

Q2 2015

PAYPROP RENTAL INDEX

State of the rental industry at Q2 2015

The most comprehensive report on the state of the
residential rental market in South Africa

APR - JUN 2015

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Q2 2015

Now in its fourth year, the PayProp Rental Index continues to grow in influence with unmatched insights into the residential letting market in South Africa. This quarter (Q2 2015) we track rental data harvested from financial transactions relating to 70 000+ active rental properties, making PayProp the largest processor of residential letting transactions in South Africa and the PayProp Rental Index the most comprehensive study on residential letting trends.

We hope you enjoy this issue.

Louw Liebenberg

CEO: PayProp

CONTINUED SIGNS OF GROWTH	4
PROVINCIAL FIGURES	5
UNDERSTANDING THE UNDERLYING PRICING DYNAMIC	6
TURNING POINT FOR DAMAGE DEPOSITS	9
THE AVERAGE TENANT IN SOUTH AFRICA	12
RETURN ON INVESTMENT	14
IN SUMMARY	15

CONTINUED SIGNS OF GROWTH

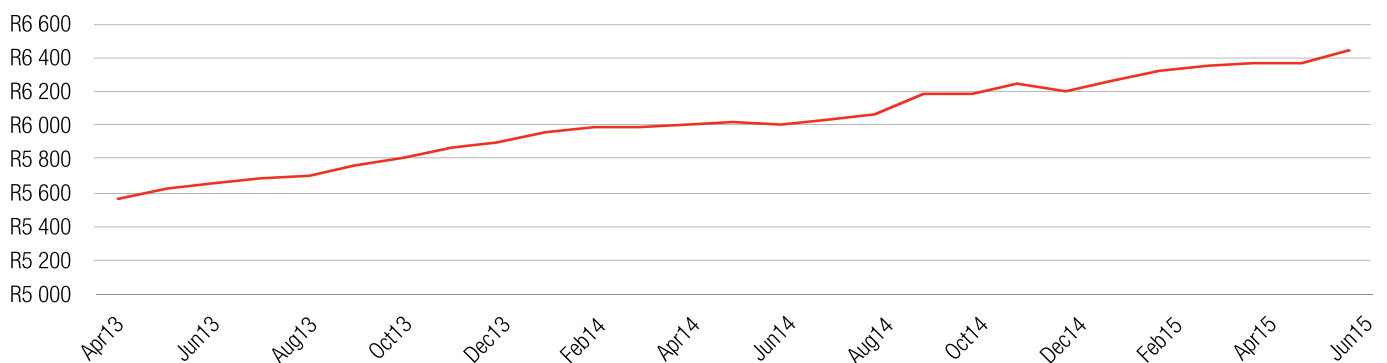
As at the end of June 2015, the national average monthly rental in South Africa stood at R6 441¹, marking 15 months above the R6 000 mark. At the current growth rate, the average rental should exceed R6 500 by the end of 2015.

Another headline statistic is year-on-year (y/y) growth – that is, the rate at which rentals grow based on a 12-year comparison of average rental values (i.e. March 2013 vs March 2014 vs March 2015, etc.). In our Q1 index we reported a glimmer of hope for landlords in the form of an upturn in this trend line – from six months’ continuously slowing growth to the first lift

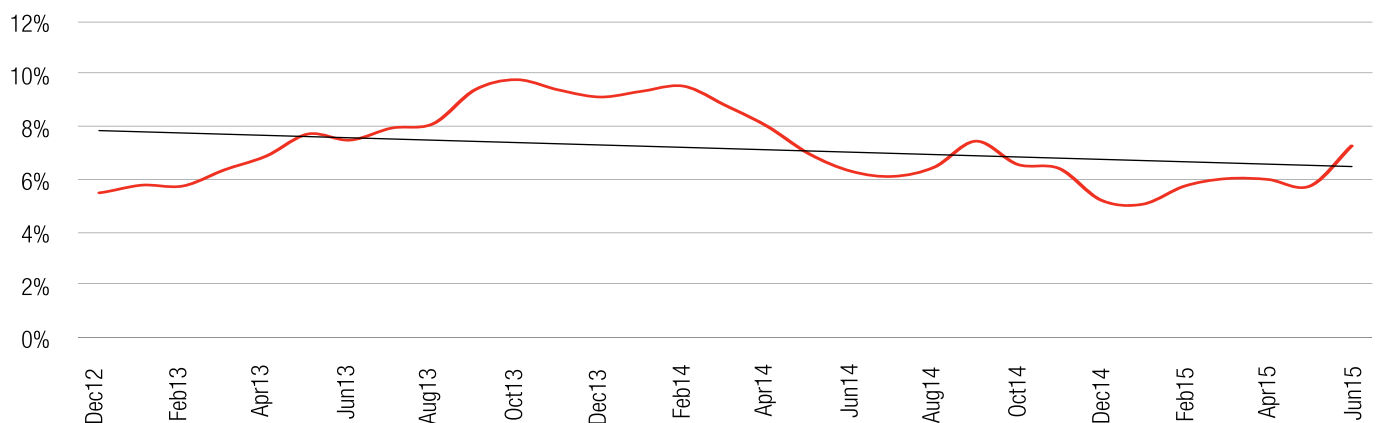
since July 2014. The good news continues this quarter.

A steady decline in the numbers has been in evidence since September 2014 before they hit a cyclical low of 5% in January 2015. Since then, y/y growth has steadily strengthened to 7.26% – where it ended this quarter.

While the upturn is good news, the slowing performance of the South African economy does not give us much confidence that this trend will gain dramatic momentum or even sustain itself for an extended period of time. ■



Average rental
Source: PayProp



Year-on-year growth
Source: PayProp

¹ Figures only include PayProp-administered tenants in the formal rental market (excluding shacks, hostels, back-rooms etc.), and tenants who use an estate agency – the assumption can be made that such tenants are financially better off.

