

Q3 2015

PAYPROP RENTAL INDEX

State of the rental industry

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

JUL - SEP 2015

PayProp lifts the weight of rental admin



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Q3 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 we track rental data harvested from financial transactions relating to 75 000+ 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

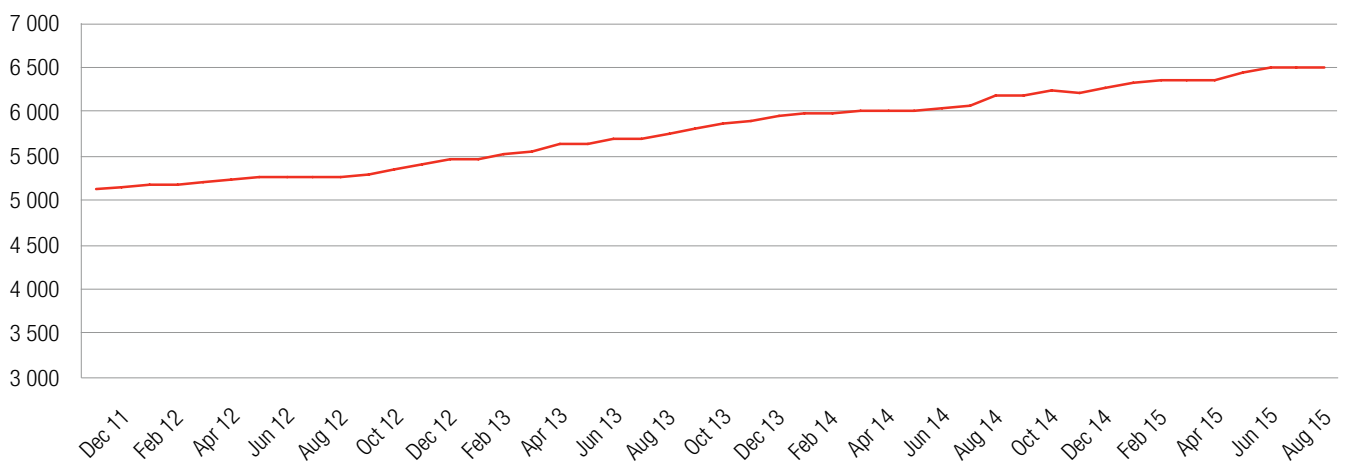
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STORM CLOUDS GATHERING

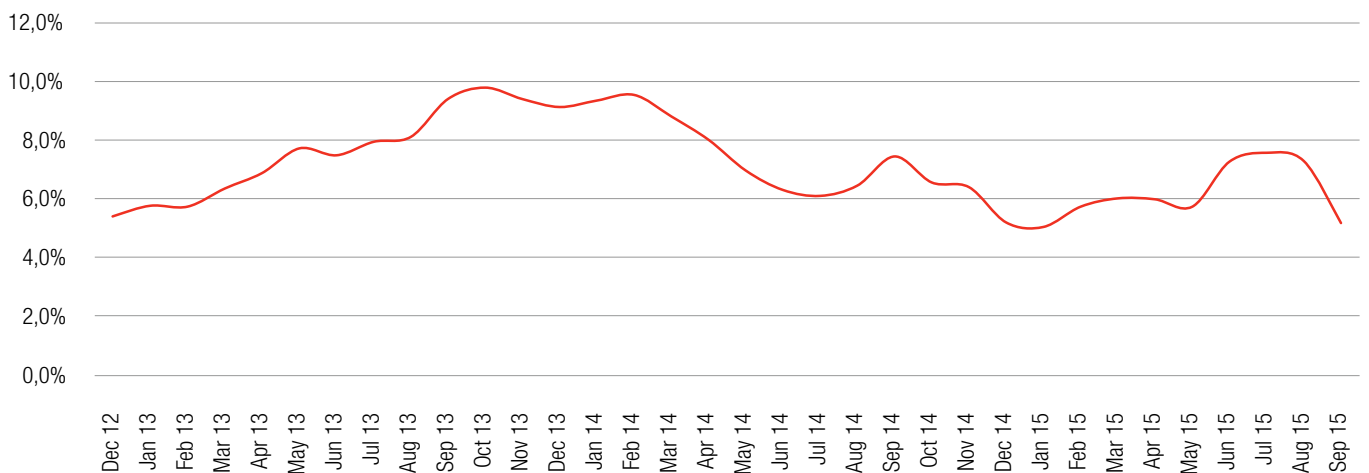
We'll start off with the good news – the average residential rental in South Africa held steady above the R6 500 level this quarter! This figure is currently at R6 508, but we should also note that there has been no upward movement in it since the previous quarter (ending in June 2015).

The stagnant growth has had far more than just a short-term effect. The background here is that long-term year-on-year growth in rentals has been rallying since January 2015, after a prolonged down-turn. Based on previous growth cycles we've been expecting the upturn to last until the end of the year at

least, and growth rates to pick up from 5.04% in January to around 10%. However, as a result of the cessation in growth, this quarter effectively marks the beginning of a dip in year-on-year growth. Average growth dropped from 7.56% in June to 7.28% in July, and ended on 5.18% in September. ■



