

RENTAL INDEX

THE STATE OF THE RESIDENTIAL
RENTAL MARKET IN SOUTH AFRICA

INCLUDING PROVINCIAL
TENANT RISK DATA

Q1 2016 ■ JAN - MAR

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TENANTS: A RISKY PROPOSITION

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BATTEN DOWN THE HATCHES



Q1 2016

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DARKER CLOUDS AHEAD FOR THE RENTAL MARKET

There's no getting away from the headlines: It's bad news on the consumer front. We were hoping to buck the trend in this first quarterly PayProp Rental Index for 2016, but sadly our view is not that much different. Luckily, there is a silver lining, as our analysis shows.

The Index bases its findings and recommendations on our ongoing analysis of actual rental transaction data relating to 80 000-plus properties registered on the PayProp platform.

Since 2012 the Index has grown in size and innovation, and thousands of agents rely on its insights to make vital business decisions about their rental portfolio growth, tenant risk management, regional activities and much more. As usual, Q1 2016 is packed with actionable insights and new additions, presented in attractive, easy-to-digest form. Enjoy reading it and if there's anything I can help with, please drop me an email or give me a call!

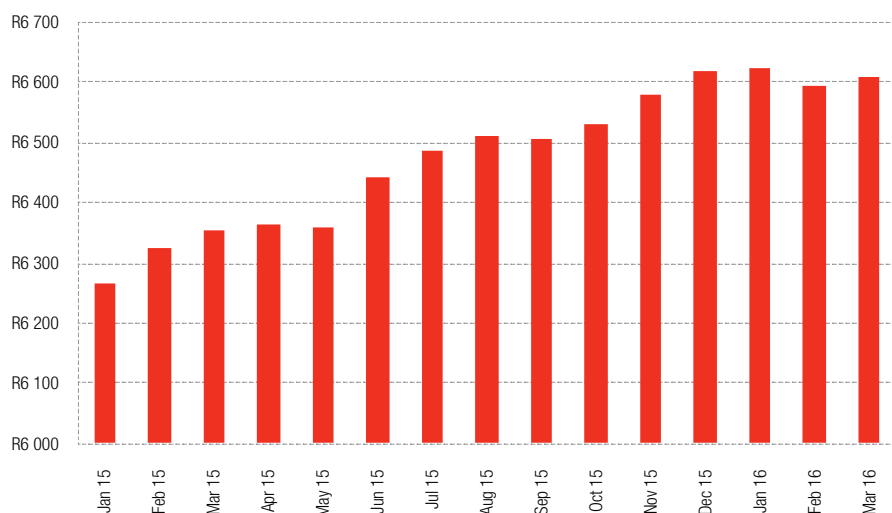
Best regards,



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AVERAGE RENTAL REMAINS FLAT

Shockingly low year-on-year growth rates



Average rental
Source: PayProp

The market ended 2015 on a weighted national average rental of R6 616 and the first quarter marginally down on R6 608. Not only have rents actually fallen, they are on average only R77 higher (+1%) than 6 months ago!

To shell-shocked South African businesses flat growth may seem acceptable – at least it is not dipping! But looked at another way, the trend is very

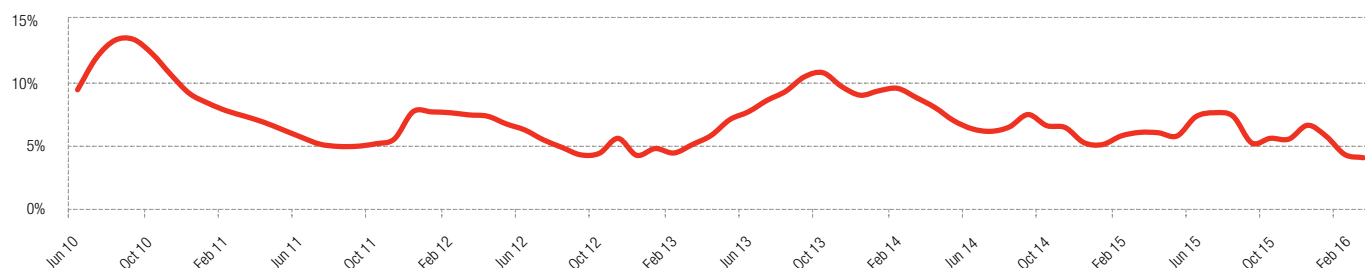
much downwards. Year-on-year rental growth is in fact slowing down dramatically. Currently, average year-on-year growth in national rentals over the quarter is 4.94%, but to better understand it, it is important to look at a longer time-line. Sitting comfortably? Tissues out?