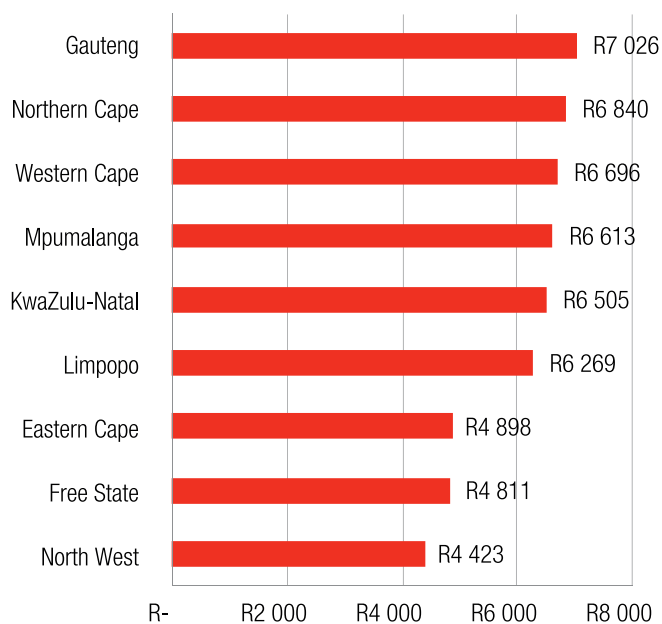
PROVINCIAL FIGURES

Gauteng still tops

For the second quarter in a row, Gauteng was the most expensive province to rent in. This comes after four years of undisputed rule for Limpopo and Mpumalanga. Over the past year, the fortunes of both these regions have steadily reversed as a result of two things: First, the industrial expansion that drove up prices in the first place appears to be waning, and moreover, additional housing capacity has been added to reduce supply shortages.

Another interesting development is the toppling of the Free State by North West as the cheapest province to rent in.

From the graph it is clear that there are two clear pricing groups among the provinces – the R6 000 group (Gauteng, Northern Cape, Western Cape, Mpumalanga, KZN and Limpopo) and the sub-R5 000 group (Eastern Cape, Free State and North West). When comparing average growth rates in the bottom group, the Free State stands out as the only province showing a semblance of growth, which may offer it the prospect of promotion out of this grouping over time.

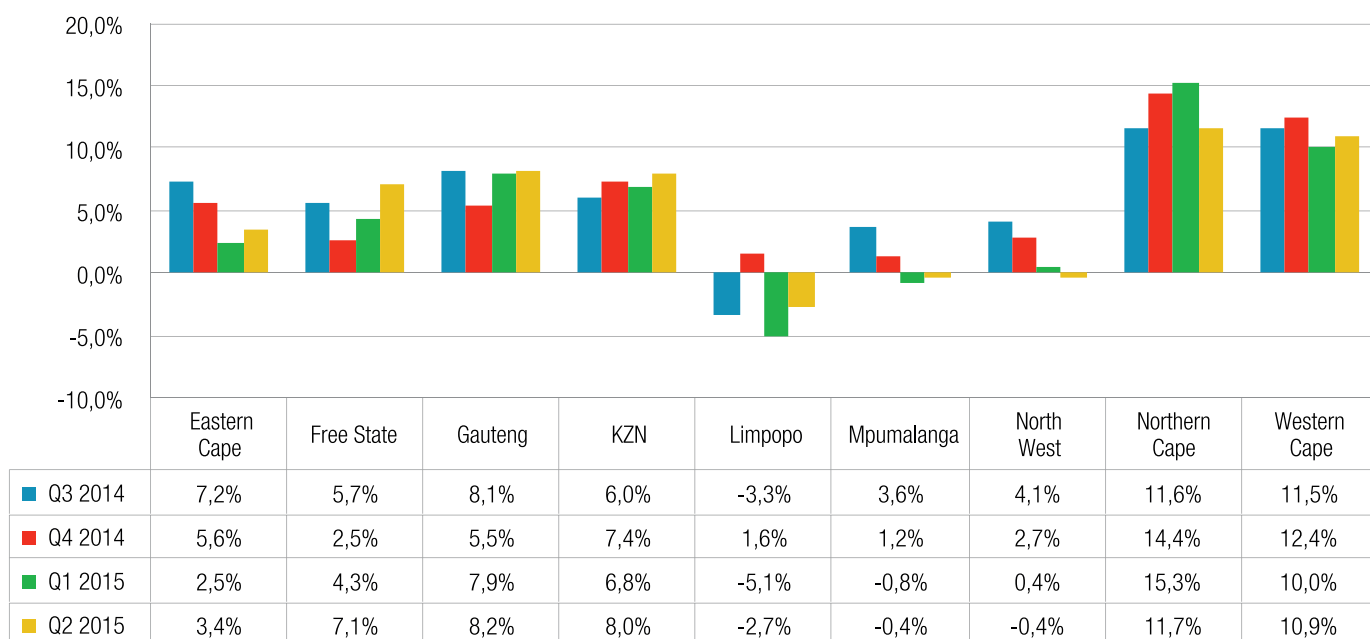


Provincial average rentals Q2 2015

Source: PayProp

Limpopo and Mpumalanga – how the mighty have fallen!

These one-time high flyers with their high average rentals and double-digit growth rates have suffered the impact of slowing economies. At the end of Q2, both continued to show negative growth rates. That is to say, average rental values are actually declining!



Provincial growth rates

Source: PayProp

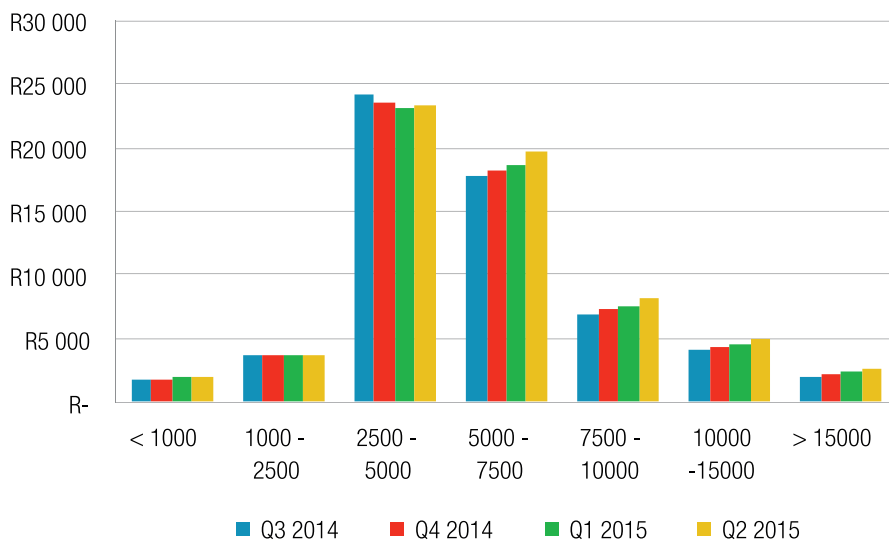
Stable growth wins the race

Investors agree that, over time, steady growth trumps brilliant short-term returns. We see this clearly in the even growth in rental values in the Western Cape, Gauteng and KZN over the past year. As with the fable of the tortoise and the hare, unspectacular growth in these provinces eventually triumphed over the short-term excessive growth of shooting stars Limpopo and Mpumalanga.