Average rental
Source: PayProp

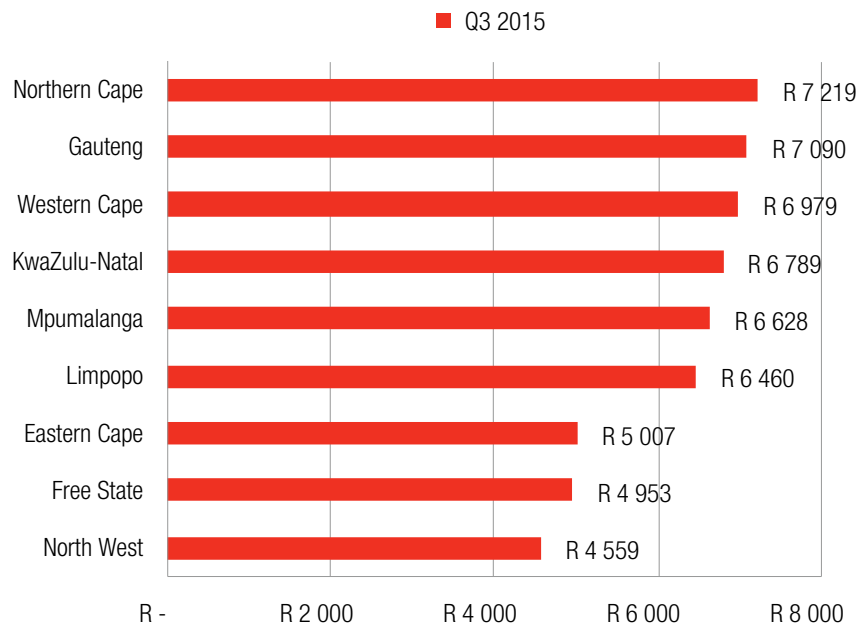


Year-on-year growth
Source: PayProp

PROVINCES – AND WE HAVE A NEW WINNER!

We've been predicting this one for some time. The Northern Cape is now officially the most expensive province in which to rent in the country, with average rentals topping out at R7 219 per month this quarter. The "other" Cape has overtaken Gauteng in this respect, which has been in the lead for two consecutive quarters.

Despite consistently high growth rates, Gauteng had no answer for the tremendous growth spurt of the newcomer, which has seen more than 12 months of back-to-back double-digit growth rates. ■

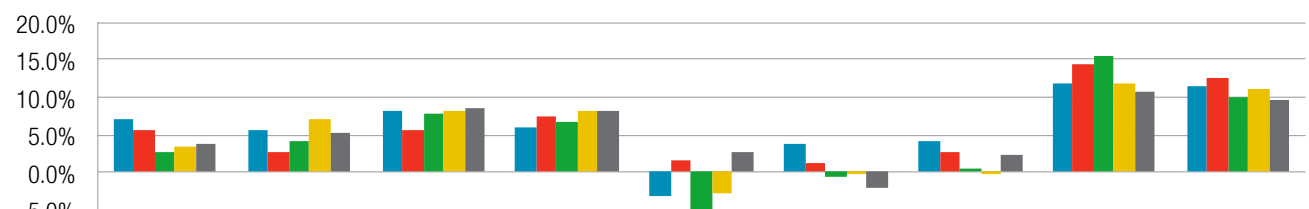


Provincial average rentals Q3 2015
Source: PayProp

PROVINCES – NO RECOVERY IN SIGHT FOR LIMPOPO AND MPUMALANGA

Mpumalanga and Limpopo, historically the top-performing provinces, have of late been languishing behind new frontrunners Northern Cape and Gauteng, and still haven't shown any clear signs of recovery in the latest period. In fact, rentals in Mpumalanga continue to decline on a year-on-year basis, with

the latest figures showing a 2.2% decline. And while Limpopo has now recorded positive growth for the first time this year, the 2.6% it registered has hardly been enough to drive a solid recovery in average rental values. ■



| | Eastern Cape | Free State | Gauteng | KZN | Limpopo | Mpumalanga | North West | Northern Cape | Western Cape |
|-----------|--------------|------------|---------|------|---------|------------|------------|---------------|--------------|
| ■ Q3 2014 | 7.2% | 5.7% | 8.1% | 6.0% | -3.3% | 3.6% | 4.1% | 11.6% | 11.5% |
| ■ Q4 2014 | 5.6% | 2.5% | 5.5% | 7.4% | 1.6% | 1.2% | 2.7% | 14.4% | 12.4% |
| ■ Q1 2015 | 2.5% | 4.3% | 7.9% | 6.8% | -5.1% | -0.8% | 0.4% | 15.3% | 10.0% |
| ■ Q2 2015 | 3.4% | 7.1% | 8.2% | 8.0% | -2.7% | -0.4% | -0.4% | 11.7% | 10.9% |
| ■ Q3 2015 | 3.6% | 5.3% | 8.6% | 8.2% | 2.6% | -2.2% | 2.4% | 10.8% | 9.5% |

