PayProp

RENTAL INDEX

THE STATE OF THE RESIDENTIAL RENTAL MARKET IN SOUTH AFRICA

THE HOLISTIC ISSUE – MORE IS MORE!

Q1 2017 ▪ JAN - MAR

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Flat growth? Look again.

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Western Cape rental market benefits from 'semigration'.

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INTRODUCTION

2017 – new quarter, new directions, new editor!

As hinted in the last PayProp Rental Index, our first edition of 2017 comes to you with a brand-new editor – and, we think, some interesting new directions.

The first change we're introducing is a more holistic, longer-term approach to the data. Since there's more safety in longer-term numbers, we unpack the trends in this issue over two years – and we find it tells a more complete story.

We also look at provincial tenant data from every possible angle where a province has an interesting story to tell. Be warned, it's not always pretty, but rest assured that we do it to bring you the most relevant data, thereby facilitating a better understanding of the market and your portfolio.

Looking back over the past few indices, it's clear that the quality of the data improved immensely over the years. I want to aim for more of the same in this and future issues, and will roll out a few ideas and concepts to that end over the course of this year and beyond.

I hope you'll be as excited as I am about future issues once you've read the first PayProp Rental Index of 2017. I'd love to know your thoughts!

For now, sit back, relax, and enjoy.

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NATIONAL RENT PRICES

Flat-line national growth comes alive

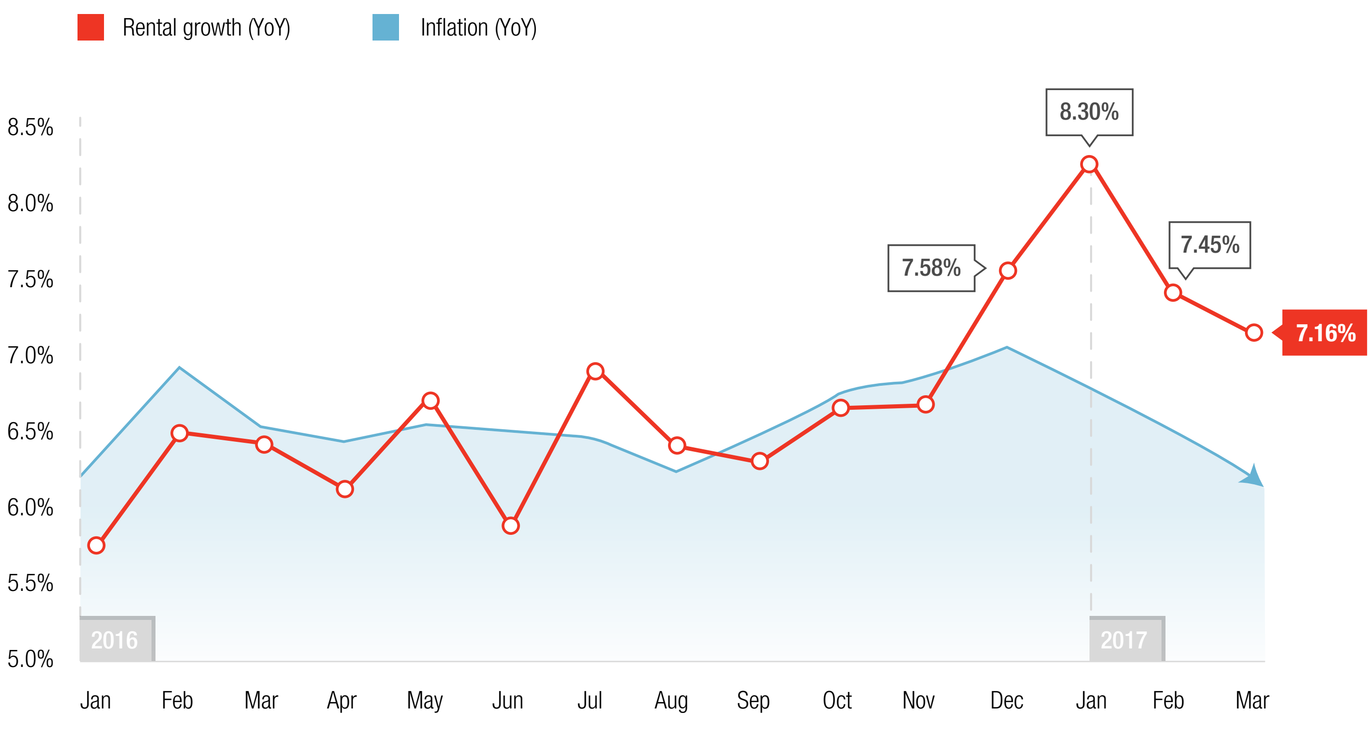
Rental data was provincially re-weighted and backdated to the beginning of 2015.

Over the last couple of quarters we've become so used to seeing flat year-on-year growth that we had to double-check if the graph below is correct – and it is!

With a newly re-weighted average, provinces with a higher contribution to the country's GDP have a more discernible impact on average national rent growth. In the event, higher than normal year-on-year growth in Gauteng rentals from December to March was largely responsible for the spike over this period, along with double-digit growth rates in the Western Cape.

Was this a temporary spike or are we seeing a more robust growth trend? We'll need a few more months' worth of data to know for sure, but Gauteng's rental growth recovery path will play a big role in a market revival.

If the spike is temporary, growth should again normalise to move with inflation. In the graph below, a clear positive correlation between the two is evident throughout 2016. If this relationship resumes and continues as before, rental growth should track above the 6% per annum mark later in the year, in line with inflation expectations for 2017. ■



Average national year-on-year rental growth vs average national year-on-year inflation
Sources: PayProp and inflation data

Higher than normal year-on-year growth in Gauteng rentals was largely responsible for the spike, along with double-digit growth rates in the Western Cape.