Going back to 2010, year-on-year rental growth shows a major drop post-2010, reversed to a significant extent by a sizeable and consistent recovery throughout

"To shell-shocked South African businesses flat growth may seem acceptable – at least it is not dipping!"

2013. Following that, 2014 was a story of gradual but unchecked decline, with some hope emerging at the start of 2015. However, this hope was short-lived as growth never breached the 8% level, and in fact started to drop back after August 2015. By the end of 2015 it did look like some recovery was again on the cards, but the last quarter has shown clearly that this was not to be.

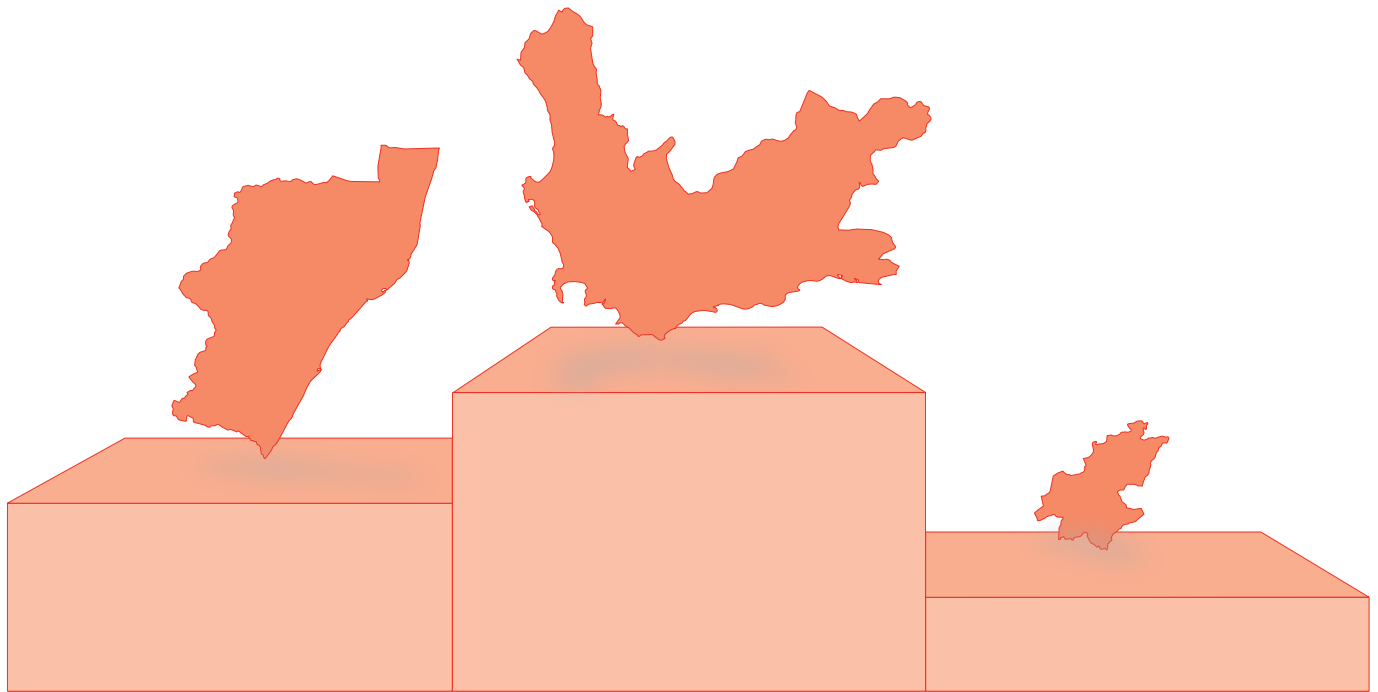
Yes, markets have their ups and downs, but every once in a while they arrive at defining moments, when previous high or low points are breached. This was the first time in the history of the Index in which year-on-year growth dropped below 4% – which is where it ended the quarter on 31 March 2016 (3.99%). ■



Year-on-year growth
Source: PayProp

A TALE OF THREE PROVINCIAL GROUPS

Powerhouses, shooting stars and stragglers



Three provincial 'groups' have formed in past indices, and continue as before currently.