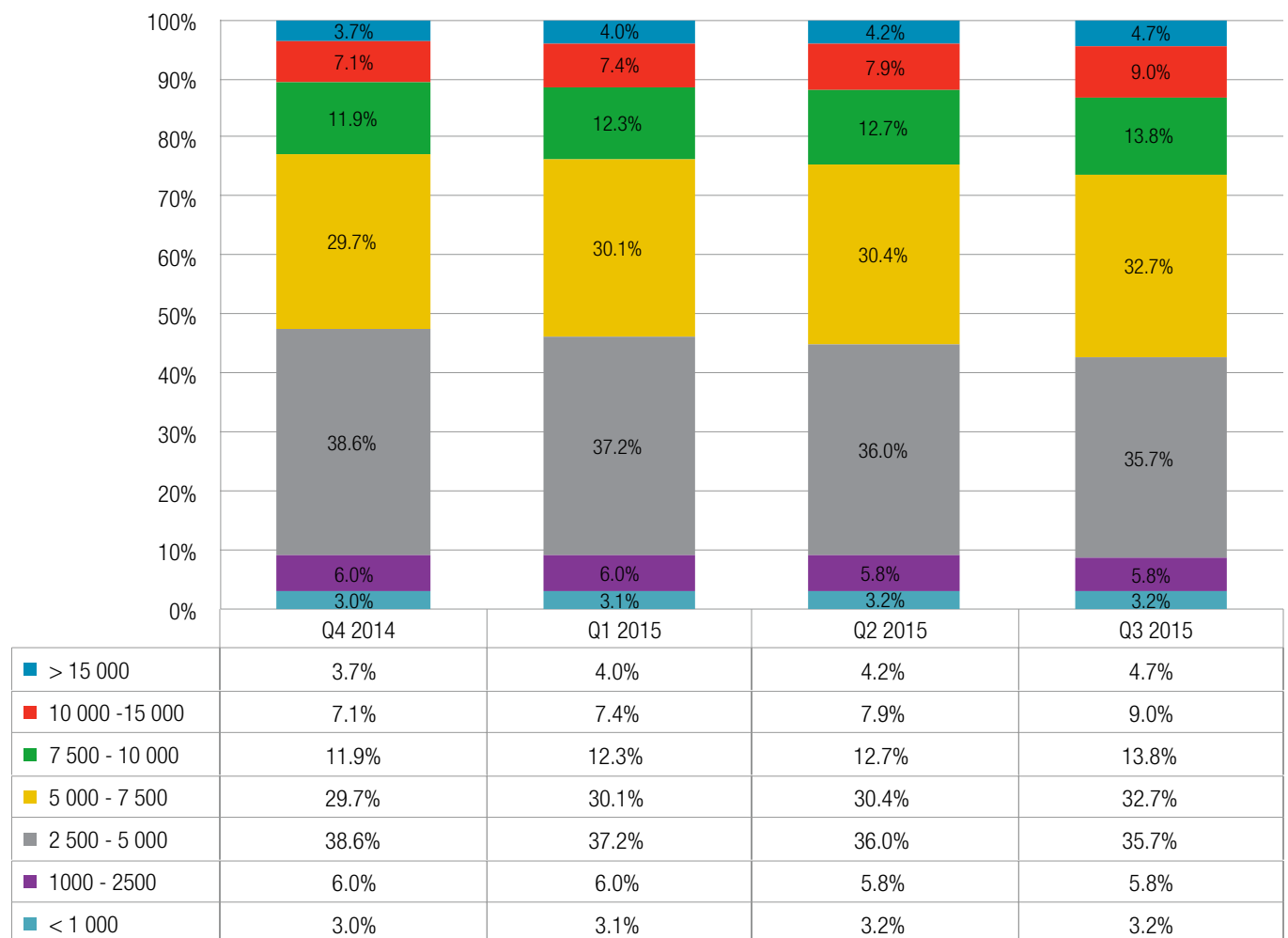
Provincial growth rates
Source: PayProp

STABILITY IN THE ANCHOR PROVINCES

It's encouraging to see that the economic powerhouses of KwaZulu-Natal, the Western Cape and Gauteng maintained their stable growth at 8.2%, 9.5% and 8.6% respectively. If the three largest provinces continue to post growth that outstrips inflation, it may soften the severity of the decline in average growth rates that we are projecting. ■

UNDERLYING PRICING DYNAMIC

Over time our quarterly report on residential letting trends in South Africa has pinpointed a migration of rentals from the lower-priced bands to the higher-priced ones. But while the graph below highlights impressive growth in the > R10 000 categories, it is important to keep in mind that 77.4% of all rentals are still below R7 500. ■



Distribution of price bands
Source: PayProp

A free lunch for your entire office if you can beat this story...



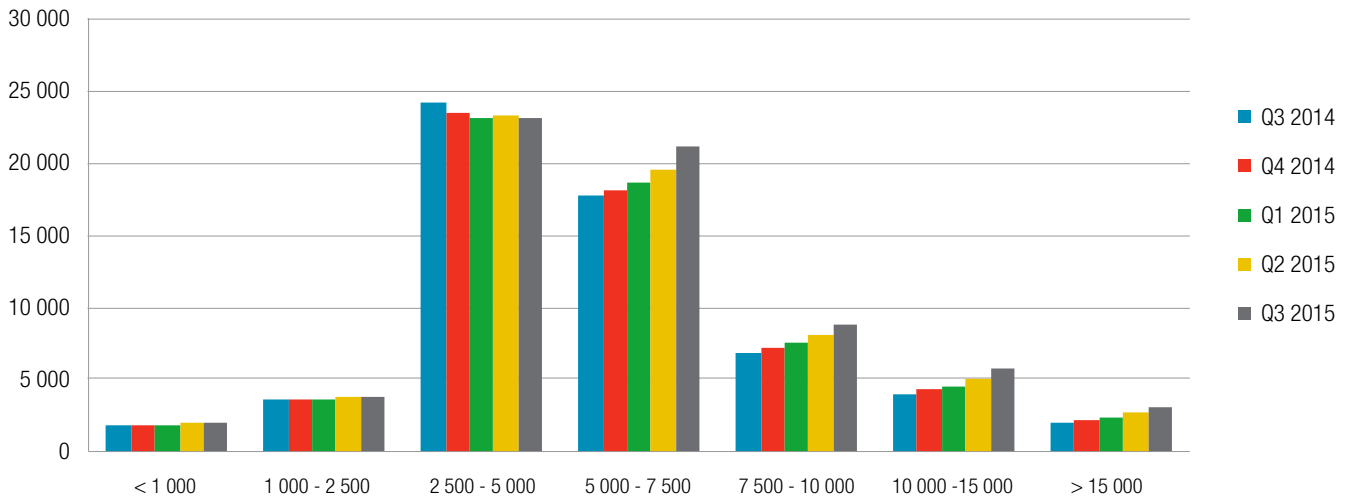
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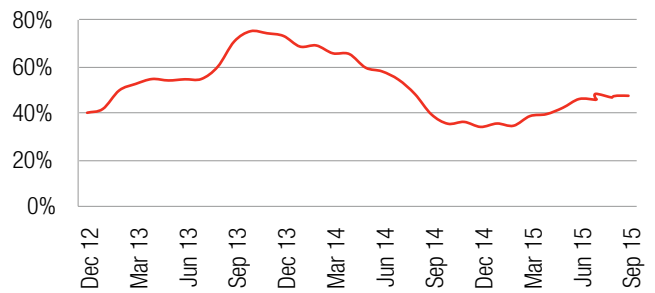