PROVINCIAL RENT PRICES

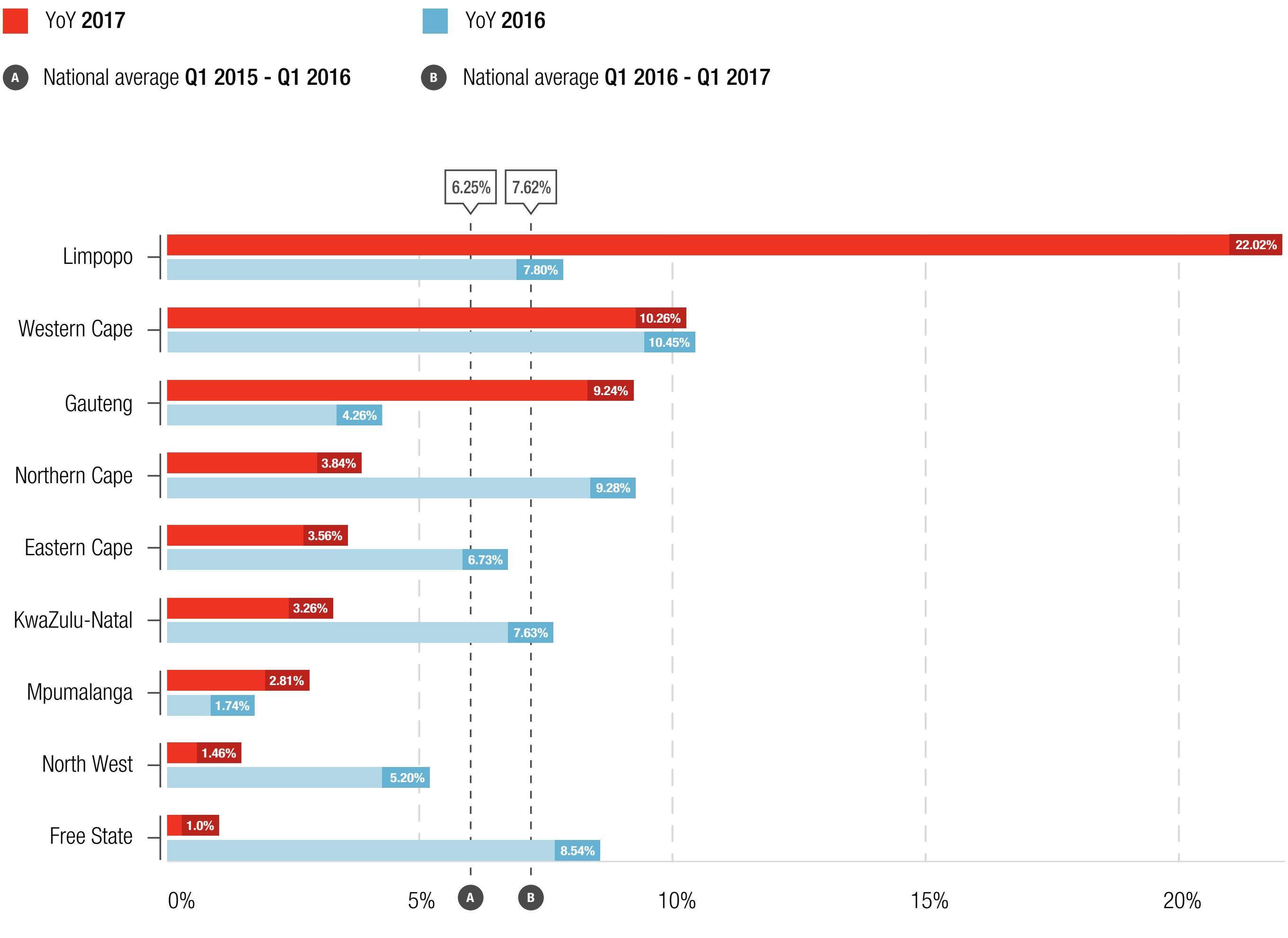
The tail that wags the dog

On average, national rents grew 6.25% year on year between Q1 2015 and Q1 2016, and 7.62% year on year between Q1 2016 and Q1 2017. How do the provinces measure up to the average?

Interestingly, while average national growth increased over the period in question, six out of nine provinces performed below the national average. Of those, the fastest-growing one managed an increase of just 3.84% – around half the national average.

Moreover, only three provinces saw an increase in growth in the last year: Mpumalanga, Gauteng and Limpopo. How, then, did average growth increase by as much as it did? It's simple: Together, these three provinces contribute almost 50% of our GDP. Their rental growth is the proverbial tail that wags the dog! ▸▸

6 out of 9 provinces performed below the national average. Of those, the fastest-growing one managed an increase of just 3.84% – around half the national average.



Average national year-on-year rental growth vs provincial year-on-year averages
Source: PayProp

Since data analysis is very dependent on sample size, it is important to focus on underlying trends in the numbers rather than the end states. This is especially true for Limpopo, the Northern Cape and Mpumalanga, where sample sizes are small.

How does your province rate?

- It's important to understand how your province is doing relative to the national average – it goes a long way in managing landlords' expectations and keeping them happy.

The Western Cape continues to show double-digit growth as people continue to 'semigrate' to the south, making it the most expensive province to rent in for a second quarter running.

Gauteng rentals have increased almost 10% year on year for the past three months. This is a bit unexpected, seeing how lacklustre Gauteng's rental growth has been. As it turns out, the country's economic engine room has been going through a growth slump going back as far as Q3 2014. Since then, rentals have increased by just 10% in total, compared to 14% on average for the other eight provinces. The high growth over the last quarter is therefore more of a long-overdue recovery off a low base value than a reason for genuine optimism.

Economic fundamentals

The other dynamic to keep an eye on is that of the provincial economies. Northern Cape and Limpopo are both interesting ones to follow from this point of view, as both are fairly dependent on mining. Limpopo's link to resources is platinum, while the Northern Cape's is iron ore.

The platinum price has been relatively stable over the last two years, and we have noted a stronger upward trend in rental prices over the same period. In keeping with this observation, rental growth in this province may well stabilise at some point if the platinum market stays stable, but this can take anything from a few months to a few years. Considering ailing tenant health there, our guess is it will happen sooner rather than later.

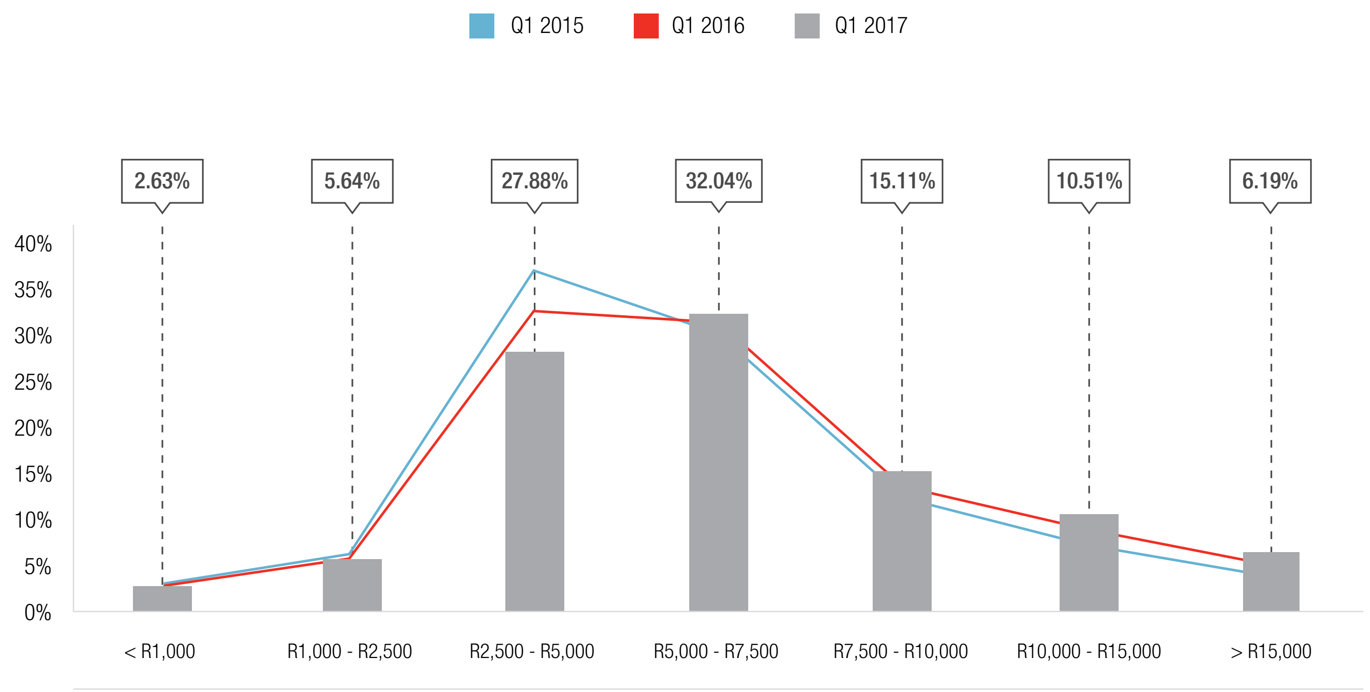
By comparison, iron ore only started recovering in the last year. If we see a similar correlation with growth in Northern Cape rent prices, rental growth could look very different in another year or two, should commodity prices stabilise. ■

PROVINCIAL RENT PRICES

Rental price brackets

Who's renting in (and, aspiring to) which price bracket? What trends do we see in the realm of rental categories? Inflation is a part of our daily lives and we see it all around us – food becomes more expensive, the petrol price increases almost on a monthly basis, and medical aid and school fees are never far behind… It's only reasonable that rents, too, will increase – and as they do, that they should migrate across price brackets.