Going great(ish) guns

We all know and love the three powerhouse regions – Western Cape, KwaZulu-Natal and Gauteng – and agree that they hold a lot of sway with average rental values, purely because of the size of the markets that they represent.

The former two did not surprise at all, continuing as before on excellent growth paths. The Western Cape in particular has been impressive, returning to double-digit growth last seen at the beginning of 2015 (10.8%). And while KZN dropped back slightly to 7.3%, it remains in the 7% – 9% band that we have grown used to over the last 18 months.

Gauteng, on the other hand, turned in a below-par performance. Historically lauded for stable growth, it has now put land-

lords through two successive quarters of declining growth. And we don't mean slightly declining growth. The shock of Q4 2015, when rentals barely registered 5.8% year-on-year growth, was no indication of the shock that awaited – in the quarter under review, average rental growth in that province plummeted to 1.1%. This is a large dip in fortunes, but one we're not altogether unfamiliar with. In December 2014, growth rates in Gauteng suddenly dropped to 4% from a healthy 9% just three months before. We will be watching this province, expecting a recovery to sanity before too long!

Declining fortunes

Well, it had to happen. Over our last three indices we've been warning of an impending decline in the fortunes of the high-flying Northern Cape, and this has now come to

"The Western Cape in particular has been impressive, returning to double-digit growth last seen at the beginning of 2015."

pass in the form of a sustained slowing in growth.

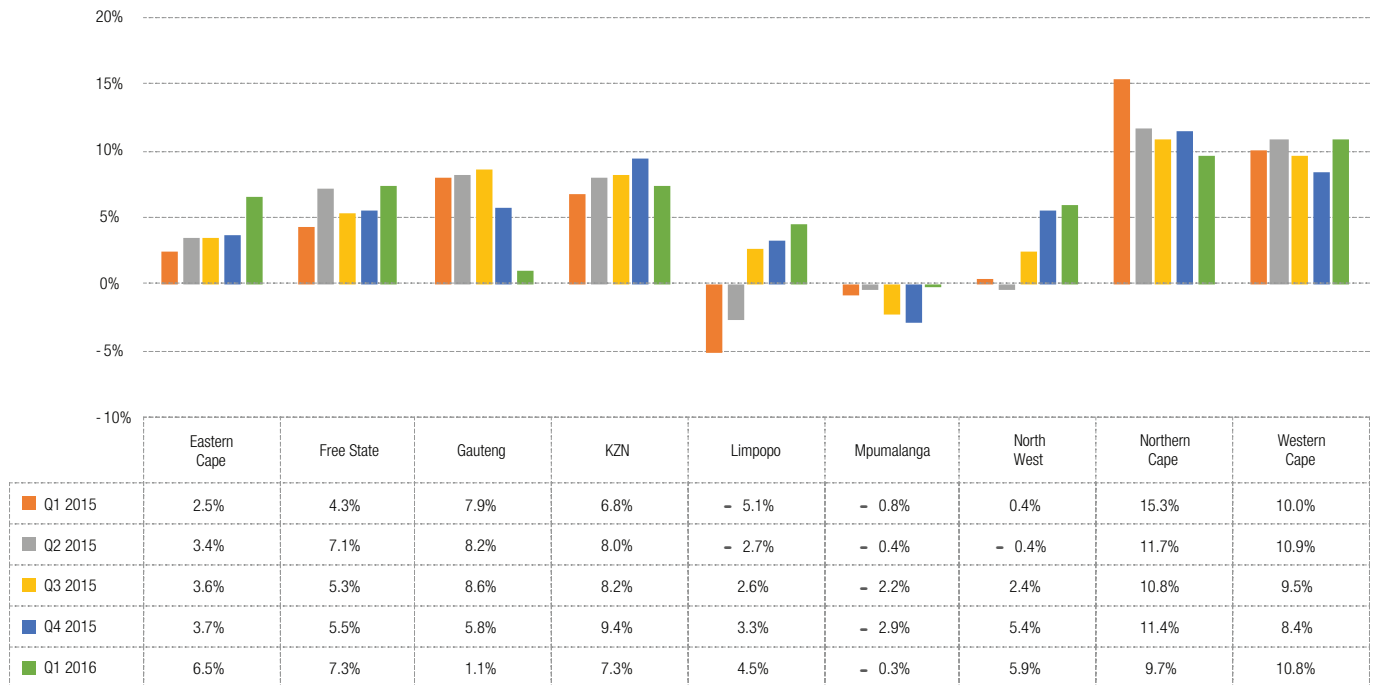
In Q1 2015, the province was scaling dizzy heights, with rent growth clocking 15.3%. One year later, sanity has returned with growth dropping back to 9.7%. Based on feedback from our clients the drop can be expected to continue into the next quarter, as mines and related industries continue to down-scale in the area. ►►