The star of the Northern Cape still burns brightly

In defiance of our concerns last quarter that the Northern Cape may soon follow the same path as Limpopo and Mpumalanga, this province continued to grow at double-digit rates for yet another quarter. Quarterly average growth has dropped from a 12-month high of 15.3% in Q1 to a Q2 average of 11.7%, but this still outstrips the national average of 7.26% by far. ■

UNDERSTANDING THE UNDERLYING PRICING DYNAMIC

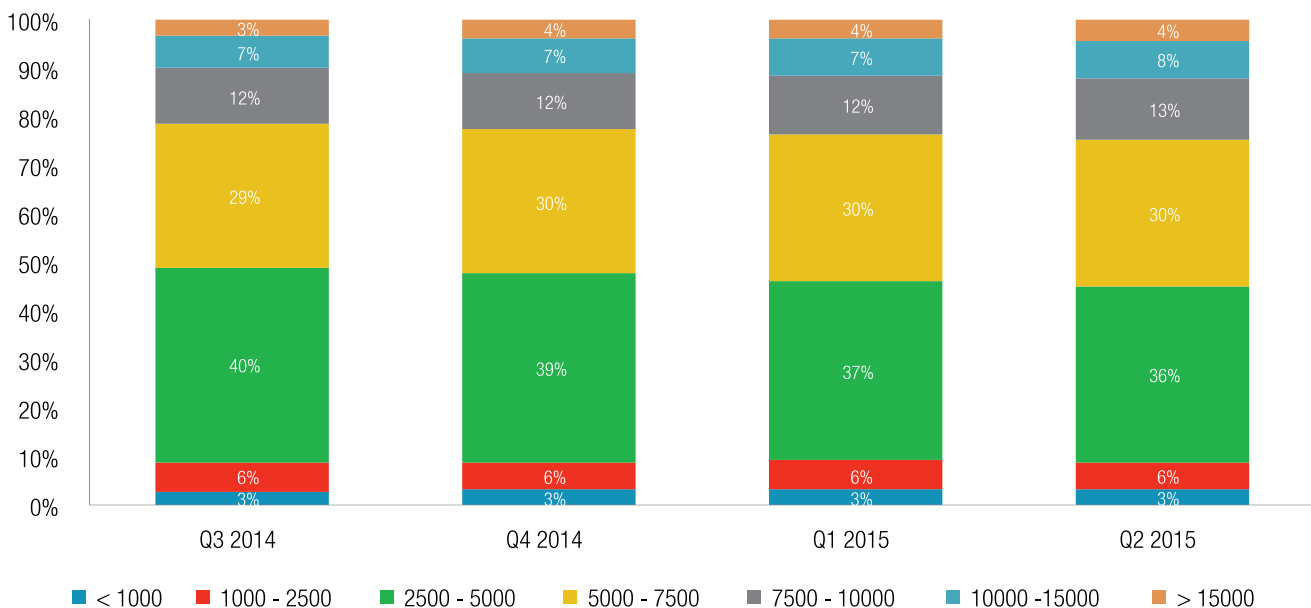


Linked to average growth rates is the distribution of rental contracts within the various price categories. The accompanying graph shows a decline in the R2 500 – R 5 000 category as a result of more rentals currently being signed in the categories above R5 000.

Further examination shows that 75.4% of rentals are priced below the R7 500 bracket, but most of the growth is occurring in the R10 000+ brackets – with the fastest growth happening in the R15 000+ band.



Rentals by price category
Source: PayProp



Distribution of price bands
Source: PayProp, PayProp Capital

A free lunch for your entire office says you can't beat this story.



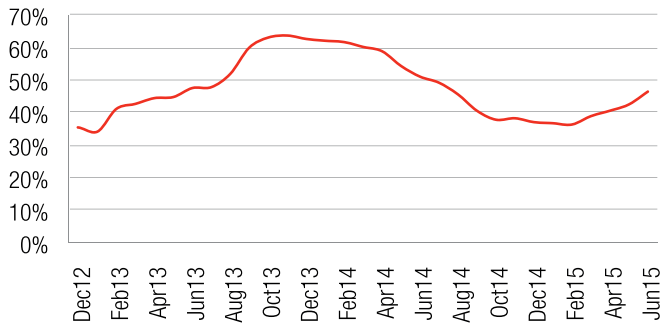
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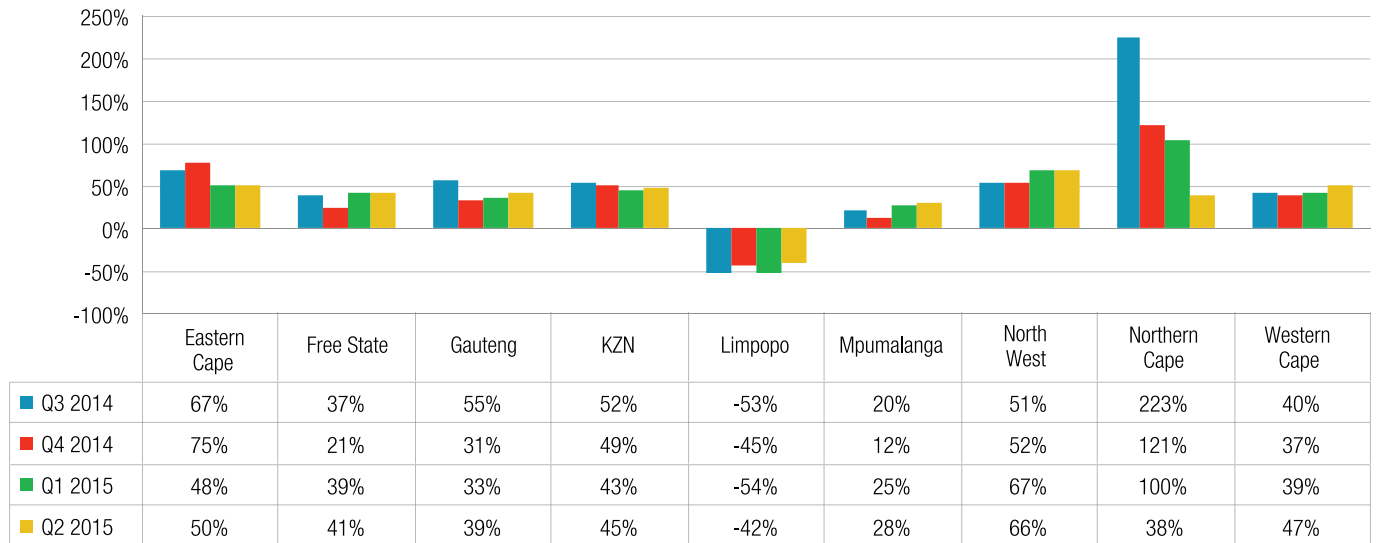
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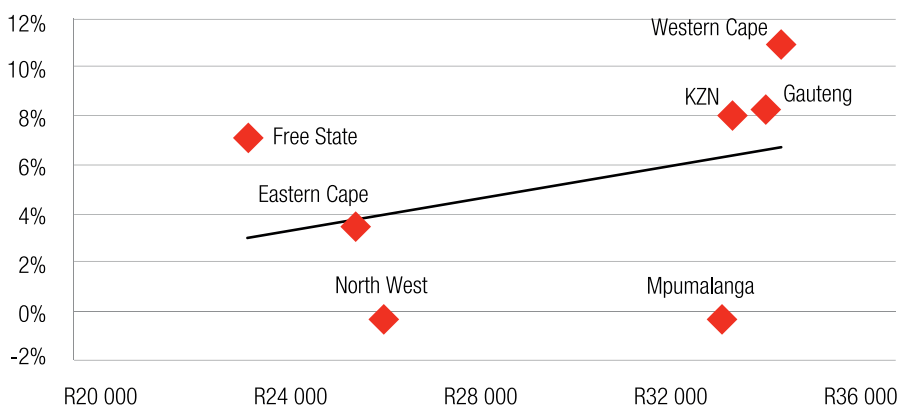
Growth in the top bracket has slowed down marginally over the last two quarters, and investigation into the underlying dynamics corroborates our findings concerning the decline in growth in Limpopo and Mpumalanga.