The most obvious observation one can make concerning the first quarter of 2017 (grey bars) is that the percentage of properties in the lower bands tends to decrease annually while increasing in the higher bands. More insightfully and valuably, the speed at which it increases tells us something about demand. ▸▸



Most populous rental bands nationally
Source: PayProp

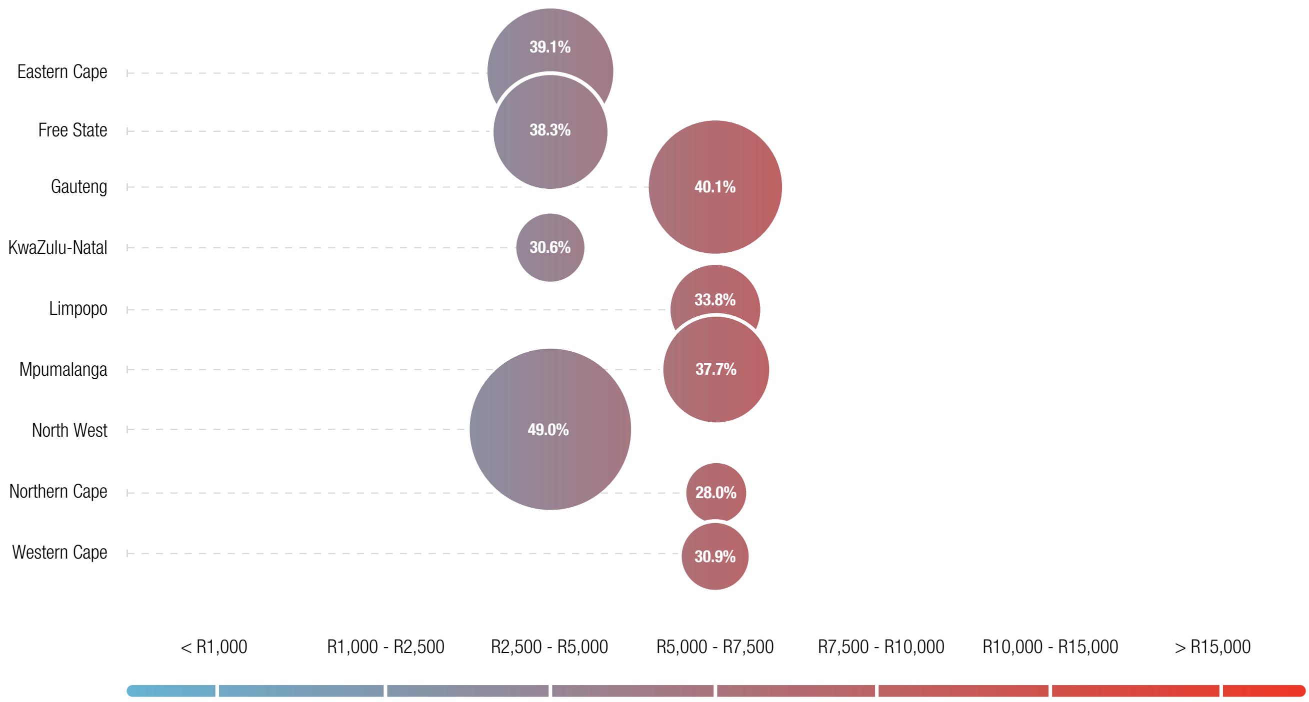
The band with the highest percentage growth since Q1 2016 is for rentals over R15,000 – these now make up 6.2% of all rentals – an increase of 25% from last year's 4.95%. The Western Cape still leads the high-rental market, with 9.3% of all rentals falling within this band. Other provinces that have shown noteworthy growth in this bracket are Gauteng, with almost 6% of rentals over R15,000, up from 4.5% a year ago, and Limpopo, with 8.2% of rentals now in this band, up from 2.5% a year ago – a remarkable increase of over 200%.

It's reasonable to suppose that provinces have varying demand across the bands; so where are most of the properties concentrated in each province, and where is growth the highest?

In the Eastern Cape, for example, 39% of properties fall within the R2,500 - R5,000 band, but the province has seen a 12.6% increase in the proportion of properties in the R7,500 - R10,000 band.

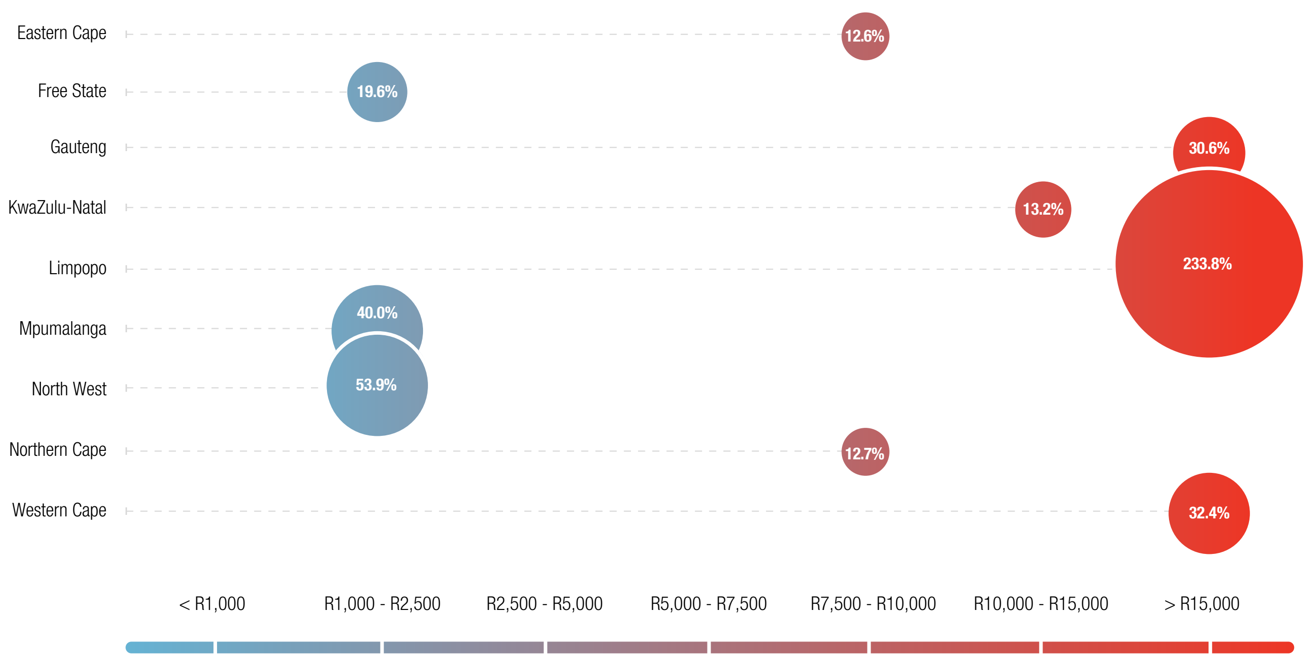
We know the average national rent currently lies in the R5,000 - R7,500 band, and this bracket also happens to be the most stable in terms of proportional representation.

The Western Cape still leads the high-rental market, with 9.3% of all rentals falling within the over R15,000 band.



Most populous rental bands per province by % of rentals in that band

Source: PayProp



Fastest-growing rental bands per province by % annual growth

Source: PayProp

- While the first table indicates current demand, the second points to future demand, and together they tell a complete story. In the Free State, for example, the biggest concentration of properties is in the R2,500 - R5,000 band, but the band below it shows the highest growth over the past year, indicating that there is in fact a demand for cheaper housing in the province. ■

The longer-term trend for the damage deposit ratio is still upwards, but over the last year the rate of growth slowed. This is to be expected in the current economic climate.

