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PROPERTY BAROMETER –FNB ESTATE AGENT SURVEY AND HOUSE PRICE INDEX – SEPTEMBER 2012

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Estate Agent Survey points to some mild residential market improvement, but this is not yet visible in FNB house price trends.

SUMMARY

The 3rd Quarter 2012 FNB Estate Agent Survey, completed in the month of August, continued not to show a very strong direction, but it did point toward a mildly improved residential market following on the previous survey. Typically, the 3rd quarter survey returns a seasonally weak result, being undertaken when Winter is still in full swing. However, this year's August survey was completed very shortly after a surprise half-a-percentage point interest rate cut by the Reserve Bank (SARB), and this small stimulus may have played a small positive role.

The 3rd Quarter Residential Demand Activity Indicator rose mildly from the previous quarter's 5.87, to 6.11 (on a scale of 1 to 10).

Other indicators emanating from survey suggest that there was a small improvement in the balance between demand and supply in the residential market, from the 2nd quarter to the 3rd quarter of 2012, something that is not only driven by demand slowing but by availability of stock for sale as well. The most important indicator in this regard is the estimated average time that a property remains on the market prior to sale. This average time dropped from 17 weeks and 4 days in the 2nd quarter to 15 weeks and 6 days in the 3rd quarter. In addition, agents report a further decline in the percentage of sellers being required to drop their asking price to make a sale, from 87% previous to 84%.

And along with these mild market improvements, agents surveyed have become significantly more optimistic about near term market performance.

However, price trend changes often lag trend changes experienced by estate agents, and as yet we have not seen too much impact from the July interest rate cut in the FNB House Price Index. Granted, the seasonally adjusted month-on-month rate of change in the FNB House Price Index declined by a lesser -0.2% in September, compared to a -0.43% decline in August, so the positive impact may be starting. But year-on-year, the House Price Index still saw growth slowing from a 5.3% revised growth rate in August to 5% in September.

Looking forward, we believe it realistic for there to have been some small positive response to the July interest rate cut, which perhaps still has to be fully seen in price data in the coming months.

In addition, a renewed round of central bank stimulus measures has started again, which may in turn lift the global and local economy off its recent lows, a mild positive for property.

However, the global economy remains a very troubled place, and the residential market still appears unrealistically priced, as reflected in an average time of

properties on the market still near to 4 months despite some quarterly improvement. On top of all of this, household indebtedness, as reflected by the household debt-to-disposable income ratio, has resumed its deterioration (increase) during the 1st half of 2012, reaching 76.3% in the 2nd quarter, and this is a key residential demand constraint. And, of course, many aspirant buyers' ability to fund deposits, when required in order to obtain a home loan, remains constrained by a national net household savings rate of zero percent of disposable income.

As such, while the July interest rate cut may have some mild impact in stalling the slowing year-on-year rate of house price inflation for the next month or two, we remain of the expectation that the FNB House Price Index will end the year on lower year-on-year growth of between 3-5%.

ESTATE AGENTS POINT TO STRONGER DEMAND IN THE 3RD QUARTER

The 3rd Quarter 2012 FNB Estate Agent Survey, completed in the month of August, continued not to show a very strong direction, but it did point toward a mildly improved residential market compared to the 2nd quarter survey. Typically, the 3rd quarter survey returns a seasonally weak result, being undertaken when Winter is still in full swing. However, this year's August survey was completed very shortly on a surprise half-a-percentage point interest rate cut by the Reserve Bank (SARB), and this small stimulus may have played a mildly positive role.

The survey is of a sample of estate agents predominantly in SA's major metro regions. The 1st question asked to agents is with regard to their perceptions of residential demand in their areas, a subjective question on a scale of 1 to 10, with 10 being the strongest level of demand.

The 3rd Quarter Residential Demand Activity Indicator rose mildly from the previous quarter's 5.87, to 6.11.