Rentals by price category
Source: PayProp

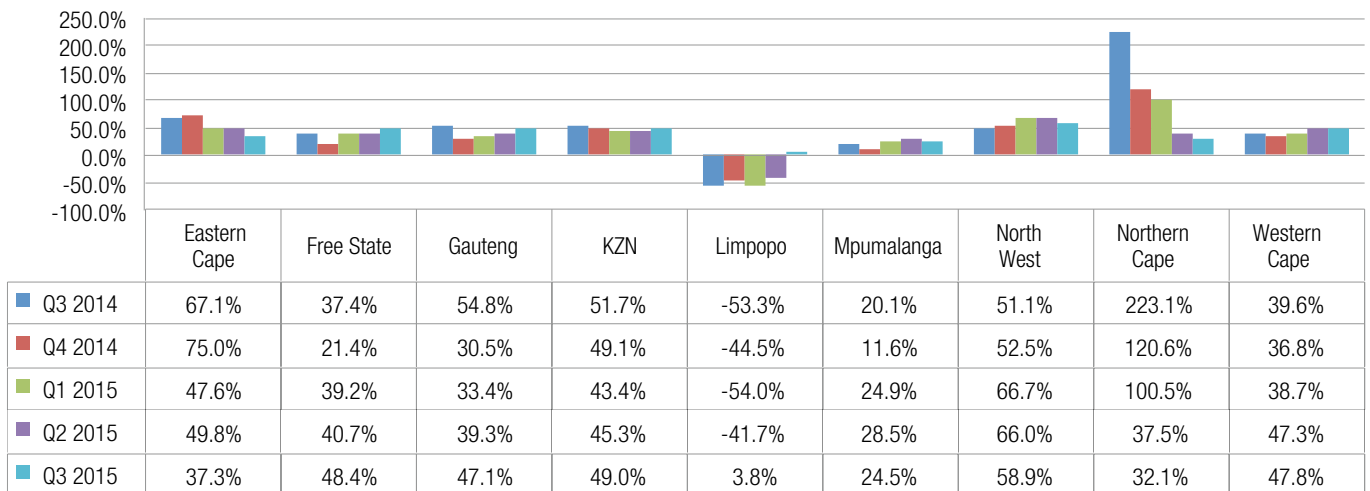
CONTINUED GROWTH IN > R15 000 RENTALS

On further examination, other interesting dynamics come to the fore regarding growth in rentals above R15 000. While the graph on the right shows a decline in that band, it is still an impressive number (from 72% at its highest down to the current quarterly average of 47%).

We often look to rentals in this price category as the "canary in the mineshaft" when projecting provincial growth rates. According to the hypothesis we've developed over the years, a drop in this price category is a first indication of a possible downward cycle in a particular area. If we look at Limpopo, for example, we see that the current downward trend in average ▶



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



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

- rental values began with lower growth in high-end rentals.

While the Northern Cape is the largest and currently still the fastest-growing province in terms of monthly rental values, we have concerns about the sustainability of this growth. The first red flag we must heed is a slowing in the phenomenal year-on-year growth that we've been seeing in this province. Currently at a quartered average of 10.8%, this figure is at its lowest in 18 months. Over the three months making up Q3, growth fell from 10.9% in July to 10.5% in August, ending in 7.7% in September. If this trend continues, the Northern Cape may not be in the top spot for very much longer.

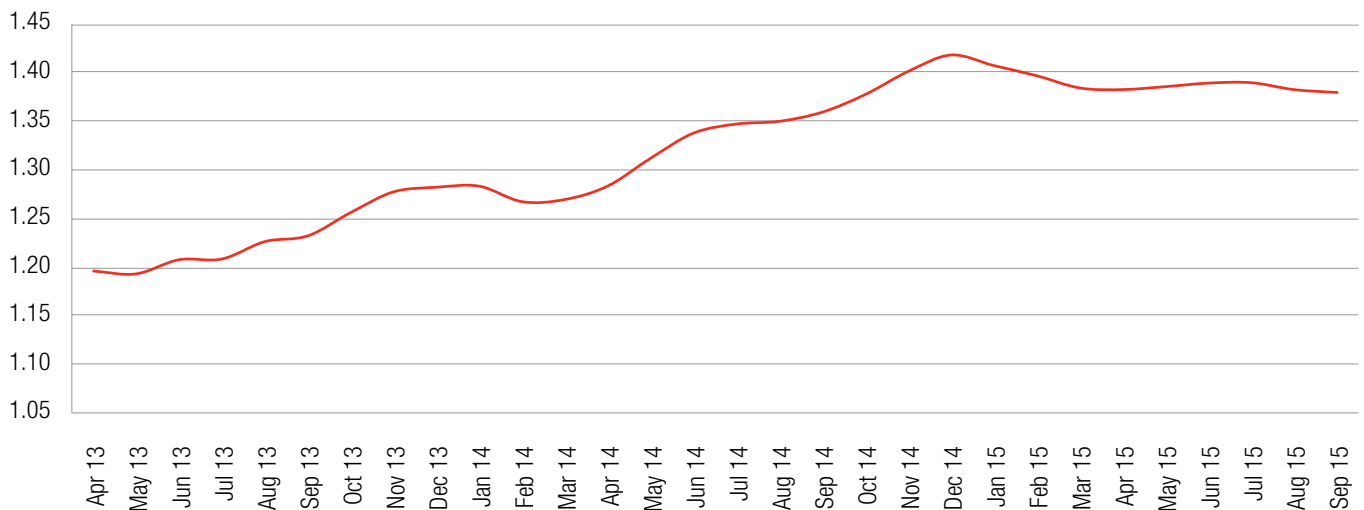
Additionally, growth in rentals above R15 000 has cooled down dramatically in this province from its heyday levels of 223% (Q3 2014).