Mixed fortunes

Great news among the stragglers! Limpopo seems to have turned the corner and has now notched up three consecutive quarters of positive growth, after as many in negative territory.

Mpumalanga, however, has not been as fortunate. This region is experiencing its fifth straight quarter of freefall, with rentals actually dropping in absolute terms each month.

The Eastern Cape also seems to be on the road to recovery and has grown ahead of the national curve this quarter. Joining it are the Free State and North West, both of which are showing early signs of a turn-around. ■



Provincial growth rates

Source: PayProp

LITTLE CROSS-BAND MOVEMENT

Stagnation amid flat rental growth

There has been very little change in the distribution of rental contracts across the different price bands since the last quarter. The bulk remain in the R2 500 – R5 000 and R5 000 – R7 500 categories. And while there has been some growth in the >R15 000 category, 85.8% of all rentals are still below R10 000 per month. ■

"While there has been some growth in the >R15 000 category, 85.8% of all rentals are still below R10 000 per month."

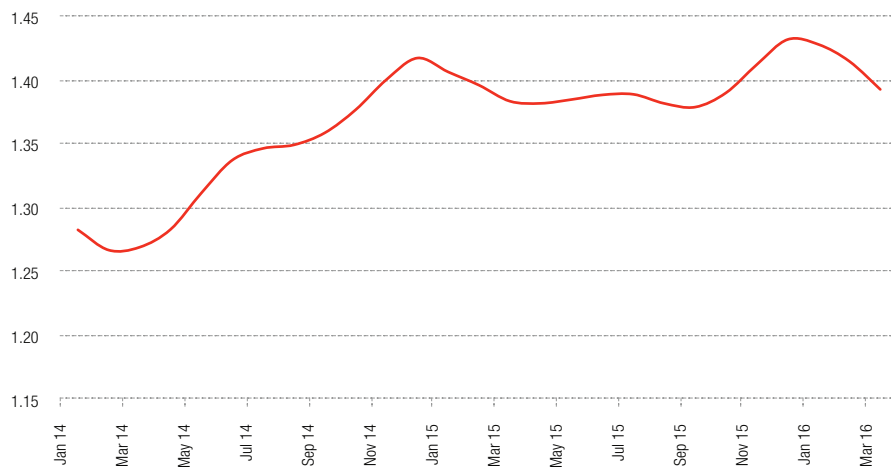
► One explanation for it could be seasonality – we noted a similar ‘post-festive season’ decline towards the end of 2014.

Fundamentally, it is a matter of affordability. With consumers under increasing pressure, affordable deposit replacement products such as the PayProp Capital Deposit Guarantee provide effective landlord protection at affordable monthly insurance premiums for tenants.

The post-festive season hang-over

Thanks to continued strong uptake of the PayProp Capital Tenant Assessment Report, the Q1 2016 Index is the first in which we have statistically significant tenant credit profile data incorporating affordability assessments. This allows the current Index to better track and understand the seasonality of tenant financial behaviour.

The data used in the analysis below has been drawn from more than 30 000 tenants who have applied for tenancies with PayProp clients (and whose suitability was assessed at the hand of the Tenant Assessment Report). The abstracted results have been used to understand how the underlying ‘quality’ and behaviour of tenants affect the market statistics that we observe.