SECURITY DEPOSITS

Trending sideways

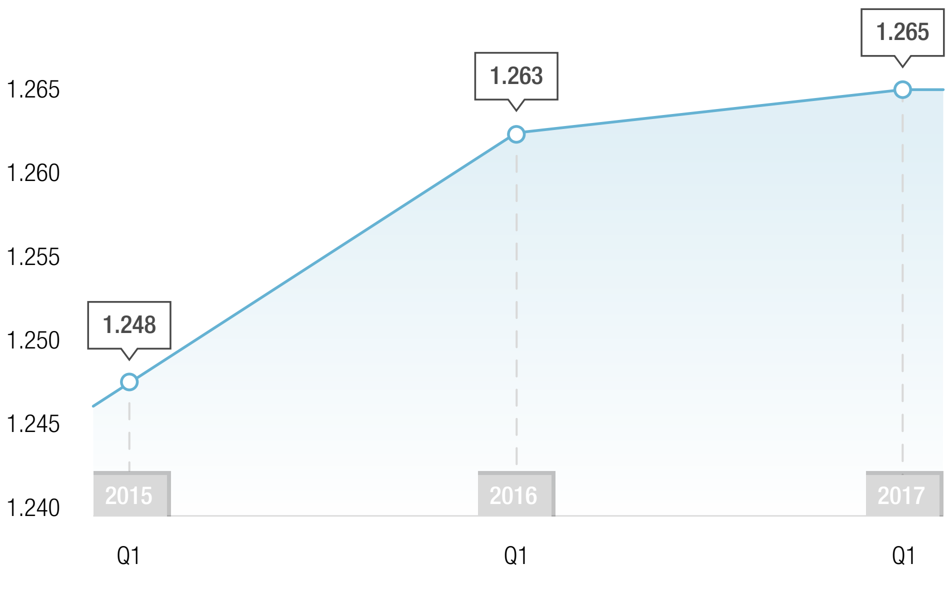
In keeping with the re-weighting of rental data, we've also re-weighted security deposit data this quarter and backdated it to the beginning of 2015. As a result, the average national deposit for December has been revised downwards from 1.45 to 1.27. This does not affect deposit trends and will happen from time to time as a statistical corrective measure.

The damage deposit ratio is expressed as a multiple of the monthly rent. For example, where the damage deposit is R12,000 and the rent is R10,000, the damage deposit ratio is 1.2.

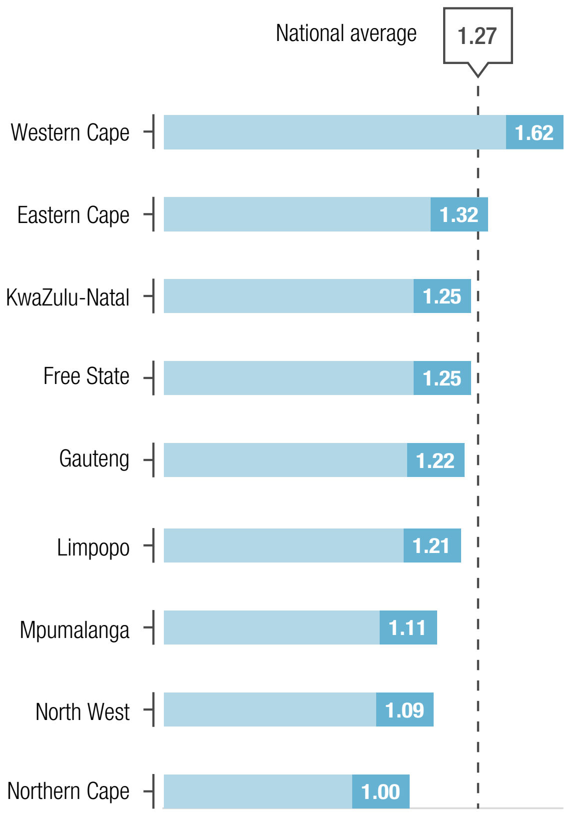
Not much can be said about damage deposits that you haven't heard before – the main reason for their existence is to protect the landlord from damage to his property (and to a lesser degree, non-payment), so it is only logical that a landlord would like this ratio to be as high as possible.

However, affordability is a big consideration in determining the amount of the deposit – not everyone has two months' rent lying around to hand over willy nilly.

The longer-term trend for the damage deposit ratio is still upwards, but over the last year the rate of growth slowed. This is to be expected in the current economic climate – tenants simply can't afford big deposits with stagnant economic growth and high inflation (known as stagflation). ▸▸



Weighted average damage deposit ratio
Source: PayProp



Provincial and national damage deposit ratios
Source: PayProp

The Western Cape still leads the pack at 1.62 times the average rent – an increase of almost 6% from two years ago. Interestingly, both Limpopo and the Northern Cape have decreasing ratios, with Limpopo's now below the national average. This is not because of low growth in deposit amounts – in fact, the average damage deposit grew at an above-average rate over the last two years. The decreasing ratio is mostly caused by the growth in rentals in the province, which was more than double the rate of the average growth in national rent.

Rent is also growing quicker than damage deposits in the Northern Cape, but only by a very small margin. The damage deposit ratio there has been trending downwards and the damage deposit is now equal to the monthly rent. The decline in the damage deposit ratio, coupled with the declining growth rate in rental income, could be pointing to an oversupply of rental properties in the province – at least in the short term.

In all other provinces, growth in the average deposit held is higher than the average rental growth, which explains why we see a consistent upward trend in the damage deposit ratio. ■

TENANT TRENDS

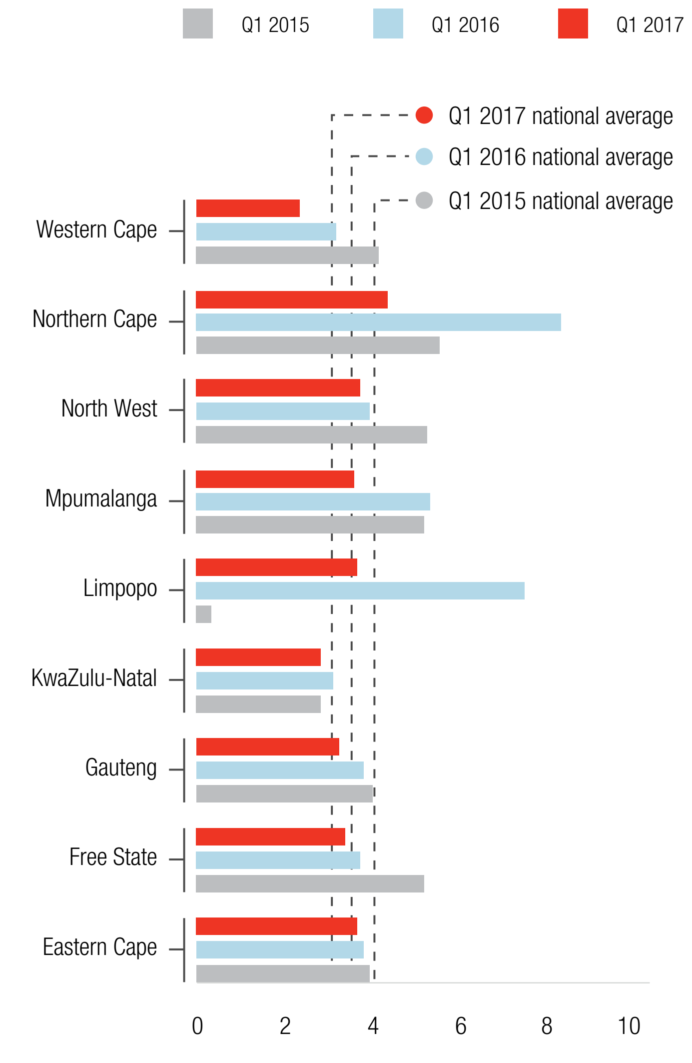
The importance of quality tenants

> CPA accounts are day-to-day accounts like retail accounts and cellphone contracts. NLR accounts are short-term loans and other types of unsecured credit.