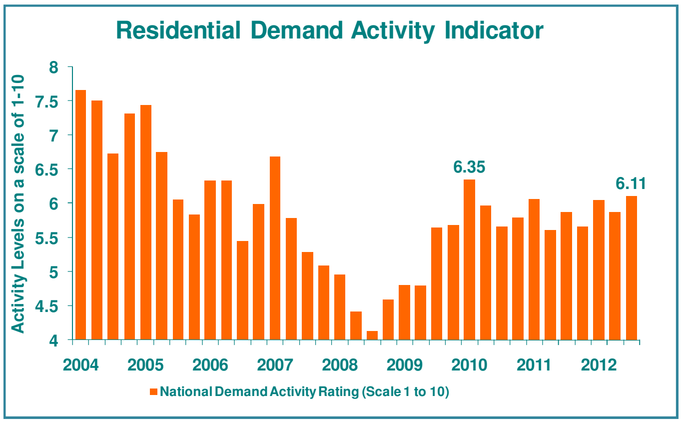
This level still remains firmly in the "stable" bracket (a level from 4 to 6), the other brackets being "not very active (1 to 3), "positive" (7 to 8) and "very active (9 to 10)

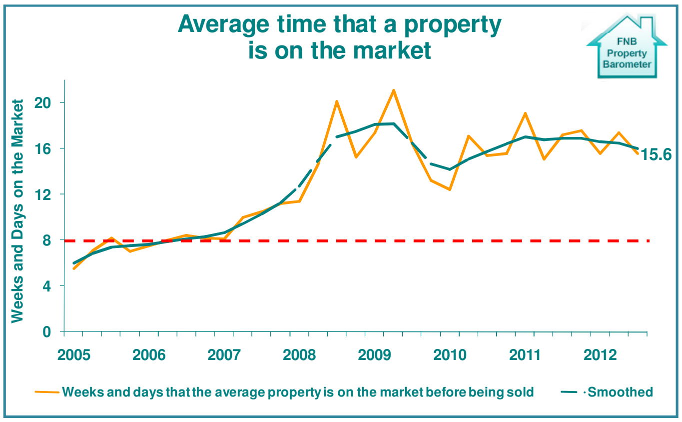
Other indicators emanating from survey suggest that there was a small improvement in the balance between demand and supply in the residential market, from the 2nd quarter to the 3rd quarter of 2012, something that is not only driven by demand slowing but by availability of stock for sale as well.

In order to examine the balance between supply and demand, or otherwise put the level of pricing realism in the market, the Estate Agent Survey asks agents to estimate the average time that properties remain on the market in their areas prior to being sold.

In the 3rd quarter, this average time on the market declined from the previous quarter's 17 weeks and 4 days to 15 weeks and 6 days. It must be borne in mind that this estimate can be volatile from quarter to quarter, but the smoothed trend line that we have created, using a statistical smoothing function, also declined slightly in the 3rd quarter.

It must be emphasized, however, that 15 weeks and 6 days, an average time on the market still near to 4 months, remains too long to represent a healthy market, and judging from the healthier market days prior to 2008, a level nearer to 8 weeks (2 months) on the market appears to be the benchmark for a "healthy" market, so there remains some way to go. One would not yet expect to see much price growth in real terms at this length of average time on the market.