Damage deposit ratio

Source: PayProp

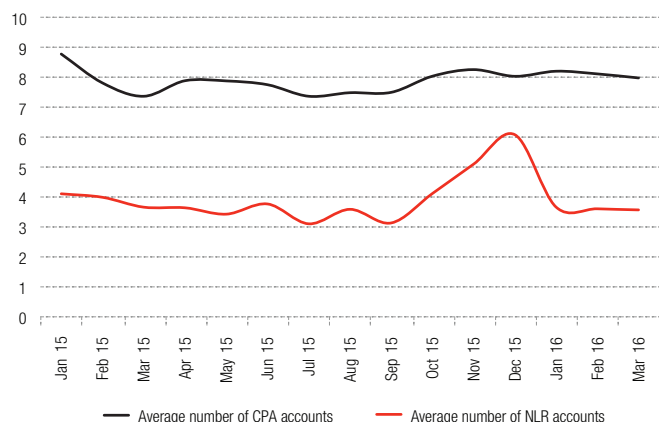
When looking back over the past two quarters, the effect of seasonality has now been reaffirmed with hard data. In the build-up to the festive season, the average tenant doubled their number of NLR (National Loan Register) accounts (i.e. credit cards, personal loans etc.) from 3 to 6. Store accounts in the form of CPA (Credit Provider Association) accounts increased from an average of 7.5 to 8.3.

This would not have been a train smash if tenants were able to manage their credit well. Unfortunately, they haven't

been doing that. In the ramp-up to the festive season, prospective tenants increased their exposure from 62% utilisation of their available credit to 69% at its peak just before December. This is not the sharpest increase imaginable, but the position has not returned to normal either. Currently at 68.4%, tenants' debt exposure has clearly not recovered, meaning they have not made a significant dent in what they owe.

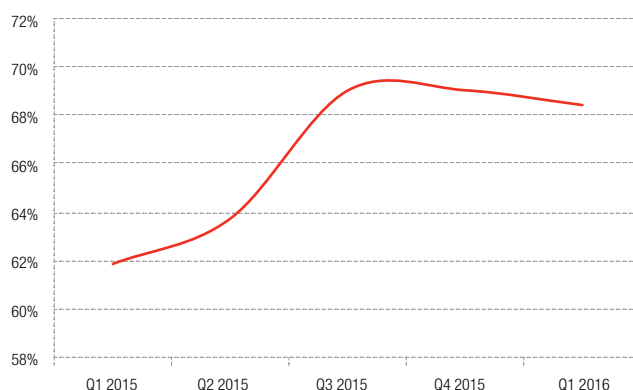
The distribution of the risk profile of tenants across rental price categories is further of interest. As expected, lower-rent- ►►

"The average tenant forks out R9 185 just on their deposit."



CPA and NLR accounts

Source: PayProp Capital and Compuscan



Current balances as a percentage of max credit

Source: PayProp Capital and Compuscan

Click... and done.

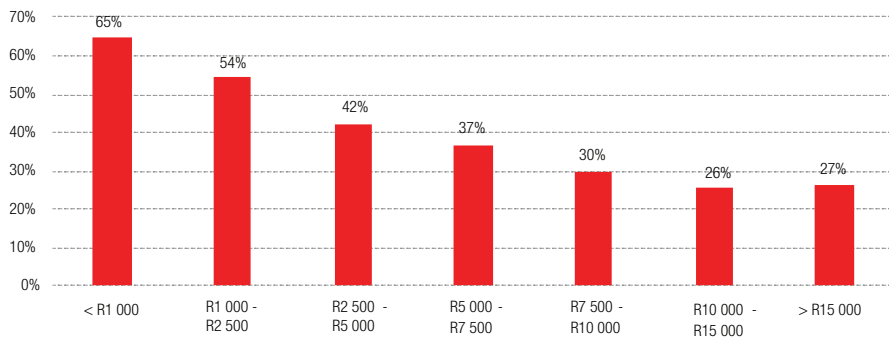


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"Tenants' debt exposure has clearly not recovered, meaning they have not made a significant dent in what they owe."



High and very high risk

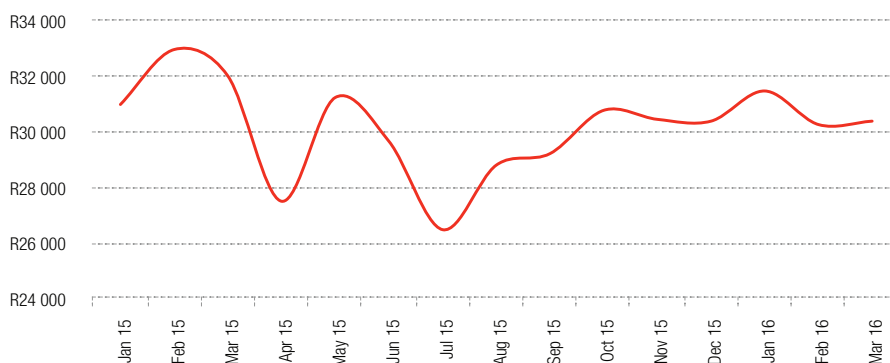
Source: PayProp Capital and Compuscan

► al tenants are higher-risk tenants – with the exception of tenants who are renting above R15 000 per month. Renters in this band continue to be a riskier prospect than their counterparts who rent in the R10 000 – R15 000-per-month band. Possibly, this points to the highest-flying consumers living above their means.