It was determined then that the runaway growth was probably the result of bulk corporate rentals being signed on the back of industrial development. We would hazard a prediction, based on the figures we are currently seeing, that the expansion boom is over and may even be contracting, possibly caused by economic shifts in towns affected by the downturn in mining activity. ■

DAMAGE DEPOSIT RATIOS DROP BACK MORE

The damage deposit ratio (how big damage deposits are in relation to rentals in a given area) continues to make for interesting analysis. This ratio peaked at 1.42 in Q4 2014 (where the average damage deposit is 1.42 times the average rental value), but has since gradually dropped to 1.38. While the difference may seem marginal, it has had a significant overall

effect. In PayProp's sample set, for example, it means that R10 million less is being held in deposit for the same value of rentals compared to a year ago. When applied to the estimated 1.5 million rental properties in South Africa, we see that R200 million less is being held in deposit to secure a rental pool of the same value. ■



Damage deposit ratio

Source: PayProp

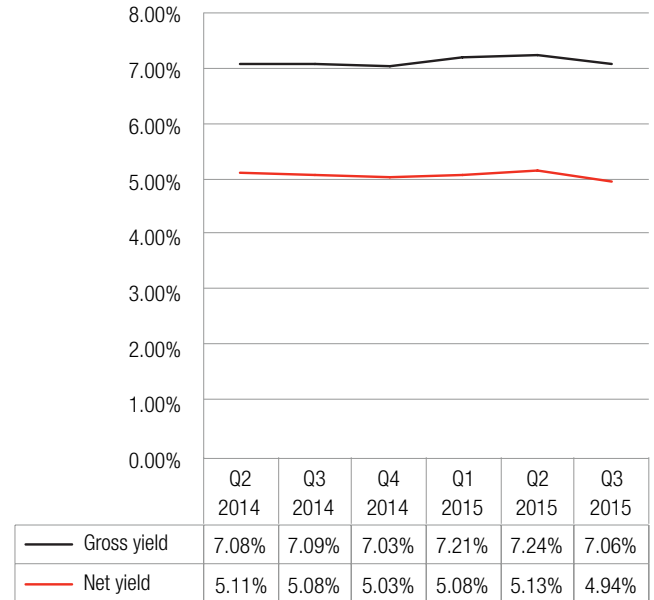
YIELDS DROP

This is the first time in more than two years that we've seen net yields drop below the 5% level – currently, they're at 4.94%. The drop has been driven by quarter-on-quarter rental growth of only 6.7% versus average property value growth (calculated on the same basis) of 7%. Combined with rising costs of ownership, this has held investors back from entering the market. We have experienced a subtle shift in the market as a result of this change in the return model. Larger institutional investors are entering the market as bulk investments generally result in lower capital costs and lower per-unit management and maintenance costs, due to economies of scale.

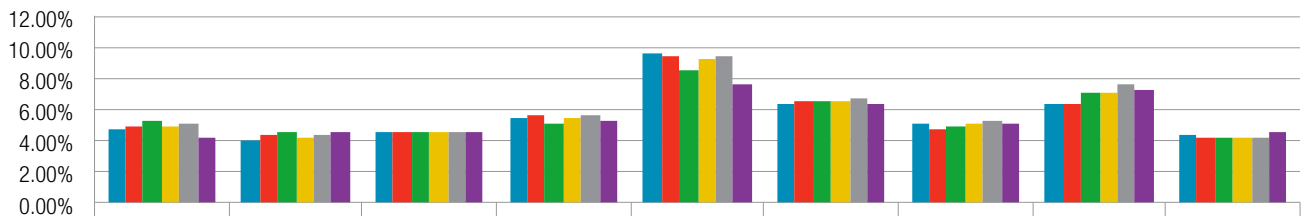
On a provincial scale, Limpopo still offers excellent returns (7.52%) despite the decline in real values – as it takes a while for the impact of slower growing rentals to affect net yields. We do however expect to see net yields in this province drop back from the number one spot by next quarter, as rental growth remains flat. The Northern Cape comes in second at 7.16% – although this is a slight drop from the 7.64% achieved last quarter.