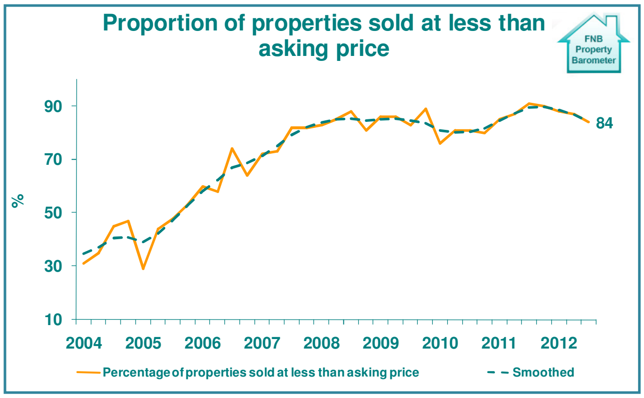


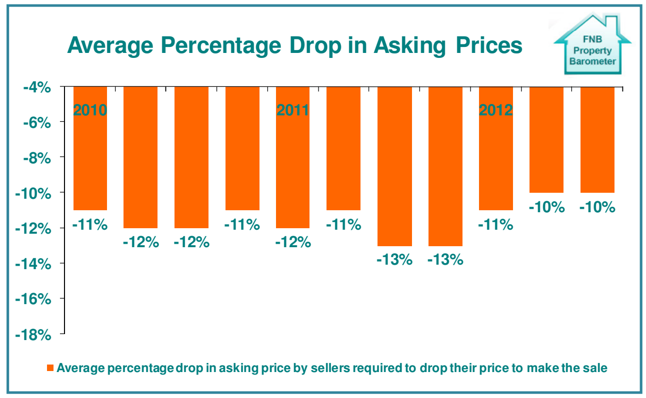
In addition to a decline in the average time of properties on the market, our 2nd indicator of pricing realism, namely the percentage of sellers being required to drop their asking price to make the sale, also showed slight improvement in the 3rd quarter survey.

The percentage of properties sold at less than asking price declined further from 87% in the previous quarter to 84% in the 3rd quarter.

Furthermore, we ask agents to estimate the average percentage asking price drop on those properties where a price drop is required to make the sale. This average drop remained unchanged at -10%, after prior moderation from -13% at the end of 2011.

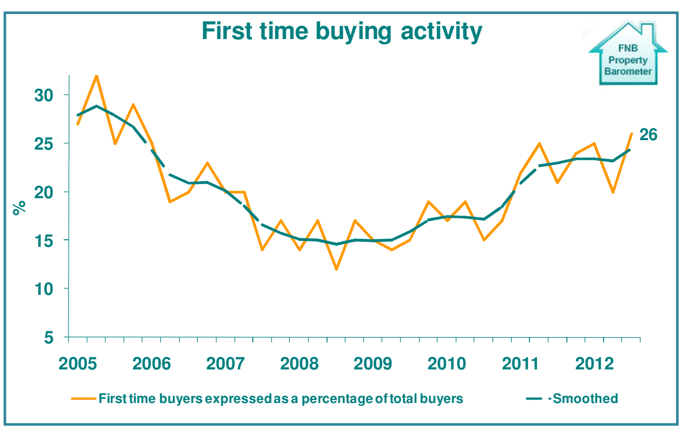
Once again, though, while there has been some gradual decline in recent quarters in the percentage of sellers dropping their asking price, still a very high percentage of sellers ultimately do have to drop their asking price, thus still pointing to a widespread lack of pricing realism.





THE MORE CYCLICAL 1ST TIME BUYER COMPONENT OF RESIDENTIAL DEMAND HAS STRENGTHENED IN THE 3RD QUARTER

1st time buyer demand tends to be more cyclical than the total market. This is arguably because many young buyers have more flexibility than established households, being able to delay their own formation of a new household by remaining in their parent's home for longer during tougher property and economic times, or by often remaining in a rental property for longer.



The level of 1st time buying, therefore, is also a good indicator of whether market conditions are improving and, given this group's high dependence on credit, possibly also an indication of whether credit is becoming easier to obtain.

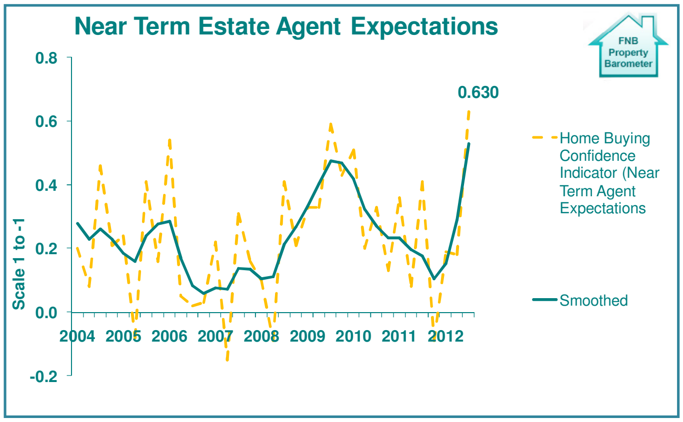
It comes perhaps as little surprise, therefore, to see an increase in the estimated 1st time buyer percentage following hot on the heels of an interest rate cut.

