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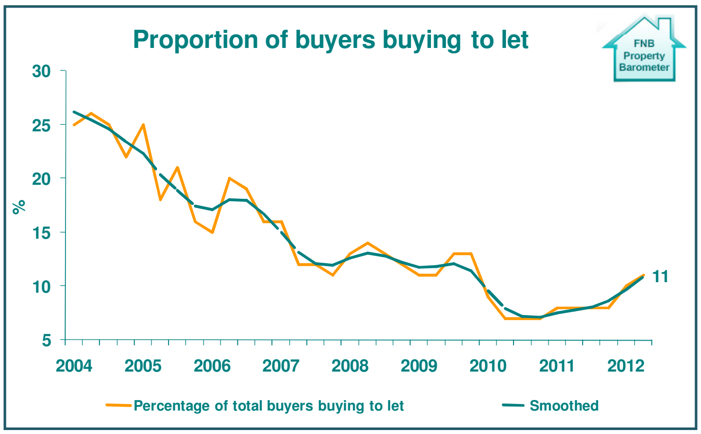
PROPERTY BAROMETER –RESIDENTIAL BUY-TO-LET AND RENTAL MARKET

Buy-to-let buying remains mediocre, but the FNB Estate Agent Survey does point to a further gradual increase in the significance of this form of residential demand in the 2nd quarter of 2012.

10 July 2012

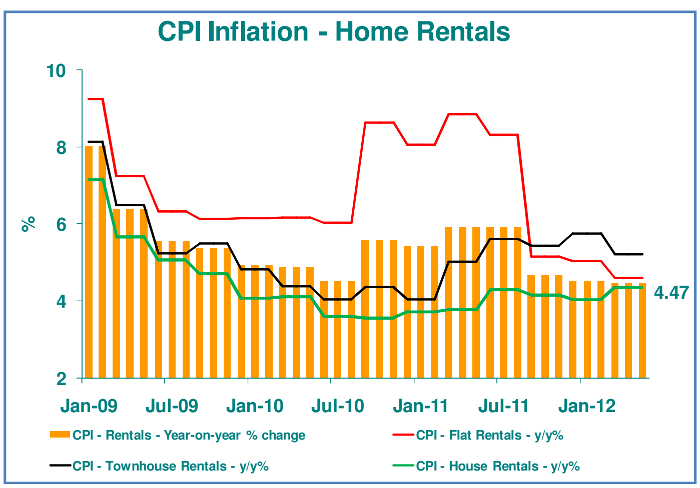
Buy-to-Let buying continues to edge up gradually to more significant levels relative to the overall home buying market, according to the 2nd quarter 2012 FNB Estate Agent Survey. Agents surveyed expect further mild increase in buy-to-let buying in the near term, but certainly not fireworks. Many aspirant investors are probably still waiting for higher yields and better capital growth prospects, rightly or wrongly, while the household sector also has significant financial pressure to deal with.



While the 2nd quarter 2012 FNB Estate Agent Survey suggested slightly weaker overall residential market demand, as the winter descended on us, it simultaneously points to a further mild rise in the significance of buy-to-let buying in the market.

By this we mean that, as a percentage of total buying, buy-to-let purchases are estimated by survey respondents to have edged up further to 11%, from 10% in the previous quarter. The increase in the percentage of buy-to-let buying is now starting to become more significant when measured from its low point of 7% through much of 2010.

Nevertheless, this percentage remains weak in comparison to the estimated 25% back in early-2004 at the height of the property boom. Besides widespread household financial pressure still being in existence, and often only "masked" by very low interest rates currently, the mediocre performance of the rental market would also not appear to make buying to let an wonderfully attractive option at this stage.