Surprisingly, the Western Cape and Gauteng are struggling at the lower end of the yield range. This is not, as may be expected, because of low rental values in these areas (which is the reason for the low yields in the Eastern Cape), but because much higher property values make it harder for a buyer to enter

the buy-to-let market, raising the barrier to achieving profitability. In these circumstances, rentals need to consistently outpace property value growth to ensure positive growth in returns for investors in these areas. ■



National gross & net yields
Source: PayProp



| | Eastern Cape | Free State | Gauteng | KZN | Limpopo | Mpumalanga | North West | Northern Cape | Western Cape |
|---------|--------------|------------|---------|-------|---------|------------|------------|---------------|--------------|
| Q2 2014 | 4.72% | 4.00% | 4.54% | 5.48% | 9.53% | 6.30% | 5.01% | 6.40% | 4.30% |
| Q3 2014 | 4.83% | 4.29% | 4.47% | 5.52% | 9.33% | 6.51% | 4.77% | 6.35% | 4.18% |
| Q4 2014 | 5.28% | 4.43% | 4.47% | 5.14% | 8.58% | 6.47% | 4.90% | 6.97% | 4.21% |
| Q1 2015 | 4.95% | 4.24% | 4.51% | 5.51% | 9.24% | 6.59% | 5.02% | 7.13% | 4.16% |
| Q2 2015 | 5.01% | 4.31% | 4.55% | 5.67% | 9.43% | 6.65% | 5.21% | 7.64% | 4.11% |
| Q3 2015 | 4.19% | 4.50% | 4.44% | 5.29% | 7.52% | 6.38% | 5.02% | 7.16% | 4.46% |



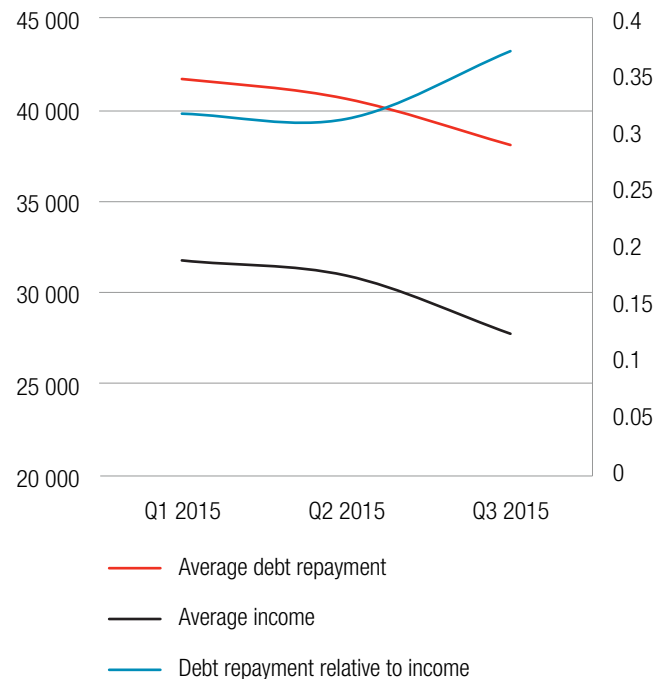
Provincial net yields
Source: PayProp

TENANT HEALTH

Our tenant analysis is based on data abstracted from tenancy applications – specifically PayProp Capital's Tenant Assessment Report (TAR). Providing a unique view on tenant risk, the TAR has grown from strength to strength in the market, and in the latest sample batch we were able to include roughly 15 000 tenant records. This data gives us a unique foundation on which to build an understanding of the financial health of the average South African who uses an estate agent to source a rental. However, this report has only been available to PayProp customers for the last 12 months. During this time it has attained coverage in all provinces, but we do not yet regard all provinces' data as reliable indicators of actual rental trends, and thus exclude some from our data set.

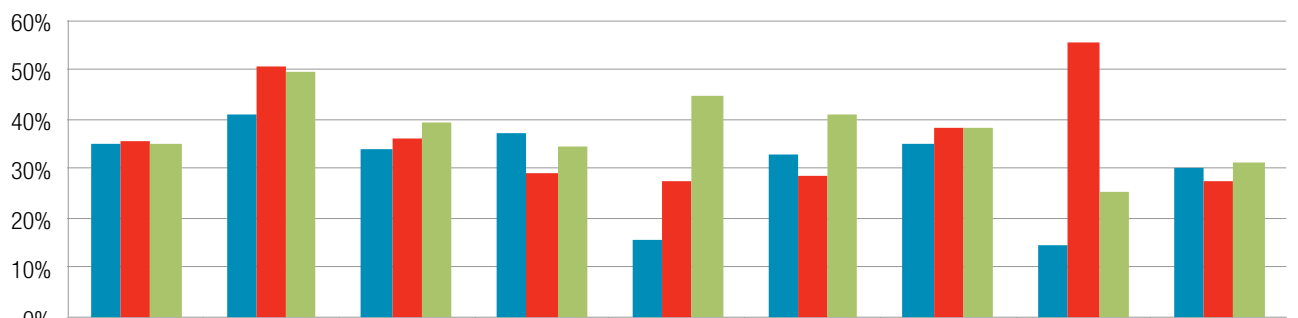
From the available data we draw our first important insight concerning the relation between tenant income and debt repayments. Over the past three quarters a concerning trend has been emerging that shows tenant incomes declining while debt repayment commitments have been increasing. As a result, tenants are currently spending close to 37% of their income on repaying debt, as opposed to 32% at the beginning of this year (otherwise known as the debt repayment ratio).

Provincially, the data provides an even more interesting perspective. Limpopo, where we have seen a decline in average rental increases, a corresponding increase in debt repayments shows up relative to income. The same trends are at work in Mpumalanga. Given that the percentage of high- to very high-risk tenants in this province has increased from 47% to 63%, the data suggests that there is significant economic pressure on tenants in this area. ■



Tenant debt & income

Source: Compuscan, PayProp Capital



| | Eastern Cape | Free State | Gauteng | KZN | Limpopo | Mpumalanga | North West | Northern Cape | Western Cape |
|-----------|--------------|------------|---------|-----|---------|------------|------------|---------------|--------------|
| ■ Q1 2015 | 35% | 41% | 34% | 37% | 16% | 33% | 35% | 15% | 30% |
| ■ Q2 2015 | 36% | 51% | 36% | 29% | 28% | 28% | 38% | 55% | 28% |
| ■ Q3 2015 | 35% | 49% | 39% | 34% | 45% | 41% | 38% | 25% | 31% |