Are salaries keeping up?

Increased debt exposure and paying higher rents would not be a problem if incomes increased at the same rate. Sadly, this is not the case. Tenant income has stagnated at R30 399 for the past six months.

It is important to note that this is a pre-tax self-declared figure for a very specific sub-set of consumers – namely those who use estate agents to find accommodation. Even when taking income tax into account, PayProp tenants' average income is almost double the average take-home pay recorded by Mike Schüssler in



Average tenant income

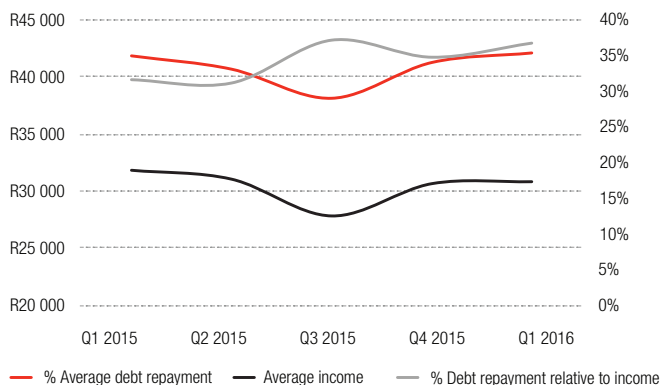
Source: PayProp Capital and Compuscan

his BankServ salary review index.

It is only when we combine salary and debt exposure that the full picture of tenant affordability emerges – a fact that sets PayProp's Tenant Assessment Report apart from other credit scoring mechanisms. With reported tenant income flattening off and increased debt levels, tenants now pay a worrying 36.7% of their

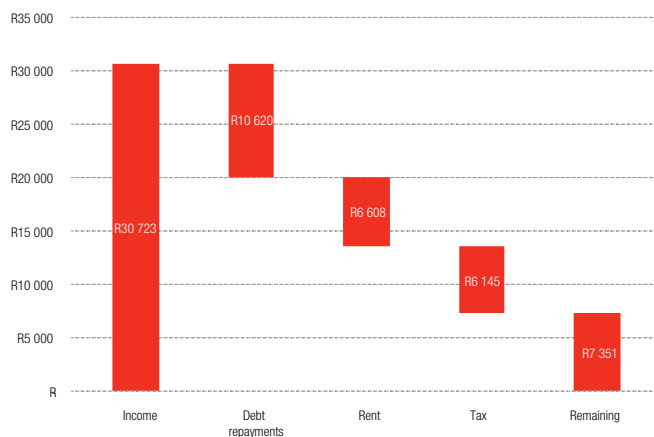
income on settling their debts.

When plotting all of this on a basic tenant income statement, it is clear that after debt, taxes and rental, tenants have only R7 351 in disposable income to get through the month. With inflation currently at 6.3%, cost of living pressure is mounting. ■



Tenant debt and income

Source: PayProp Capital and Compuscan



Tenant financial analysis

Source: PayProp Capital and Compuscan

ARE OWNERS MAKING MONEY?

Yes – and you can thank a decline in cost of ownership.

Despite the challenges facing tenants, there has been some improvement in both gross and net yields this quarter.

Gross yields increased to 7.12% (up from 7.06% in Q3 2015) and net yields rose to 5.05% (from 4.94% in Q3 2015). How is this possible in a slowing market?