The decline in high-priced rentals in the Northern Cape may just be the sign we have been looking for in trying to determine the long-term growth prospects for this province. In our experience, high-value rentals in small 'anomaly' towns are typically driven by corporate leases for industrial expansion, such as mining or manufacturing. A dip in this category in the Northern Cape could therefore point to a future decline in average rental values.

National growth in number of rentals >R15 000
Source: PayProp



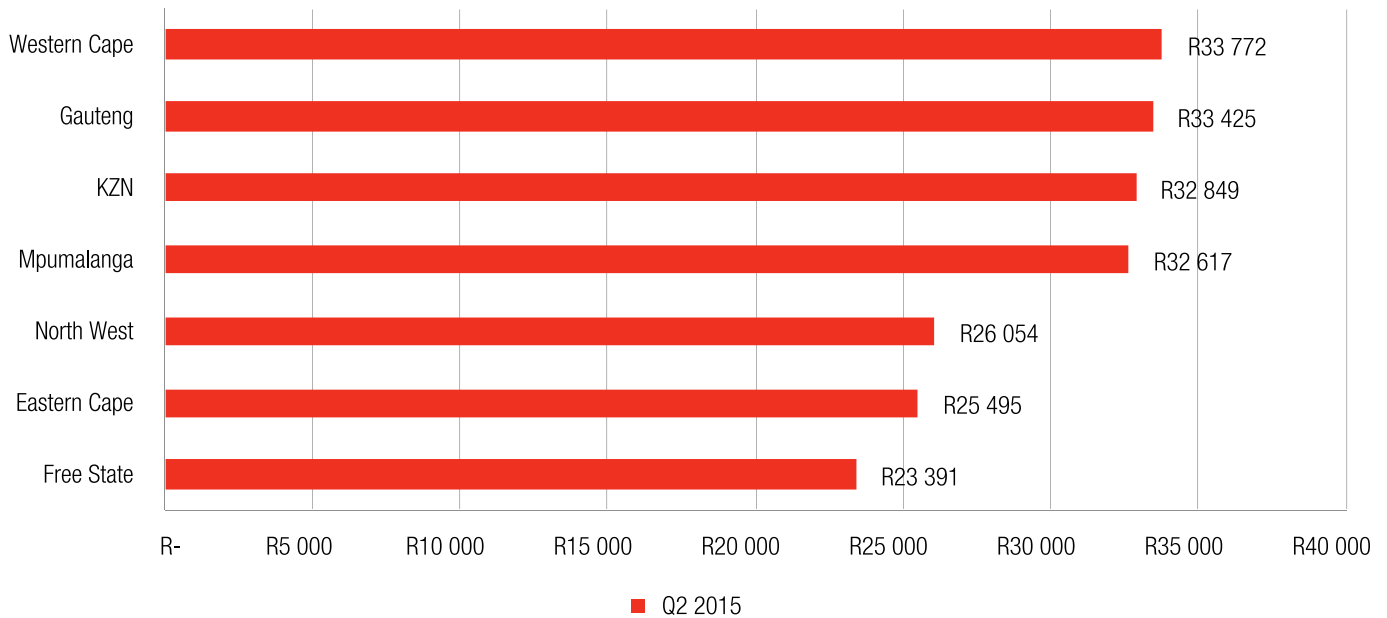
Provincial growth in number of rentals >R15 000
Source: PayProp



Another way to look at underlying rental pricing dynamics is to compare average tenant income in different provinces. Here we see that rentals grow fastest in provinces where prospective tenants' declared income is the highest (Western Cape, Gauteng and KwaZulu Natal). The converse is also true: In lower-income areas (Eastern Cape, Free State and North West) rentals grow at a slower pace. ■

Growth rates vs income
Source: PayProp, PayProp Capital

Our Tenant Assessment Report data pool is only a few months old. Although we already have 10 000 records to analyse, we do not have adequate data in some of the smaller provinces to make statistically valid deductions and have therefore omitted them where required.



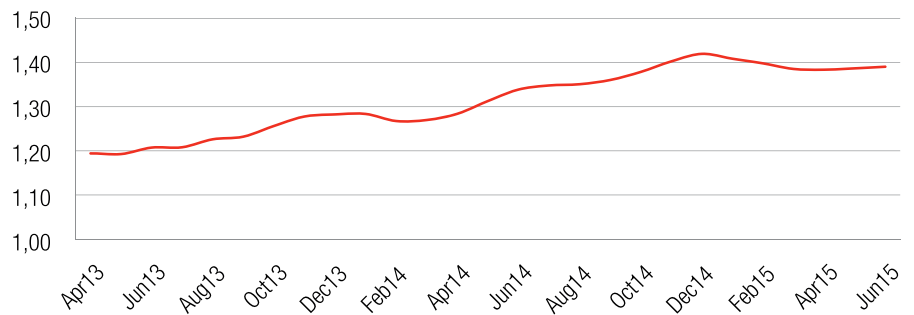
Average income by province
Source: PayProp, PayProp Capital