From 20% in the 2nd quarter, the estimated level of 1st time buying as a percentage of total buying rose to 26% in the 3rd quarter survey, and while quarter to quarter movements in this percentage can be volatile, the smoothed trendline has also risen slightly.

HOW AGENTS SEE THE NEAR TERM OUTLOOK

In short, therefore, estate agents that participated in our 3rd quarter Estate Agent Survey appear somewhat more upbeat than the panel a quarter before.

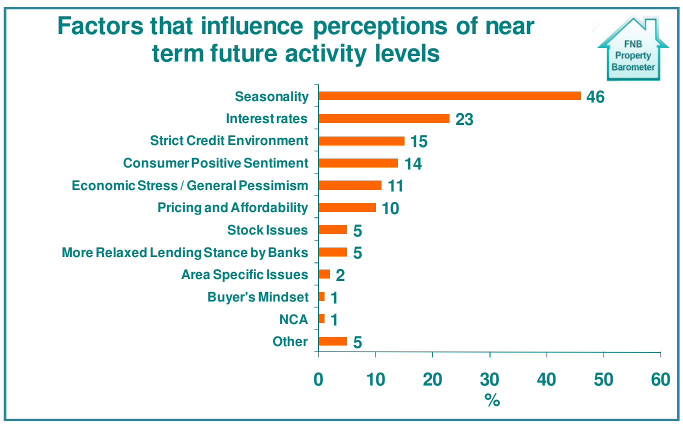
We also ask them for their expectations of residential demand strength in the near term, i.e the three months subsequent to when the survey takes place, requesting them to choose between 3 options, namely the market will "strengthen", "weaken", or "remain the same".



In the 2nd quarter survey, only 30% of respondents expected an increase in demand levels in the 3rd quarter of 2012. In the 3rd quarter survey, this percentage expecting an increase in demand in the following quarter shot up to 64%, a very high percentage. By comparison, 35% expected unchanged demand, while only 1% predicted weaker demand.

This all translates into a very noticeable rise in the Home Buying Confidence Indicator from a previous of 0.18 to 0.63 (on a scale of 1 to -1).

The smoothed trendline on the Home Buying Confidence Indicator was also trending sharply up in the 3rd quarter, reflecting recently improved agent expectations compared to late-2011.



When asking agents for the factors influencing their near term expectations, seasonal factors come up as the most common factor, with the approaching Summer typically a strong period.

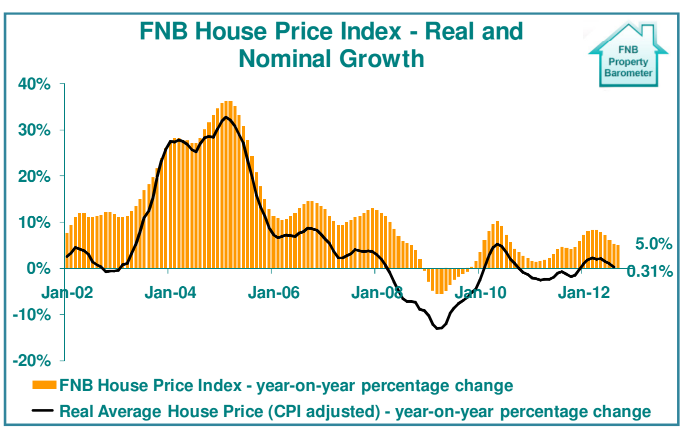
However, ignoring seasonal factors, the next most important factor cited by agents is that of "Interest Rates"., not surprising following the recent cut, and 14% are experiencing a "positive consumer sentiment".