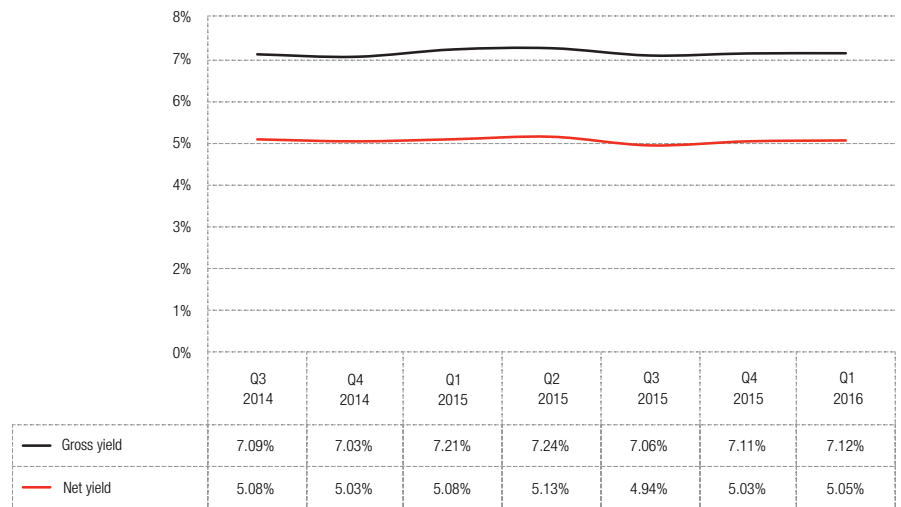
To all appearances, it is the result of house prices slowing down – if it is cheaper for a prospective landlord to buy an investment property and all else stays the same, return on investment must be higher. However, as we see in the graph below, rents have also fallen. As is well reported elsewhere, house price growth has slowed down markedly – from 9% in Q1 2014 to 6.0% in Q1 2016. Interestingly, rental growth rates have followed suit. In the circumstances, the only other variable that could have nudged yields upwards is a decline in the cost of owning and operating a property.

Which province delivers the most yield value?

The Northern Cape is no longer the country's leading source of residential landlord returns, with net yields dropping to 6.67% from a high of 7.64%.

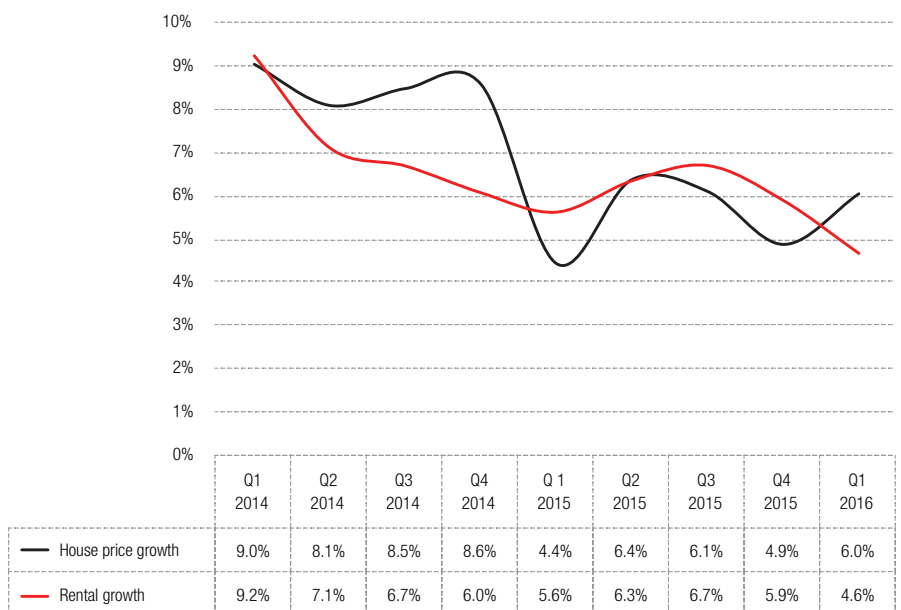
Limpopo, on the other hand, offers dramatically lower house prices and a relatively cheaper way to enter the investment market. With rentals still high after the heady days of a few years ago, returns of 8.06% can still be had. However, as time passes and rentals grow at rates below the norm, returns will continue to decline as they have been over the past five quarters, starting at 9.33% in Q3 2014.

KwaZulu-Natal offers an interesting third investment scenario. Rentals have been growing at fairly good rates while property prices have been stable, resulting in a net regional yield of 5.30% – above the national average. What is even more attractive is the stability of this figure over the past five quarters.