TURNING POINT FOR DAMAGE DEPOSITS

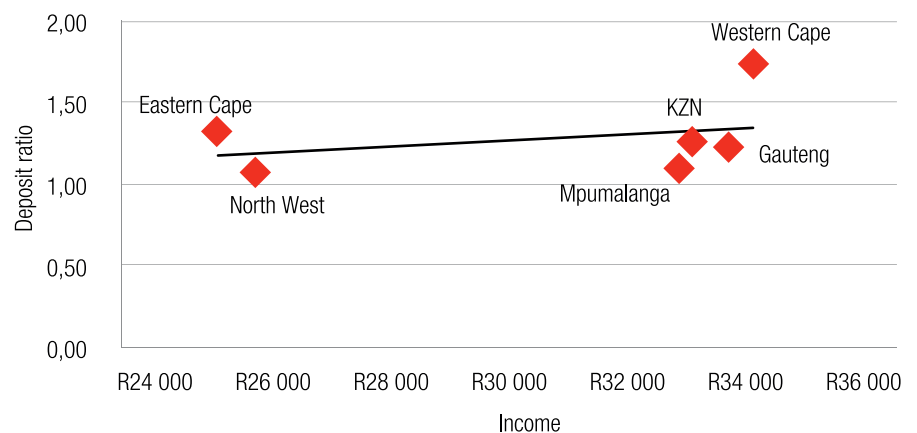
This is the first quarter since the inception of the PayProp Rental Index in which we have seen a decline in the damage deposit ratio. The damage deposit ratio expresses the value of the deposit relative to the value of the rental – if the ratio is 1.5, the average damage deposit is 1.5 times the value of the rental.

In this quarter the national damage deposit ratio ended at 1.39 – down from a four-year high of 1.42 in December 2014.

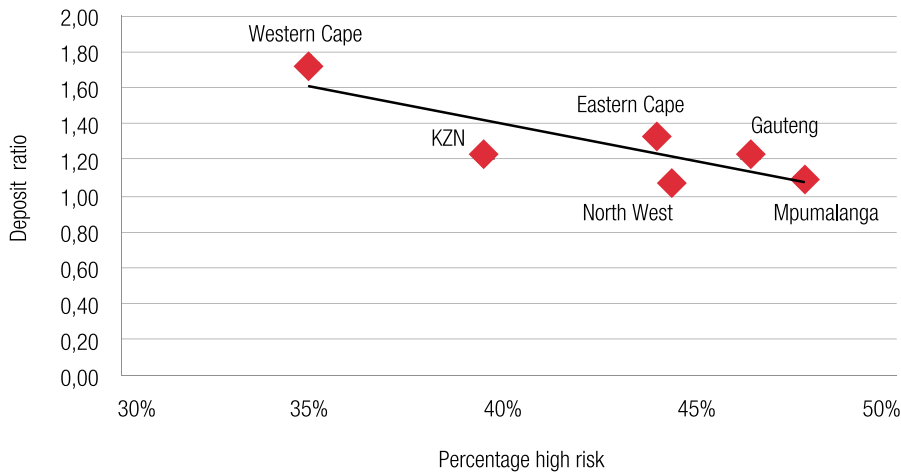
The role of the damage deposit is to provide protection to the landlord in case of damage to the property – and therefore one would expect its quantity to be closely linked to the underlying risk of non-payment exhibited by the tenant. However, when we compare the damage deposit ratio to tenant income and tenant risk, the graphs show that the market is more likely to use income as a factor for increasing deposits than an assessment of the tenant's underlying risk.



Damage deposit ratio
Source: PayProp



Income vs deposit ratio
Source: PayProp

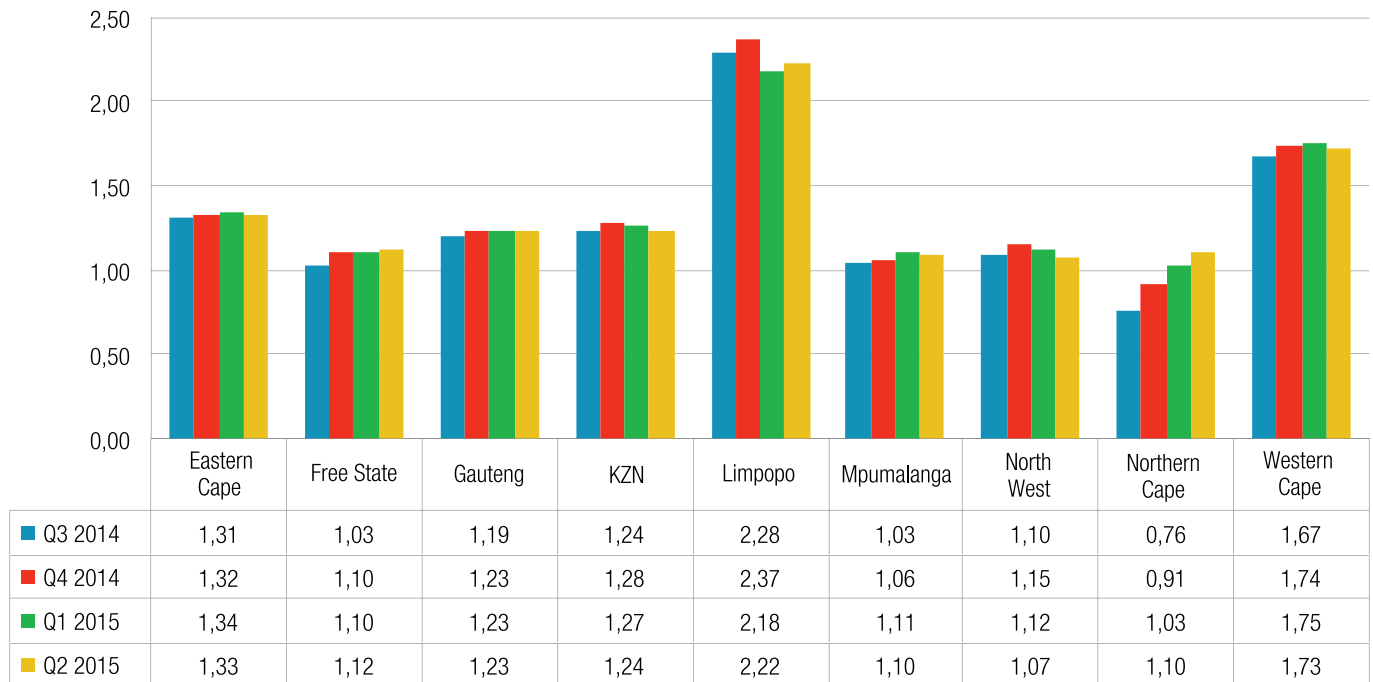


While the correlation between income and damage deposit ratios has weakened between the two quarters, the counter-intuitive relationship between damage deposits and high-risk tenants persisted. The higher the risk, the lower the deposit ratio! The jury is still out on the underlying reason for this. One contention is that areas in which tenants exhibit high risk are areas where they are under pressure financially. Consequently, they simply cannot afford to pay more (and, in turn, landlords cannot extract higher sums). In more affluent areas, on the other hand, where tenants have lower risk ratings, they are relatively better off and can afford to pay higher deposits.