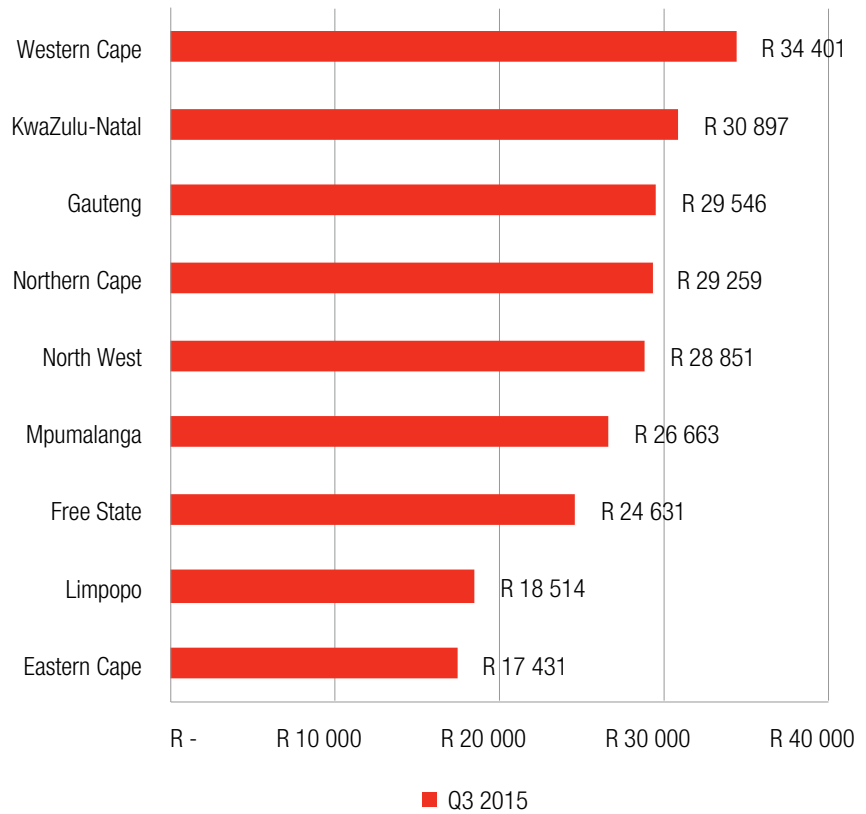


Provincial debt repayments relative to income

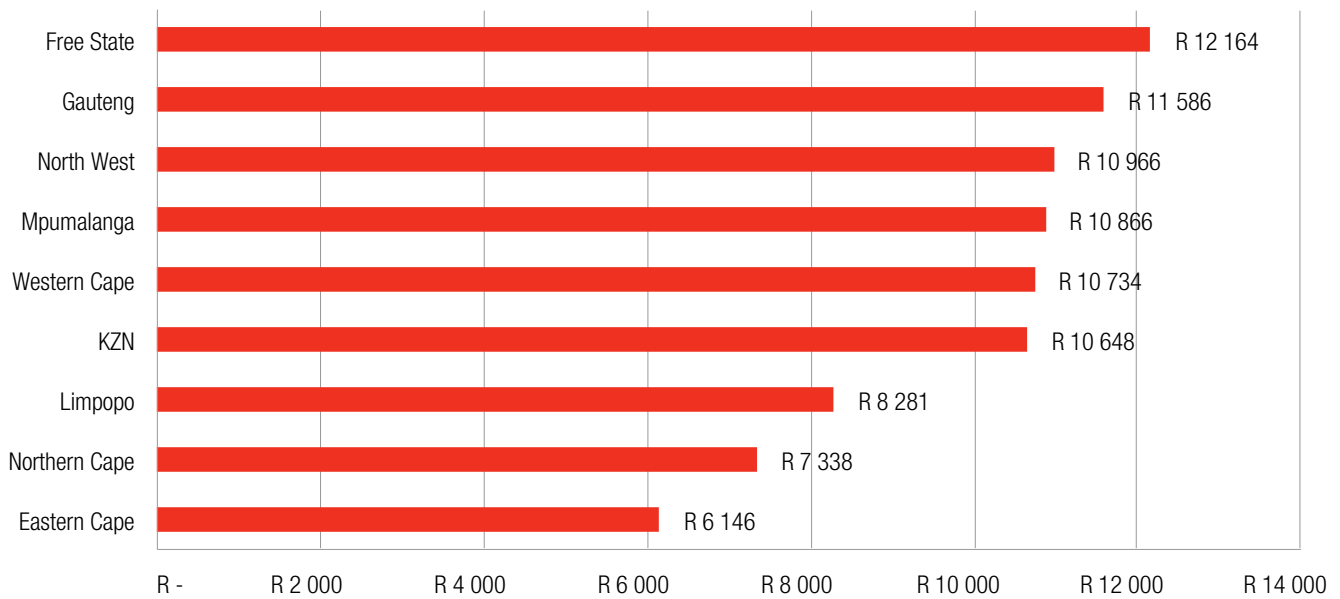
Source: Compuscan, PayProp Capital

In Gauteng, the debt repayment percentage is of particular concern, as the percentage of high-risk tenants has likewise increased, from 41% to 44%. The Western Cape debt-to-income ratio has been fairly stable, but is accompanied by a decrease in the percentage of high-risk tenants in this province – from 36% to 32% over the past three quarters. KZN shows a similar trend, with a stable debt repayment ratio and a high-risk percentage holding steady at 41% over the three quarters.

When examining the debt repayment ratio in terms of its component parts – debt and income – Western Cape tenants report the highest average income. Worryingly, the Free State has the highest debt repayment commitment but only the third-highest reported income.