It isn't positive all over, however, with a significant 15% of agents still citing the "strict credit environment" as a constraint, while 11% still point to "economic stress/pessimism.

Nevertheless, agent near term confidence is significantly improved on the previous quarter. But is it justified?

AS YET, WE HAVEN'T SEEN SIGNS OF A STRONGER MARKET FILTERING INTO YEAR-ON-YEAR HOUSE PRICE GROWTH

Price trend changes can lag actual market trend changes by a few months, because it takes a while before increased "feet through a show house door" translates into increased transactions and average price changes. Indeed, when examining the FNB House Price Index for September on a year-on-year basis, any positive response by prices to a July interest rate cut has yet to become strongly visible.



The FNB House Price Index showed a further slowing in its year-on-year growth rate in September, from a revised 5.3% rate in August to 5.0% in September. The further slowing in the year-on-year growth rate is more or less in line with what we had expected, as we have seen signs of a weak patch in the global and domestic economy during the Winter months.

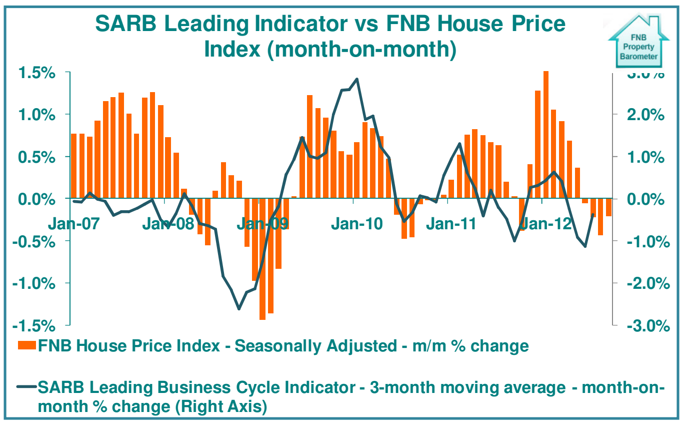
In real terms, adjusted for consumer price inflation, as at August the index showed a slight year-on-year growth slowing from a revised 1.1% in the previous month to 0.3%. The slowing in real house price growth was helped on by the combination of slowing nominal house price growth as well as a slight increase in consumer price inflation in August, from 4.9% in July to 5%.

The Index's average price of homes transacted was R851,500

This means that since the "boom-period" real house price peak reached in February 2008, real house prices (house prices adjusted for CPI inflation over the period) were -15.8% lower at August 2012. In nominal terms prices were +14.2% higher than February 2008, as at August 2012.

However, compared to price levels at the inception of the FNB House Price Index back in July 2000, real prices were still 64% higher as at August 2012, while nominal price levels were +225.4% higher in September 2012.

HOWEVER, ON A MONTH-ON-MONTH BASIS WE MAY INDEED BE SEEING EARLY SIGNS OF A "POSITIVE" IMPACT FROM THE INTEREST RATE CUT



But when searching for price momentum changes, a theoretically better way to do it is on a month-on-month seasonally adjusted basis.

It is admittedly early days, but on a seasonally-adjusted month-on-month basis, the September average house price estimate may indeed be showing some early indication of a positive response to the July interest rate cut. The month-on-month rate of change was still negative to the tune of -0.2% in September, but this was slightly less of a decline than August's -0.43%.

Another few months' worth of data will tell us the full picture.

And if there is to be a return to positive month-on-month growth in the next few months, it is not necessarily only due to an interest rate cut. Month-on-month house price fluctuations track the country's business cycle fairly well, and we did see an improvement in the 3-month moving average of the SARB Leading Business Cycle Indicator for July, in the form of less decline than prior months. The SARB reported that the Leading Indicators of SA's major Trading Partner countries had a positive influence on SA's Leading Indicator. So it may just be that the most recent "soft global economic patch" has been alleviated slightly for the time being, and that the economy is beginning to have a slightly less constraining impact on the residential market.