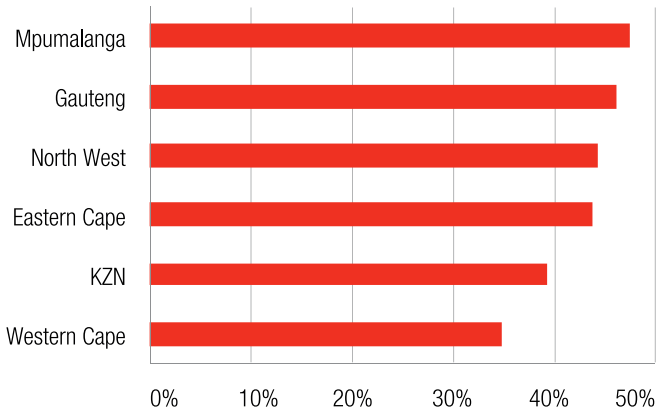


Damage deposit ratio
Source: PayProp, PayProp Capital

Provincially, Limpopo towers above the rest with the highest deposits in the country.



Provincial damage deposit ratios
Source: PayProp



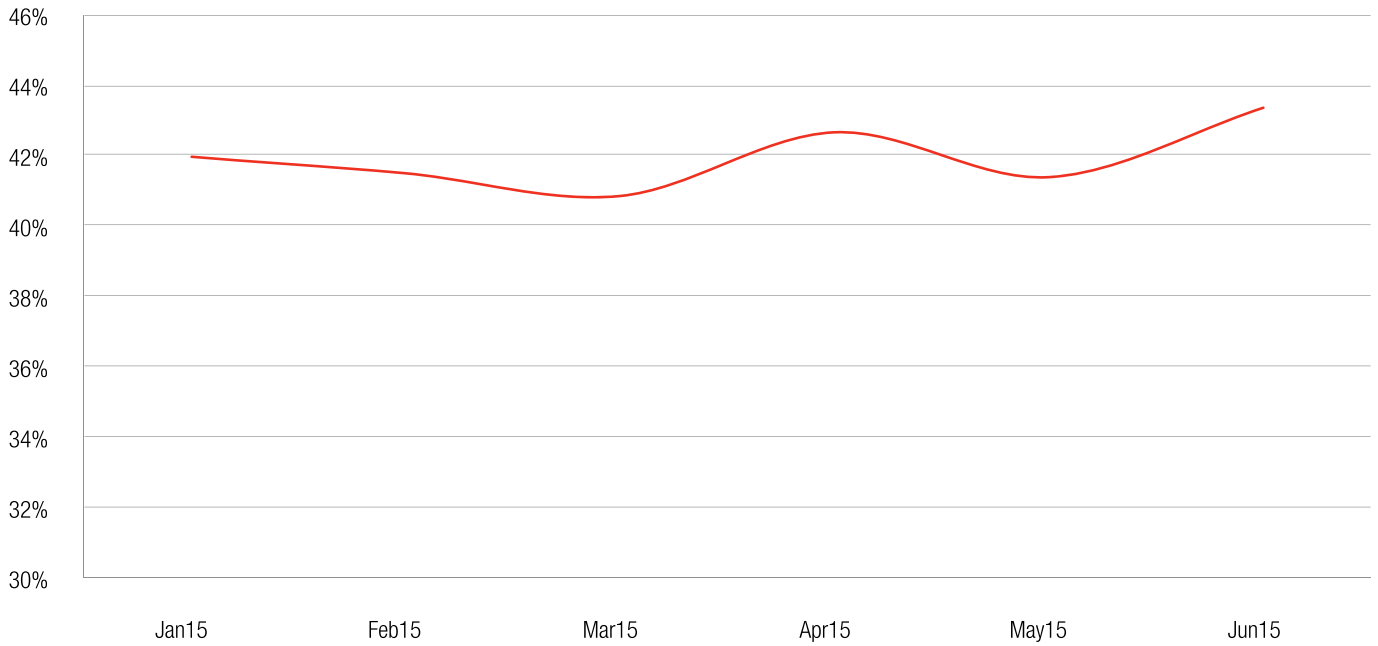
When looking at the percentage of tenants categorised as high- and very high risk*, the Western Cape scores the lowest. Based on this evidence and the state of affairs in Mpumalanga, the theory above may hold water. The latter province has one of the lowest damage deposit ratings, and yet it features one of the highest risk percentages.

At the national level, the percentage of tenants who fall in the high- and very high risk categories has remained fairly stable over the last two quarters, with Q2 posting a minor climb over Q1.

**Tenants' risk profiles are an aggregation of individual ratings by the PayProp Capital Tenant Assessment Report, based on a range of custom-developed variables. ■*



Percentage high-risk tenants
Source: Compuscan, PayProp Capital



National percentage high- & very high risk tenants
Source: Compuscan, PayProp Capital

THE AVERAGE PAYPROP TENANT IN SOUTH AFRICA

From the analysis on pages 9-11 it is clear that the financial state of the tenant has a clear influence on underlying growth rates and damage deposit ratios in the different provinces. The question that begs answering is what the average tenant in South Africa looks like. Combining these credit variables gives us some insight into that.



MONTHLY DEBT REPAYMENTS

R9 755



AVERAGE INCOME

R32 944*



AVERAGE RENTAL

R6 388

NUMBER OF MONTHS SINCE
LAST 90 DAYS IN ARREARS

10.65

MAXIMUM NUMBER OF
MONTHS IN ARREARS

3.68

ACCOUNTS IN
ARREARS 2014

2

AVERAGE DEPOSIT PAID

R8 880

NLR ACCOUNTS

4

CPA ACCOUNTS

8

AVERAGE AGE

38

% OF AVAILABLE CREDIT USED

69%

CREDIT SCORE

630

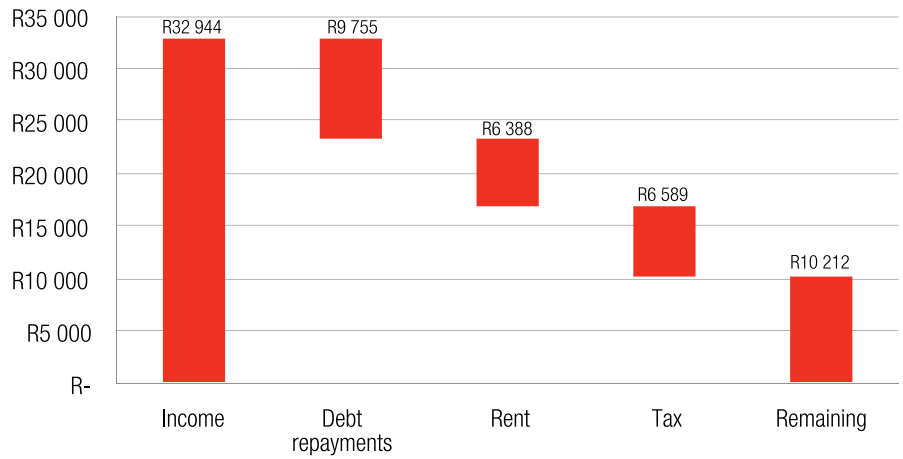
* Figures only include PayProp-administered tenants in the formal rental market (excluding shacks, hostels, back-rooms etc.), and tenants who use an estate agency – the assumption can be made that such tenants are financially better off.