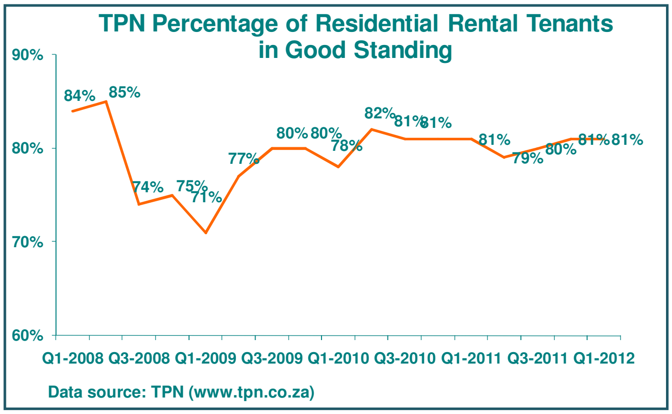


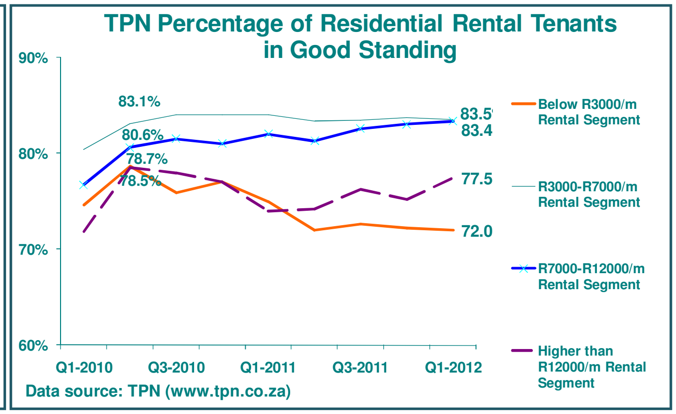
It must be said that South African rental data is "soft". StatsSA provides some insights via its consumer price index (CPI) surveys. The most recent survey points to modest rental inflation which, given current house price inflation in the region of 8.9% year-on-year according to FNB data, would probably be doing little to increase average yields on residential rental properties.

The CPI for rentals in the May CPI (last surveyed in March, due to be surveyed again in June) showed 4.47% year-on-year inflation, slightly lower than the previous quarter's rate of 4.53%. After showing some promise of strengthening in 2010 and early-2011, the CPI for rentals has thereafter shown a weakening growth trend. Whilst this is good from a point of view of keeping overall CPI inflation under control, and thus interest rates low, it does little to make buying to let more attractive at present.

With interest rates currently so low, one should probably not expect a very strong rental market. 1st time buyers are significantly more than a few years ago, and so they would be in these times of very low interest rates. That would imply a lower rate of "retention" of young tenants by the rental market compared with back in 2008/9 when interest rates were moving through a high part of the cycle and the economy was in recession.

Nevertheless, some aspects of the rental market have improved it would appear, and here I am referring to the levels of tenant payment behavior. According to TPN (Tenant Profile Network), the percentage of tenants that are in good standing with regard to rental payments was 81% in the 1st quarter of 2012. While this percentage is unchanged from the previous quarter, it is up from 79% in the 2nd quarter of 2011, and well up from the 71% low reached in the recession early in 2009.





Data source: TPN (Tenant Profile Network)

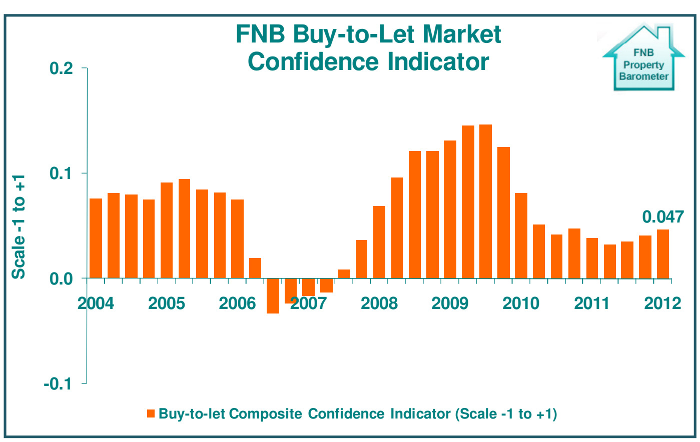
Broken up into rental segments, the worst tenant rental payment behavior appears to be in the below-R3,000/month rental segment, where one saw a lowly 72% of tenants being in good standing in the 1st quarter. Back in early-2011, the highest priced rental segment, i.e. the R12,000+ band, looked every bit as poorly performing as the "below-R3,000 segment. However, this appears to have changed, with this highest rental segment's percentage of tenants in good standing having risen to 77.5% by the 1st quarter of 2012, from 64% a year before.

But the best performing segments, in terms of payment record of tenants, remain the middle two segments, i.e. the R3,000-R7,000 segment with 83.5% of tenants in good standing, and the R7,000-R12,000 segment with 83.4% of tenants in good standing.

CONCLUSION

With a considerable lag, following the initial residential market post-recession strengthening of 2009/10, the buy-to-let component of residential buying appears to be gradually making something of a comeback. Despite this mild improvement, however, at 11% of total residential buying buy-to-let demand remains significantly weaker than the around-25% of the boom years, and so it probably will for some time to come.

Much of the would-be buy-to-let market awaits the combination of a more attractive yield on residential property, which would be driven by stronger rental inflation, a better household sector financial situation, and for some aspirant investors significantly better capital growth prospects.



At present, though, it would appear that the agents surveyed believe that further mild strengthening in the Buy-to-Let market is expected in the near term. In our survey, we ask them to state whether they expect buy-to-let demand to increase (which gets a rating of +1), stay the same (rated as zero) or decline (rates as -1).

The FNB Buy-to-let Market Confidence Indicator is the average of these different ratings, and the 2nd quarter survey came out more positive at 0.047, *slightly higher than the revised 0.041 of the previous quarter (scale of 1 to -1). This would suggest that the survey panel as a group is biased slightly towards strengthening buy-to-let demand in the near term, but the level suggests no expectation of "fireworks", with the confidence rating having still well-down from a peak of 0.147 back in the 3rd quarter of 2009.*

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