CONCLUSION

So what is to be made of the various data and perceptions? We believe it realistic for there to have been some small positive market response to the July interest rate cut, which perhaps still has to be fully seen in price data in the coming months. There is also the coming of summer, which normally has a positive seasonal impact on the residential market.

In addition, a renewed round of central bank stimulus measures has started again, which may in turn lift the global economy off its recent lows.

However, the global economy remains a very troubled place, and stimulus measures can be expected to have only a mild and temporary impact at best, while the residential market still appears unrealistically priced, as reflected in an average time of properties on the market still near to 4 months despite some quarterly improvement. On top of all of this, household indebtedness, as reflected by the household debt-to-disposable income ratio, has resumed its deterioration (increase) during the 1st half of 2012, reaching 76.3% in the 2nd quarter, and this is a key residential demand constraint. And, of course, many aspirant buyers' ability to fund deposits, when required in order to obtain a home loan, remains constrained by a national net household savings rate of zero percent of disposable income.

As such, while the July interest rate cut may have some mild impact in stalling the slowing year-on-year rate of house price inflation for the next month or two, we remain of the expectation that the FNB House Price Index will end the year on lower year-on-year growth of between 3-5%.

Notes:

Note on The FNB Average House Price Index: *Although also working on the average price principle (as opposed to median or repeat sales), the FNB House Price Index differs from a simple average house price index in that it could probably be termed a "fixed weight" average house price index.*

One of the practical problems we have found with house price indices is that relative activity shifts up and down the price ladder can lead to an average or median price index rising or declining where there was not necessarily "genuine" capital growth on homes. For example, if "suburban segment volumes remain unchanged from one month to the next, but former Black Township (the cheapest areas on average) transaction volumes hypothetically double, the overall national average price could conceivably decline due to this relative activity shift.

This challenge of activity shifts between segments is faced by all constructors of house price indices. In an attempt to reduce this effect, we decided to fix the weightings of the FNB House Price Index's sub-segments in the overall national index. This, at best, can only be a partial solution, as activity shifts can still take place between smaller segments within the sub-segments. However, it does improve the situation.

The FNB House Price Index's main features are as follows:

- *The weightings of the 10 sub-segments were determined by their relative transaction volumes over the 5 years from 2003 to 2007. The weightings are fixed (to be revised periodically):*

- *Sectional Title:*
  - *Less than 2 bedroom (Weight – 0.0718)*
  - *2 Bedroom (Weight – 0.2106)*
  - *3 Bedroom (Weight – 0.101)*
  - *4 Bedrooms (weight – 0.0031)*
  - *More than 4 Bedrooms (Weight – 0.0002)*
- *Full Title:*
  - *Less than 2 Bedrooms (Weight – 0.053)*
  - *2 Bedrooms(Weight – 0.1092)*
  - *3 Bedroom(Weight – 0.3561)*
  - *4 Bedroom (Weight – 0.0811)*
  - *More than 4 Bedroom(Weight – 0.0139)*

- *The Index is constructed using transaction price data from homes financed by FNB.*
- *The minimum size cut-off for full title stands is 200 square metres, and the maximum size is 4000 square metres*
- *The maximum price cut-off is R10m, and the lower price cut-off is R20,000 (largely to eliminate major outliers and glaring inputting errors).*
- *The index is very lightly smoothed using a Hodrick-Prescott smoothing function with a Lambda of 5.*

Note on the FNB Valuers' Market Strength Index: **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 (100)", "average (50)", and "weak (0)". From all of these ratings we compile an aggregate demand and an aggregate supply rating, which are expressed on a scale of 0 to 100. After aggregating the individual demand and supply ratings, we subtract the aggregate supply rating from the demand rating, add 100 to the difference, and divide by 2, so that the FNB Valuers' Residential Market Strength Index is also depicted on a scale of 0 to 100 with 50 being the point where supply and demand are equal.*