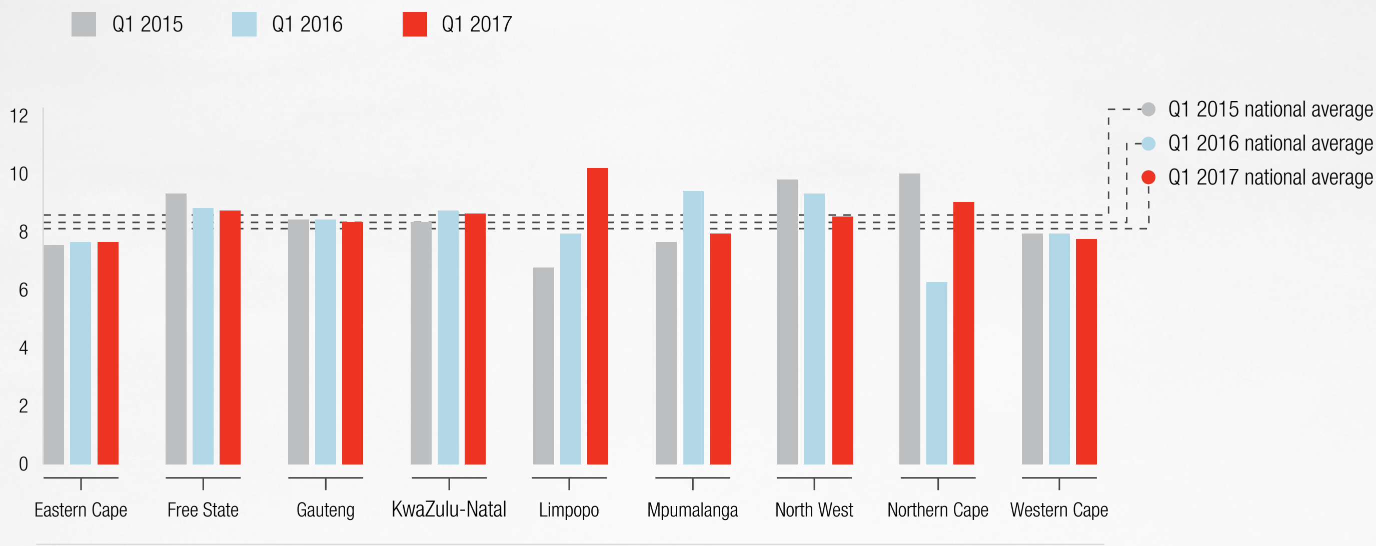
Just as provincial rental trends deviate from the norm, so tenants fare differently in the provinces compared to the national average and over time. So, how are tenants doing today versus a year and two years ago?

From 2015 to the present, we see a downward trend in the number of NLR (National Loans Register) accounts held by the average tenant nationwide, and likewise with CPA (Credit Providers' Association) accounts. CPA accounts are day-to-day accounts like retail accounts and cellphone contracts, so the flat graph we see on the next page is as expected – these accounts are rarely closed and usually held long term. NLR accounts are short-term loans and other types of unsecured credit, and some volatility can be expected in people's reliance on them in times of financial stress.

It therefore seems positive to witness a decrease in NLR accounts. But if we dig a little deeper, we see that average debt repayments have increased slightly while income has remained relatively flat. ▸▸



Average number of NLR accounts
Source: PayProp

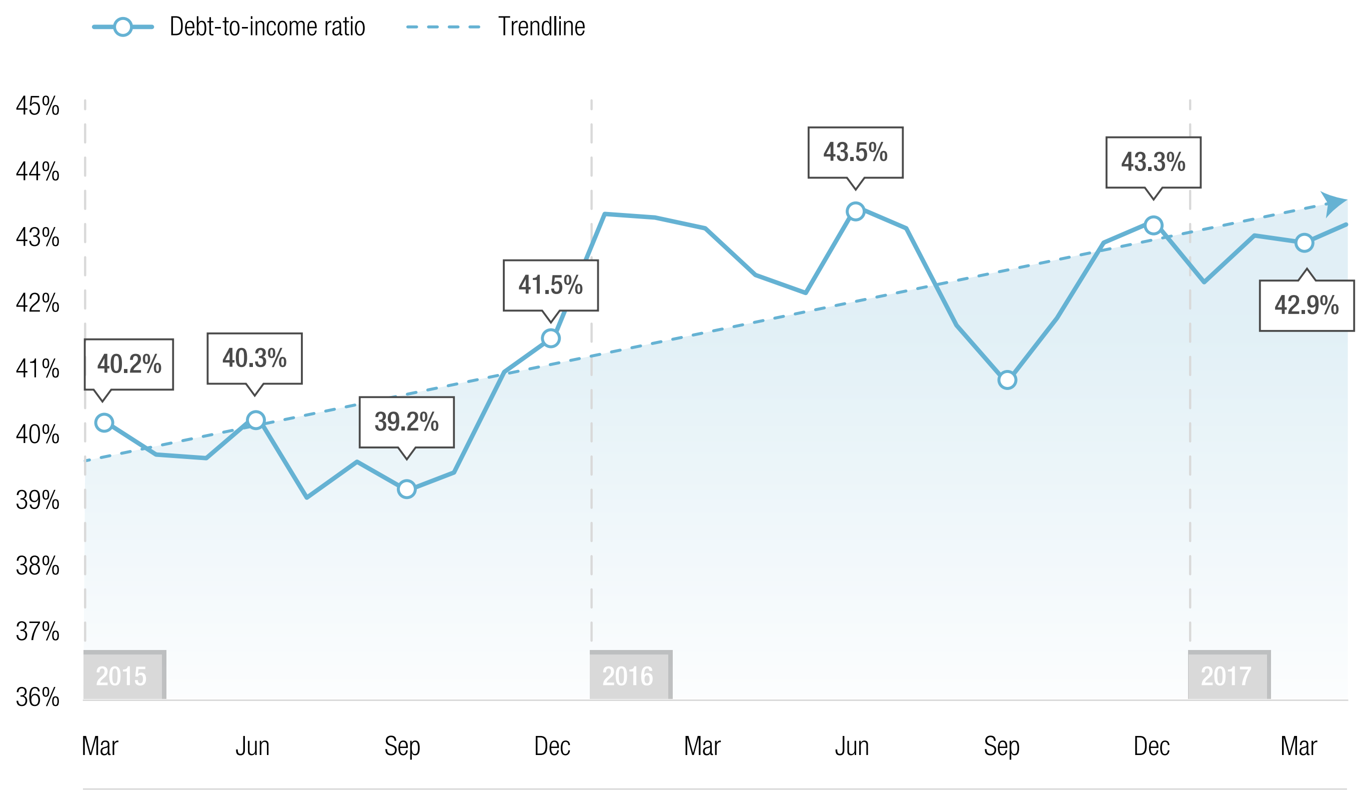


Average number of CPA accounts
Source: PayProp

We see a downward trend in the number of NLR accounts held by the average tenant nationwide, and likewise with CPA accounts.

So, while tenants have fewer loans, they owe more on them, and debt repayments relative to income have increased slightly. That is completely understandable. The lack of economic growth, coupled with the worst drought in decades and relatively high levels of inflation, leaves the average tenant worse off than a year or two ago.

Does this mean tenant quality is deteriorating? Not necessarily. The average credit score in our sample base has not declined over the past two years, which means that, while tenants have slightly more debt, they seem to be managing it well, at least for now. The rising debt-to-income ratio does, however, mean agents have to be more diligent in selecting tenants.