Average income by province
Source: Compuscan, PayProp Capital

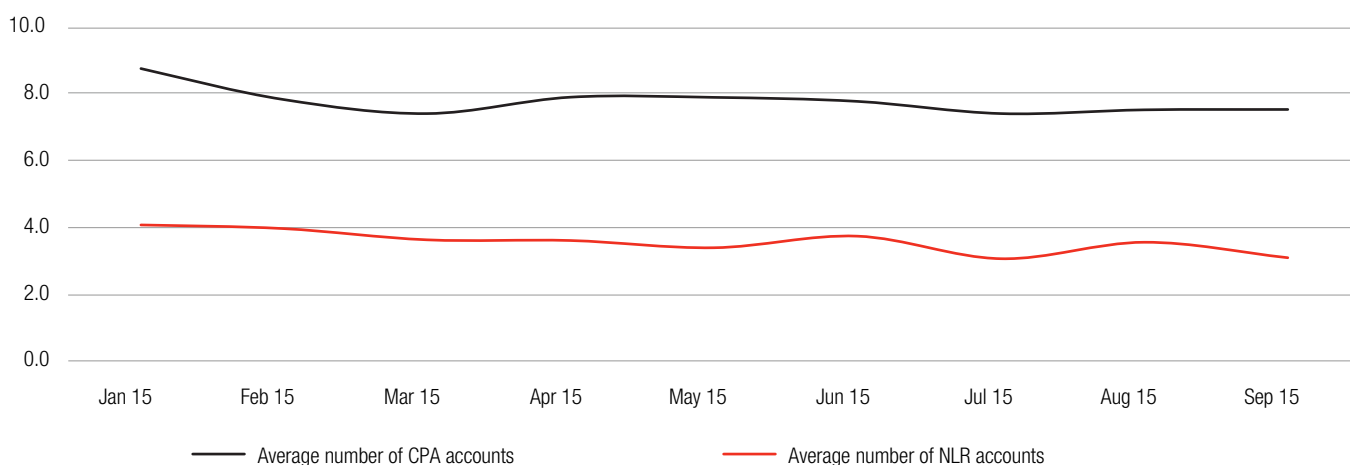


Debt repayment by province
Source: Compuscan, PayProp Capital

The high debt repayment levels are driven by the high number of accounts held by prospective tenants. On average, a prospective tenant holds 7.5 CPA accounts (Credit Providers Association accounts, consisting largely of asset finance, retail credit and contractual service providers) and 3 NLR accounts (National Loan Register accounts, which typically involve the provision of cash on credit).

The number of accounts has stayed fairly stable over the year and it would be interesting to see if this figure increases over the festive season.

A tenant's credit behaviour is reflected through their credit score. Most credit bureaux use a numeric scoring system that rates a tenant's creditworthiness on a range between 500 (bad) and 700 (excellent). The average tenant scored 596 for this quarter, which is marginally down from 601 the previous quarter. ■

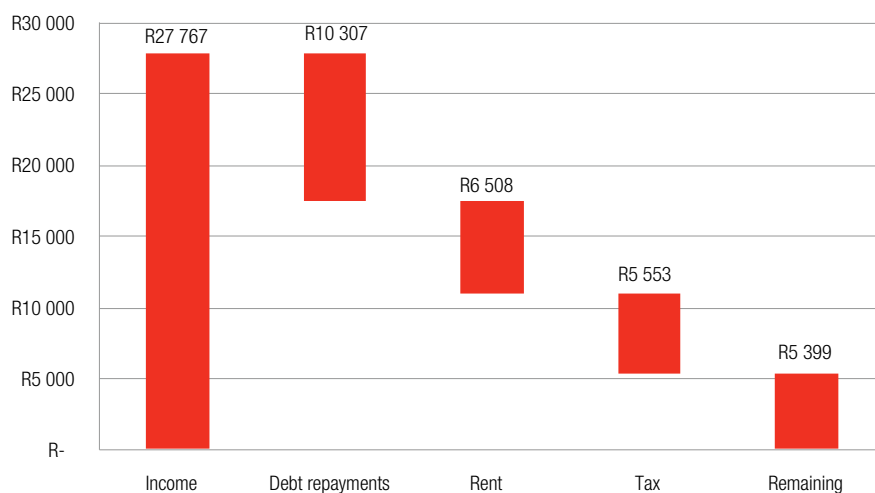


CPA and NLR accounts

Source: Compuscan, PayProp Capital

THE AVERAGE TENANT

What does all this mean for the average tenant? If we combine debt repayment with all of a tenant's other obligations in a cash-flow analysis, it is of concern to see how little is left for living expenses (once taxes, rental and debt repayments are deducted). ■



Tenant financial analysis

Source: Compuscan, PayProp Capital

SUMMARY AND CONCLUSION – INTERESTING TIMES AHEAD

Unfortunately, there is precious little positive news about this quarter – and more significantly, the forecast for the near future. Firstly, we are concerned about the slowing growth rate in rentals, which, coupled with a drop in the damage deposit ratio, makes it clear that tenants are under pressure.

When looking at the actual financial data of tenants, our concerns are supported by the increasing levels of indebtedness and a drop in average credit scores.

Provincially, North West, Northern Cape, Limpopo and Mpumalanga ought to provide interesting test cases to see how these dynamics will play out in areas where an underlying resource-based economy is under pressure. Our advice to agents and landlords remains to ensure adequate tenant risk assessments are done, to ensure tenants are able to afford the rentals that they apply for and to consider additional processes and products, including our DepositGuarantee, to cover landlord and business risk. ■

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 third quarter of 2015.

Contact details

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