CPA – Credit Providers Association

NLR – National Loan Register

What is sobering about this analysis is the extent to which debt repayment commitments affect the cash flow of the average prospective tenant. At the end of this quarter, he or she had less than a third of their income left to pay for things like medical aid, electricity, school fees, insurance and groceries.

To better understand the structure of those debt repayments, we look at the number of accounts an average tenants holds by age group. This amounts to eight traditional credit-based accounts (CPA accounts typically include credit cards, contracts, short-term insurance and asset finance) and four accounts on the National Loan Register (NLR), such as microloans and personal loans.



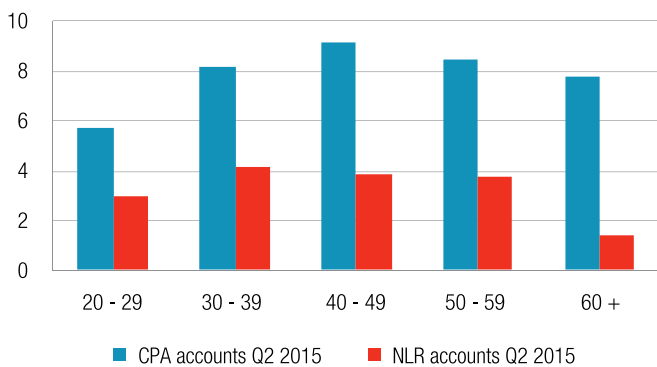
Tenant financial analysis
Source: Compuscan, PayProp Capital

From the graph below it would seem that consumers become wiser and better managers of their credit facilities as they grow older.

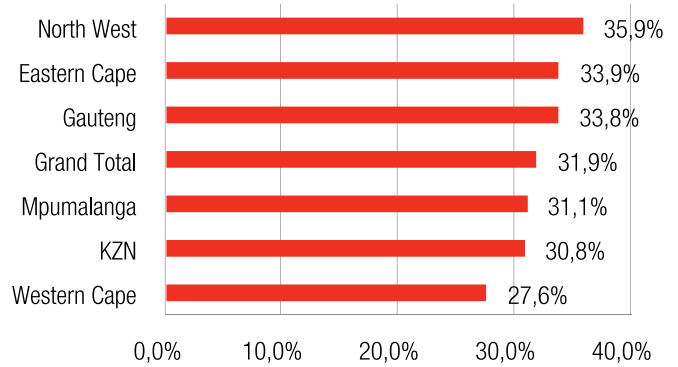
Provincially, there is a fairly dramatic variance in the value of debt repayments as a percentage of income. The Eastern Cape is the worst off, with tenants spending on average 33.9% of their gross income on repaying debt – while the Western Cape is cruising at 27.6%. Adding to the concern about debt levels is the fact that, for this quarter, the average tenant has already used up 69.16% of the total annual credit

granted to them, according to PayProp Capital's Tenant Assessment Report findings.

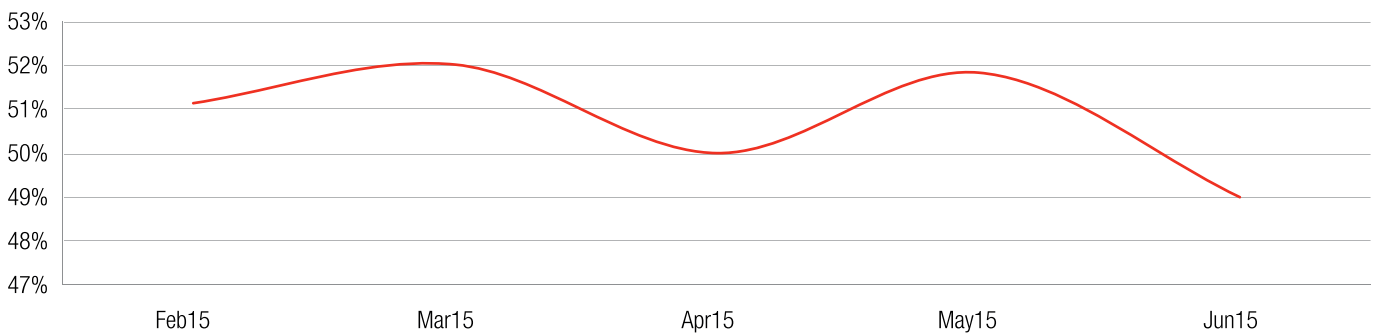
This means that tenants have very little 'breathing space' to absorb life's unexpected financial knocks. In our analysis of the significant tenancy application data available to us, the percentage utilisation of available credit is an important indicator in assessing tenant payment risk. Accordingly we have noticed an increasing downward trend in the proportion of tenants who qualify for the DepositGuarantee. ■