National gross and net yields

Source: PayProp



Rental growth vs house price growth

Source: PayProp

The Western Cape and Gauteng, both known for their dependability, continue to offer returns in the 4% - 5% range – and have done so for the last seven quarters. This constancy is important to

investors, whereas volatility could have the market suddenly turn on home owners (as we expect it to do in the Northern Cape), ruining the return owners expect. ■

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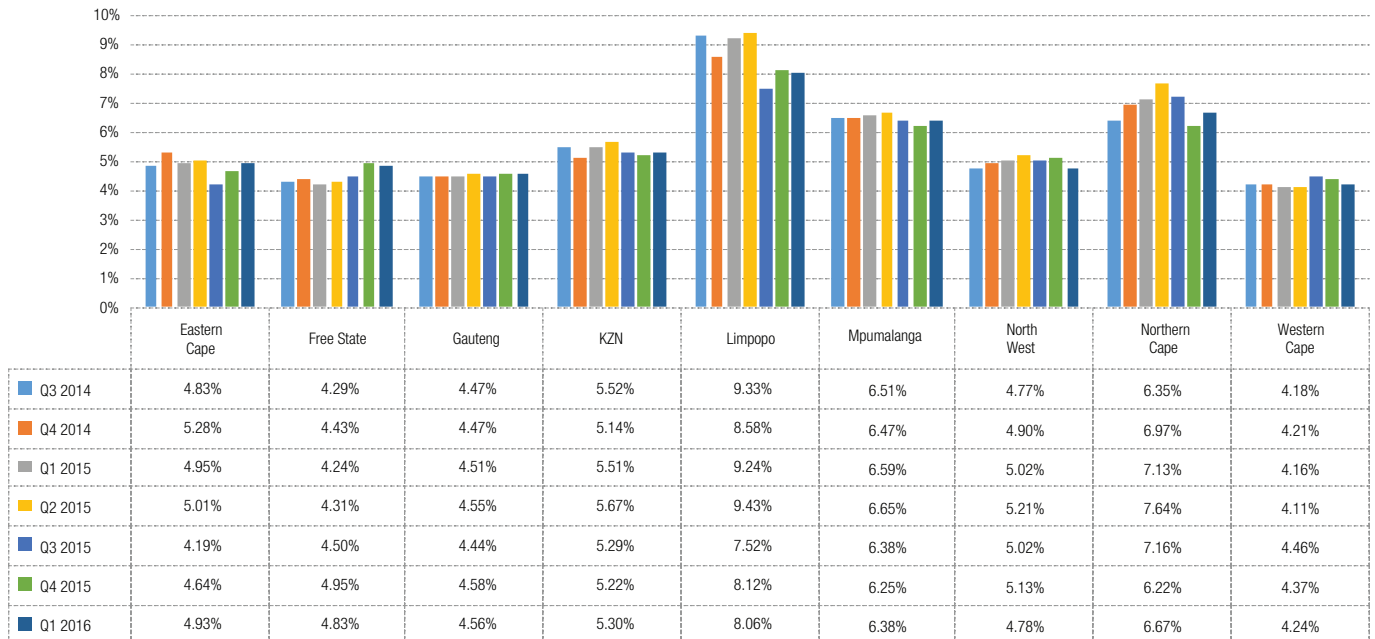
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087 820 7260 or email us:
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"Despite the challenges facing tenants, there has been some improvement in both gross and net yields this quarter."



Provincial net yields
Source: PayProp

IN SUMMARY

Batten down the hatches.

The time has come for battening down the hatches in the rental market. Rentals are not growing as fast as they used to, because tenants cannot afford to pay vastly increased rentals and deposits.

This, in turn, is the result of their having further increased their debt exposure and managing their debt worse post-festive season than they've done before. While their salaries have not increased, the general cost of living is increasing at fully 1.5 times the rate at which their rental is growing.

In this type of situation, the best advice we can offer rental agencies is three-fold:

1. Spend more time understanding a prospective tenant's debt position (as opposed to just their credit profile) and ensure that they can afford the rental they are applying for.
2. Watch late and non-payment closely, and act immediately and decisively. You are one of a growing list of creditors and need to ensure you are a tenant's first payment each month.
3. Perhaps counter-intuitively, now is the time to expand or start a rental portfolio. Property prices are down, sales are down and accordingly sales commissions are down. Rental commission offers a stable annuity income that could just help an agency through a tough time in the sales market. ■

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 first quarter of 2016.

Contact details

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