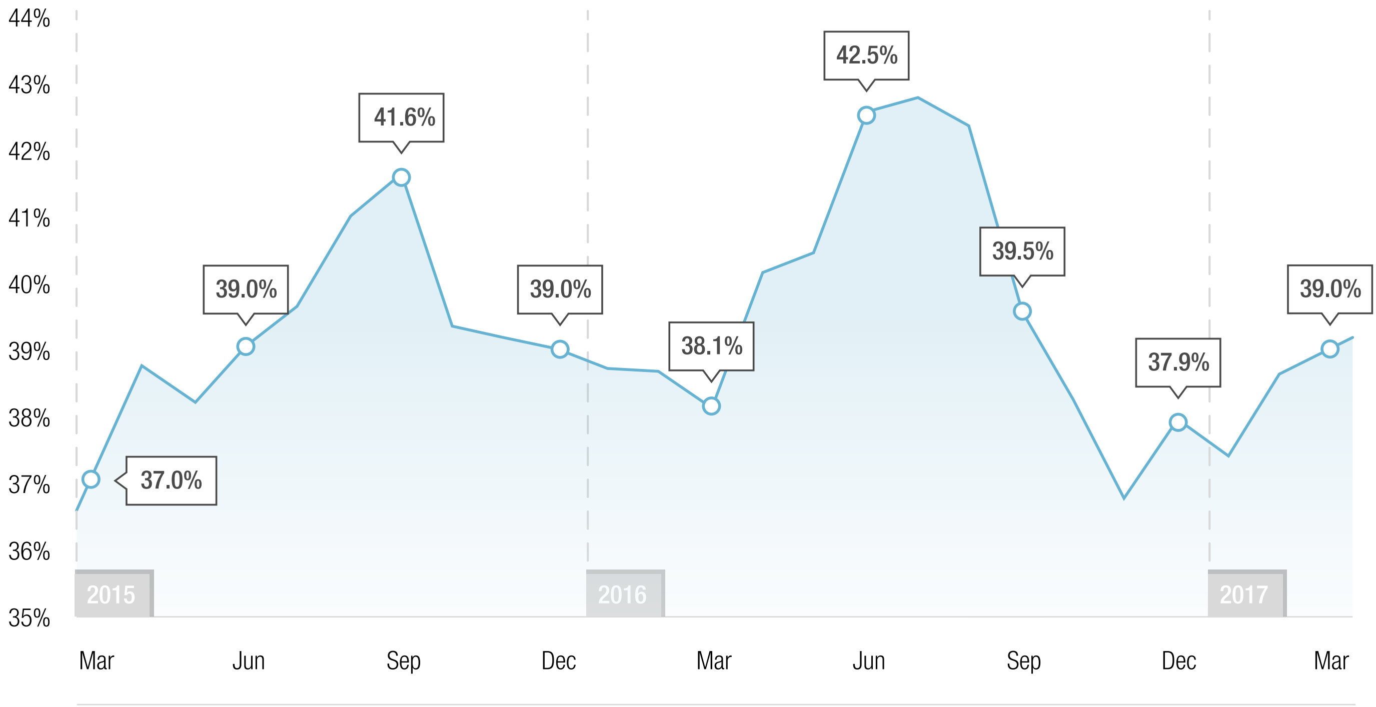


National debt repayment relative to income

Source: PayProp

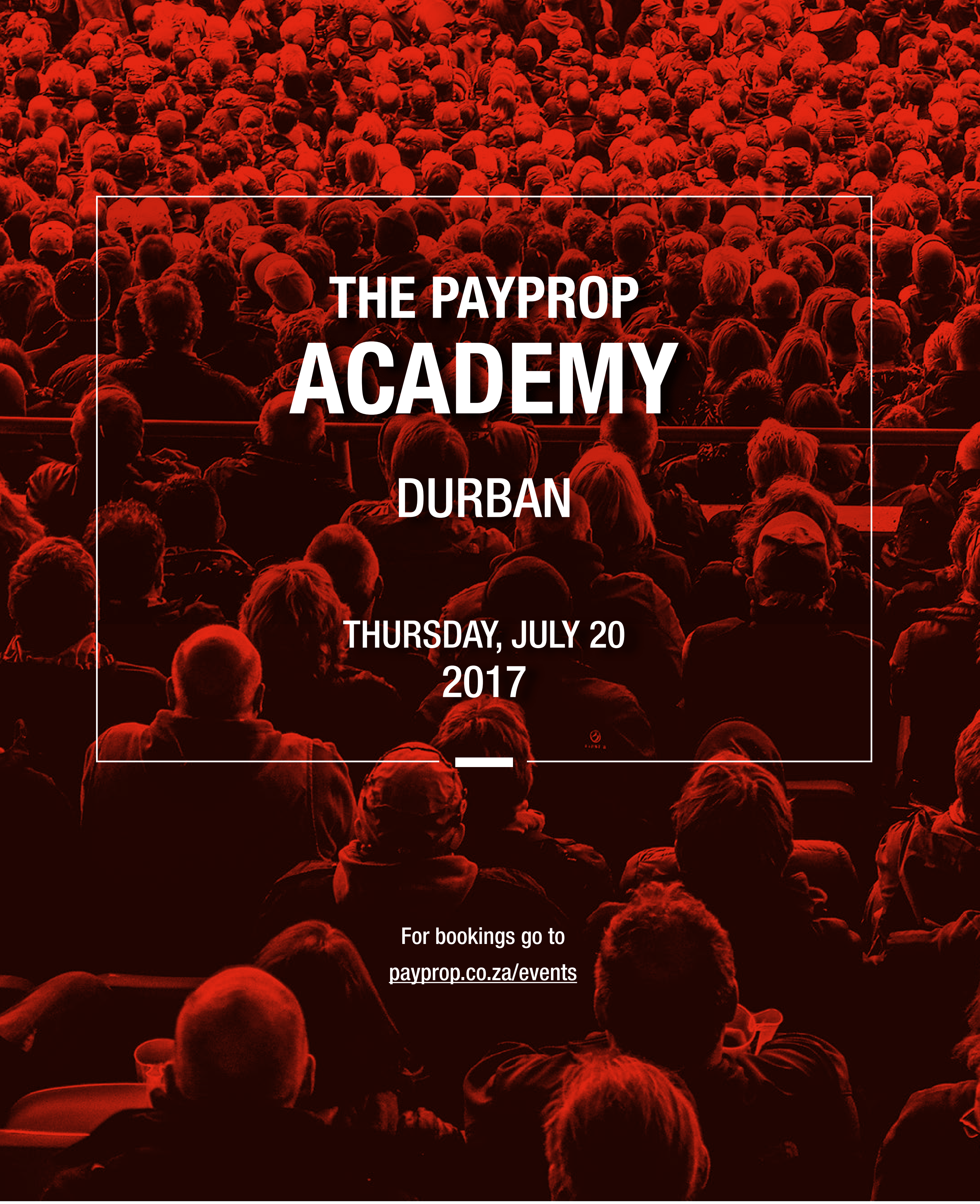
Why do we say that?

In our 2016 PayProp Annual Review, we mentioned that the percentage of high- and very high-risk tenants has declined during the year, which is true – and a great statistic to see. But don't seek comfort in this short-term downward trend. Over a longer time period, it's quite clear that there is no definite trend. The decrease that we've seen can either be the start of a downward trend or more lateral movement along the current trend line.



