents about their market expectations in the near term, we allow them to provide a list of factors that influence their expectations, both in a positive and a negative way. In the 3rd quarter of 2011, we saw something of a spike in the percentage of agents citing stock constraints as an issue to 11%, on the back of a mild demand increase in that quarter. However, the 4th quarter saw a decline in that percentage to 7%, which would not appear high, nor out of line with the percentages recorded in the past few years.

HOW AGENTS SEE THE NEAR TERM OUTLOOK

In terms of expectations of demand in the near term, the 4th quarter agent survey returned a very weak response.

We ask them for their expectations of residential demand strength in the near term, i.e the three months subsequent to when the survey takes place, requesting them to choose between 3 options, namely the market will "strengthen", "weaken", or "remain the same".

In the 4th quarter of 2011 survey, there was a very significant drop in the percentage of agents expecting demand to increase, from 44% in the previous quarter to 17% in the 4th quarter. This was the lowest percentage of respondents expecting strengthening since the 2nd quarter of 2005.

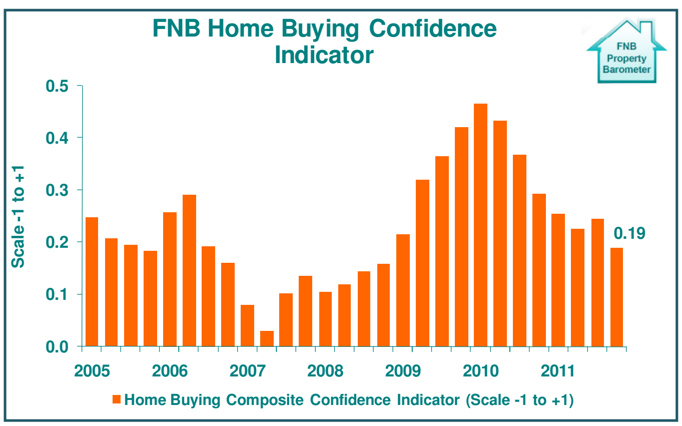


When asking agents for the factors influencing their near term expectations, seasonal factors play the most important role in this deterioration by far, because at the time of the 4th quarter survey in November, they were looking at 2 months of quiet time ahead as the holiday season approached.

However, there are certain other negative factors that have are significant:

- *First on the list of influencing factors behind seasonality is the perceived "strict credit environment, cited by 17% of agents as an issue. While we made mention previously that certain agents had noticed more 1st time buyers coming to the market with the required deposits and transfer fee money, this constraint has far from disappeared in SA's low household savings environment.*
- *Secondly, 15% of agents also cited "economic stress/general pessimism" as key. These agents believe that would-be buyers are still uncertain about the economic future, remain financially strained and thus run tight budgets, and that much of their pessimism is fuelled by negative global economic news and the possibility of fallout from the global crisis affecting SA. By comparison, only 5% of agents point to "consumer optimism"*
- *Thirdly, unrealistic pricing by sellers is still seen as a negative factor, with still-many aspirant buyers not being able to qualify affordability-wise at these levels, although this is believed to have improved in recent times.*
- *Finally, but probably most significantly, few (7%) see interest rate levels as still being a positive. The last rate cuts took place in 2010, and the stimulus from rate cuts has worn off.*

In order to eliminate the strong influence of seasonal factors, we aggregate the results for near term expectations on a 4-quarter moving average basis, and the result is what we call the FNB Home Buying Confidence Indicator. The Indicator is on a scale of -1 to +1, with a -1 number assigned to a "weakening expectation" by an agent, a rating of zero to an "unchanged" expectation, and a +1 rating to a "strengthening" expectation.



Here again, with seasonal factors eliminated, we see the 4th quarter Home Buying Confidence Indicator declining mildly on the previous quarter's level, from 0.25 to 0.19.

The agents surveyed, therefore, appear to have become more pessimistic in their near term expectations, seasonal factors aside.

IN SUMMARY – A STILL-UNBALANCED AND FRAGILE RESIDENTIAL MARKET WILL BE HOPING FOR NO NASTY SURPRISES FROM THE SARB THIS WEEK

In the past week, there has been some discussion about whether the current time is the time to buy property, on the back of some assertions that residential property market "equilibrium" has been reached. Although it is challenging to ascertain when a market has reached equilibrium, the price level where demand matches supply, especially as equilibrium levels fluctuate over time, we are of the opinion that the FNB Estate Agent Survey does not suggest that market equilibrium (or balance) has yet been reached.

Although admittedly subjective, we believe that at 17 weeks and 6 days, the average time of properties on the market continues to be inappropriately long, pointing to a market still unrealistically priced given the currently mediocre demand conditions which agents perceive to be weakening mildly. In addition, still 90% of sellers are required to drop their asking price to make the sale, which we would suggest is a rather high number.

We are thus of the opinion that further real house price (house prices adjusted for consumer price inflation) decline is required in the near term in order to shift the residential property market towards a balance between demand and supply or, otherwise put, equilibrium.

Therefore, at this stage, the residential property sector would be sensitive to any unwanted surprises in the form of an interest rate hike at this week's MPC meeting of the Reserve Bank. Fortunately, at this stage such an event seems unlikely, with the expectation that CPI inflation is nearing its peak, after which it is expected to decline back into the target range of 3%-6% without requiring help from interest rates at this stage.