NLR and CPA accounts by age bracket
Source: Compuscan, PayProp Capital



Percentage high-risk tenants
Source: Compuscan, PayProp Capital



DepositGuarantee eligibility
Source: Compuscan, PayProp Capital

RETURN ON INVESTMENT

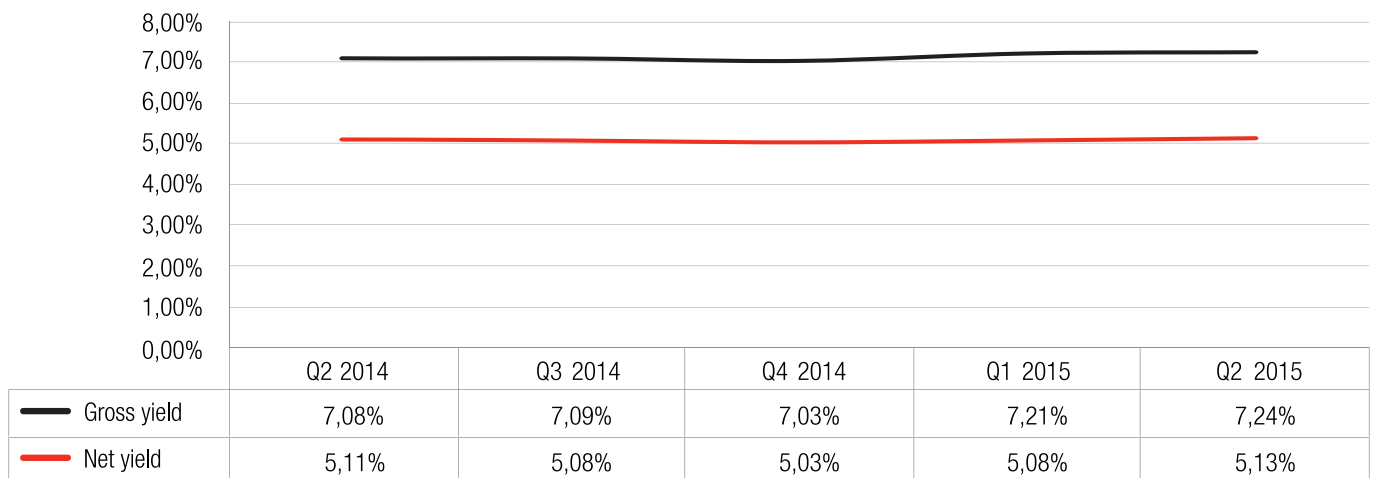
Finally, and perhaps most importantly, what does all this mean for investors?

This quarter we expected to finally see an increase in the net returns earned by owners. We based it on strengthening growth in average rental values (just over 7%) combined with a gradual decline in the average house price growth (from 9% in Q1 2014 to just under 4% at the end of Q2 2015). However, a third factor has changed matters: At the same time, the cost of owning and maintaining a property has also increased. This has resulted in a situation where gross yields (rental/cost of property) have grown over the past 12 months, from 7.08% to 7.24% – while

net yields barely increased from 5.11% to 5.13% over the same period. That said, net yields had increased substantially in the previous quarter, from 5.03% at the end of 2014.

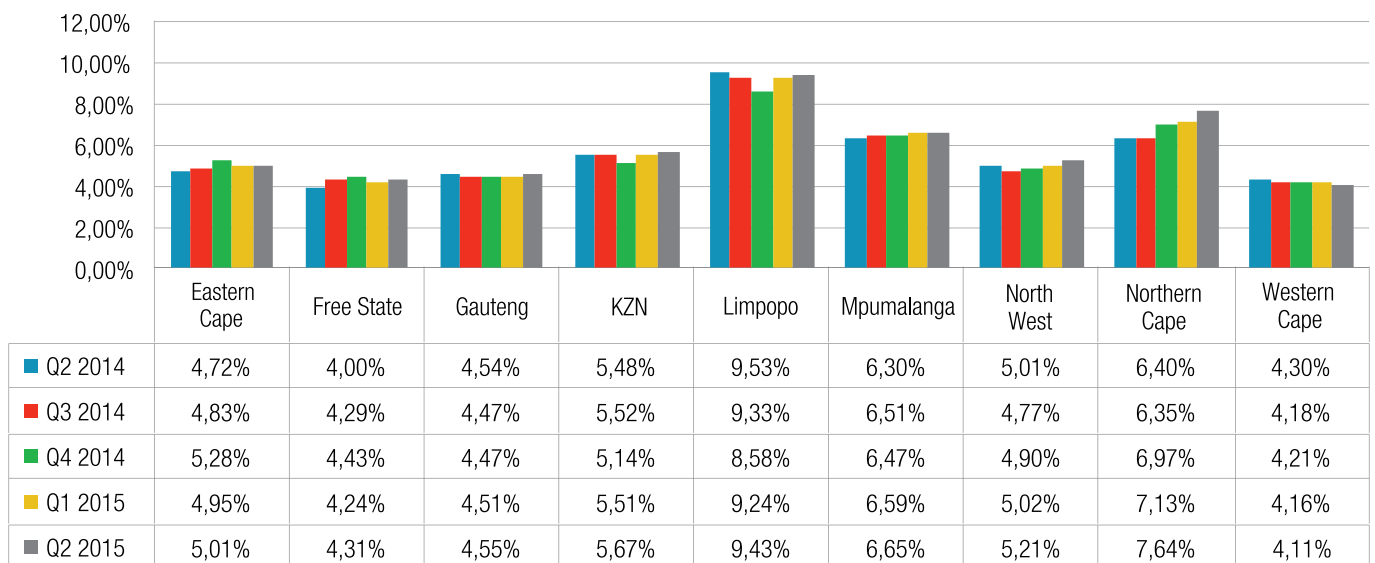
Provincial yields

Provincially, the picture has remained fairly stable over the past four quarters, with Limpopo still offering excellent returns despite the dip in rentals, and the Northern Cape and Mpumalanga continuing to shine. Interestingly, net yields in the Western Cape and Gauteng remain fairly low – largely as a result of higher house prices in these areas, relative to rental values. ■



National gross and net yields

Source: Compuscan



Provincial net yields

Source: Compuscan

IN SUMMARY

This quarter's results have shown that the declines in Limpopo and Mpumalanga are not just 'blips on the screen', but part of a longer-term trend of decline in rental values. The Northern Cape remains the rising star, although the decline in high-value rentals does raise some concern that this province may be destined for the same path.

Furthermore, we are hopeful that the upward trend in rental growth will continue. However, we temper our excitement in view of the continued weakening in the financial health of tenants – especially their growing levels of debt relative to income.

In our experience, growth in average rentals that is not backed by simultaneous economic growth will most likely result in worsening tenant payment behaviour in the long term. We would recommend that property owners and managers pay increasing attention to the higher risks associated with tenant selection and lease management.

It is in these circumstances that the true value of letting agents as professional and well-informed advisors of property owners becomes crucial. Earning a commission should not just be about efficient process administration, but most importantly about advising landlords on how to maximise returns while minimising risk. Therefore understanding broader economic trends, knowing when tenants are being stretched beyond their means and being able to advise on appropriate deposit pricing and deposit alternatives is increasingly becoming part of the skill set that any serious letting agent should have.

Therefore make the quarterly PayProp Rental Index part of your essential knowledge armoury.

Furthermore in these difficult times, trust our tenant risk mitigation solutions – the PayProp Capital Tenant Assessment Report and DepositGuarantee – to safeguard your landlord's business and your own. ■

PayProp Rental Index

The PayProp Rental Index is a quarterly guide on trends in the South African residential rental market, and is compiled from actual transactional data collected by PayProp, the largest processor of residential letting transactions in South Africa. This edition details market conditions for the second quarter of 2015.

Contact details

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GROW

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PayProp works on all devices, so you can approve payments from your mobile device, wherever you are.



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PayProp Tenant Assessment Reports combine tenants' historic payment behaviour with their future propensity to pay – delivering deeper insight into tenant risk.



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