Percentage high- and very high-risk tenants
Source: PayProp

- High-risk and very high-risk tenants are most prevalent in the lower-income brackets, which makes intuitive sense. It is the lower-income tenant who will feel the effects of a slow economy the most. Of tenants earning less than R10,000 a month, almost two-thirds fall into the high-risk category. This percentage decreases as income increases to about a third of tenants in the R20,000 - R30,000 income bracket. ■



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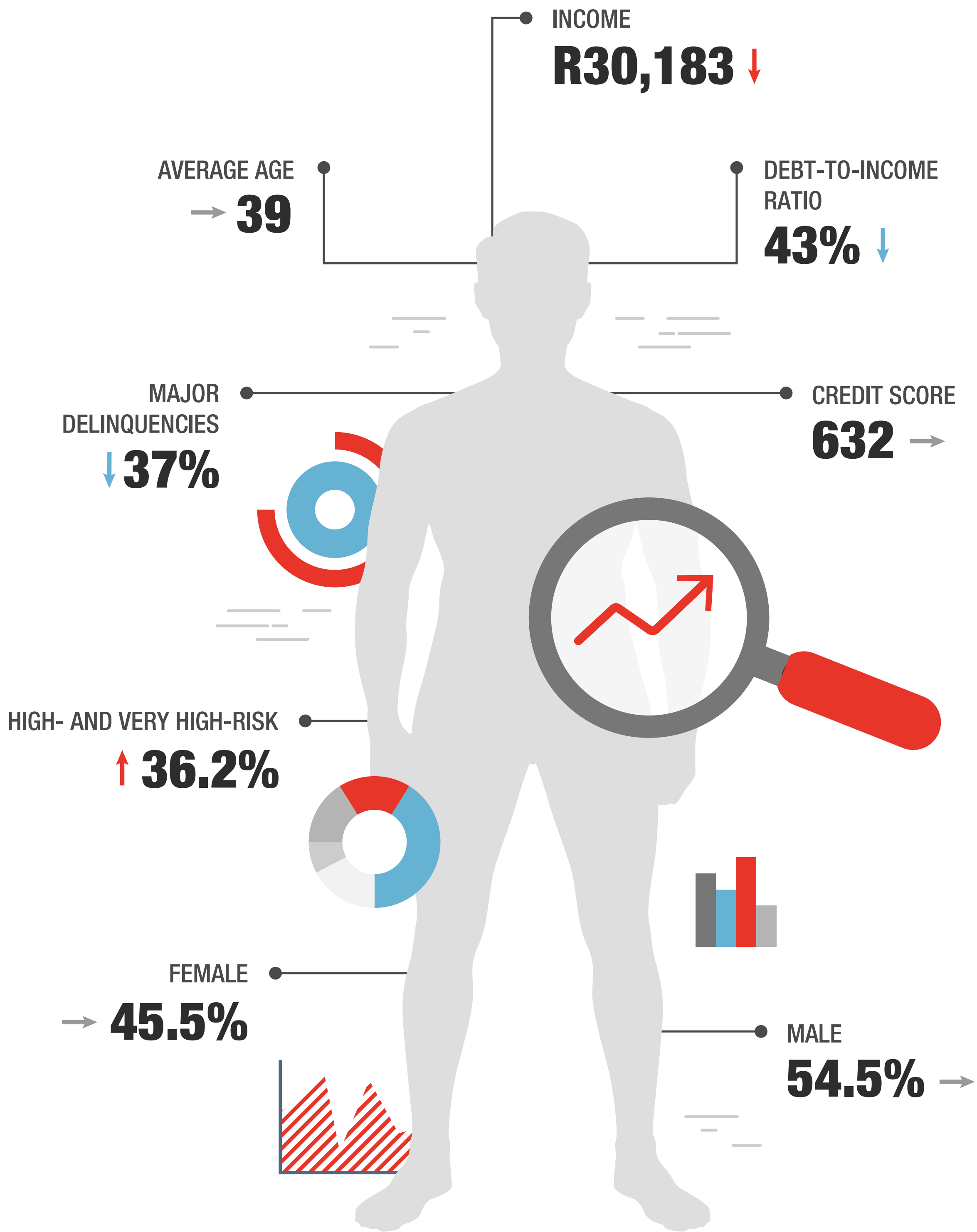
TENANT TRENDS

The average national tenant



All eyes on the provinces

It is immediately obvious that tenants are doing better in some provinces than others. In keeping with our holistic approach for this issue, we dug a little deeper and looked at a variety of additional statistics to try and unearth the story behind it.

To begin with, the average debt-to-income ratio deteriorated slightly over the past two years (from 40% in Q1 2015 to 43% in Q1 2017) – but this was not the case for all provinces. The Eastern Cape, KwaZulu-Natal and the Western Cape showed no change, for example, while Free State tenants managed to improve their debt ratio from 48% to 43% of income, bringing it in line with the national average.

So, while the average national credit score is unchanged at 632 after two years, and average debt compared to income has deteriorated, it should come as no surprise that the Eastern Cape, KwaZulu-Natal and the Western Cape all showed slight improvements in their credit scores.

The quiet desperation of the Free State tenant

In the Free State, the debt-to-income ratio has improved over the past two years, but beneath the surface calm a myriad forces are at play – and not all of them friendly, as our analysis will shortly reveal.

While the province's debt-to-income ratio has improved substantially (by just over 10%), income has increased by just 6%, which means debt levels must have dropped. Yet, we are seeing a drop in the average credit score. Why is this? Note that the percentage of Free State tenants with major delinquencies has increased from 40% to 46% over two years (while the national average has fallen to 37%), and that its percentage of high-risk tenants increased from 37.5% to 41%. Clearly, tenants aren't managing their debt properly. That would explain the drop in credit score – which, in turn, limits a tenant's access to credit and could explain low debt figures – might they be barred from accessing new credit?

If that is so, a possible explanation is that Free State tenants' non-credit expenses (rent, food, medical expenses, etc.) have increased to breaking point and that we're starting to see the effects of this. Free State tenants must start managing their debt better or they could soon look like Limpopo's tenants...

Even though the Free State's debt-to-income ratio has improved substantially, income has increased by just 6%, meaning debt levels have dropped. Yet, we are seeing a drop in the average credit score.

Bad apples

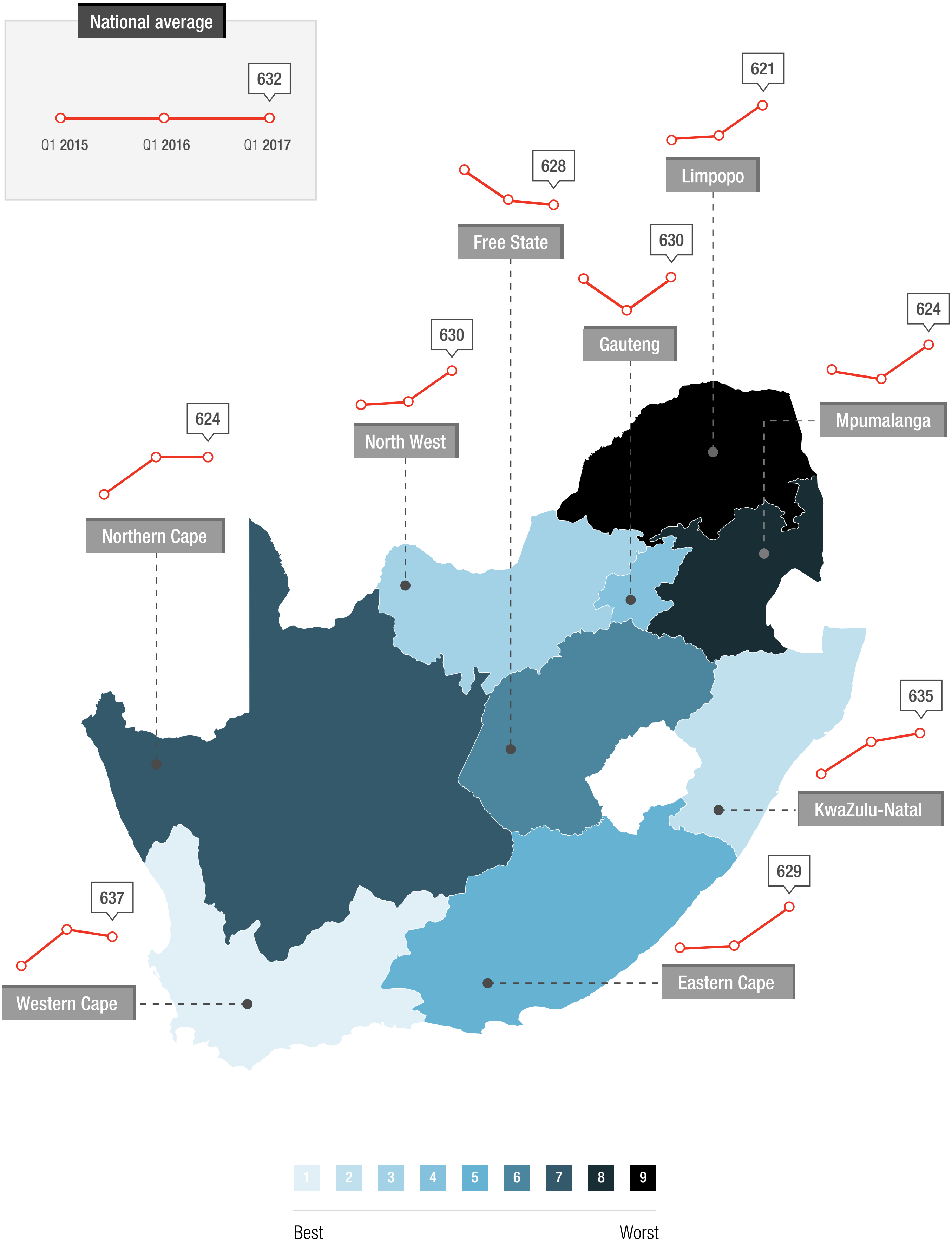
We've seen in previous indices that rent in Limpopo has skyrocketed over the last few quarters, and that has boosted yields for landlords.

But one man's meat is another man's poison, as they say. And all the tenant statistics in that province bear this out – credit scores are deteriorating, income is dropping, debt levels are rising, tenants are using higher percentages of maximum credit and the number of high-risk tenants is on the rise. It seems as though higher rentals are pushing tenants to an uncomfortable place, and agents will have to be that much more diligent in their tenant selection.

The other province where tenant health is deteriorating faster than the average is the North West Province. Here, our data shows that income levels have dropped almost 15% since the beginning of 2015. Not surprisingly, there is also an increase in the debt-to-income ratio from 49% to 55%, which is significantly higher than the national average of 43%. It is also one of the only provinces where the average credit score is deteriorating and the prevalence of high- and very high-risk tenants has increased over the past two years. ■

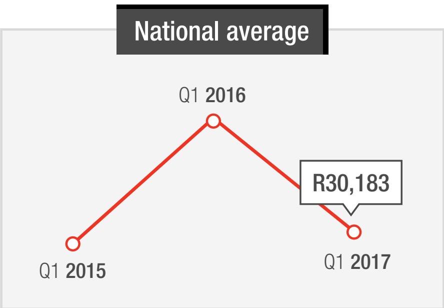
PROVINCIAL DATA

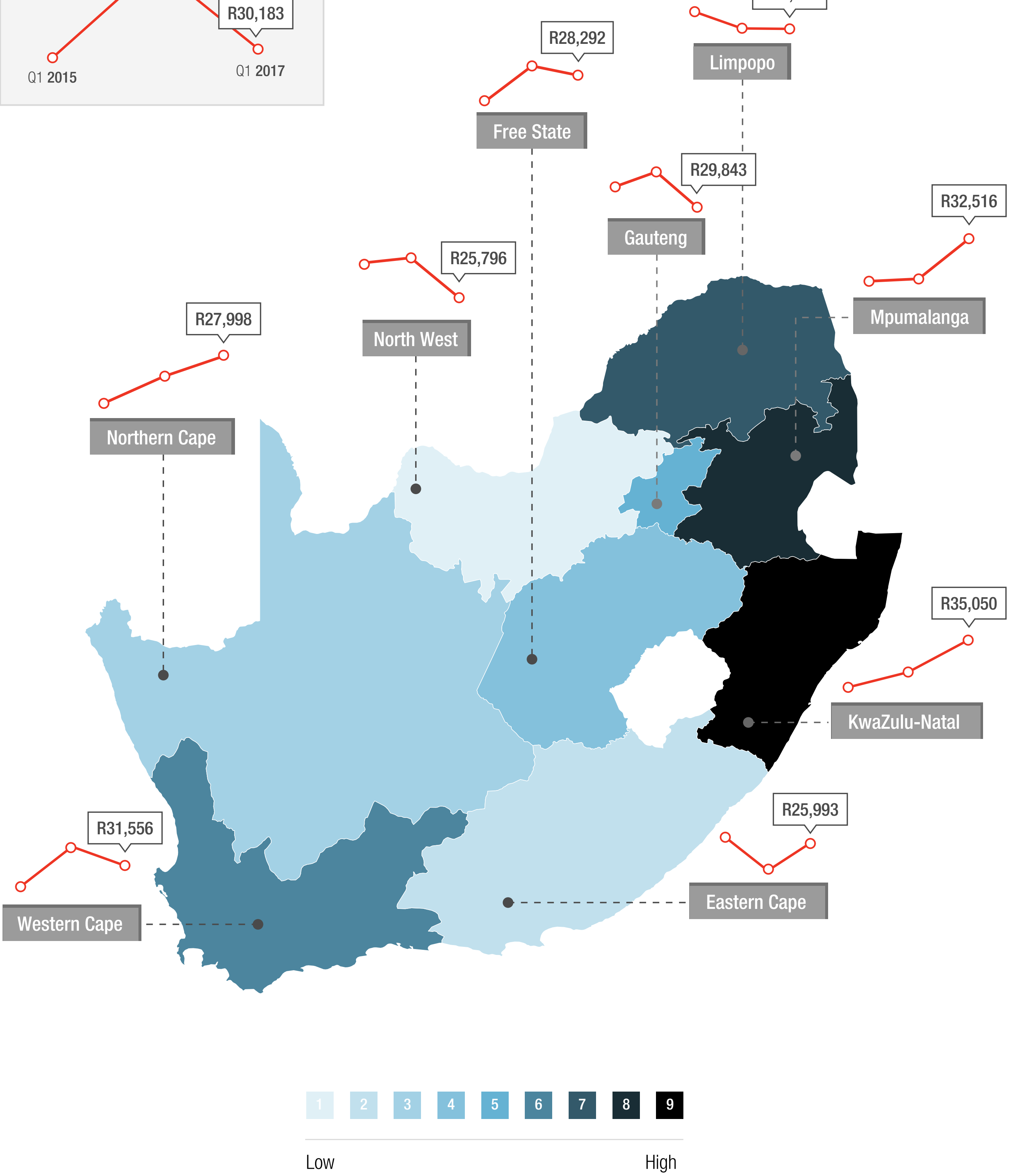
Average credit score



PROVINCIAL DATA

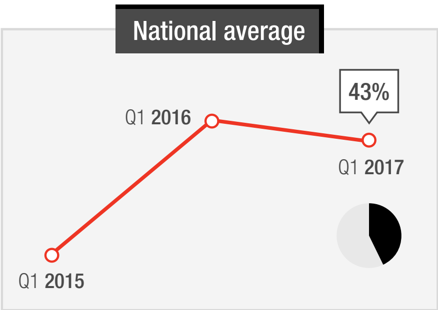
Average income

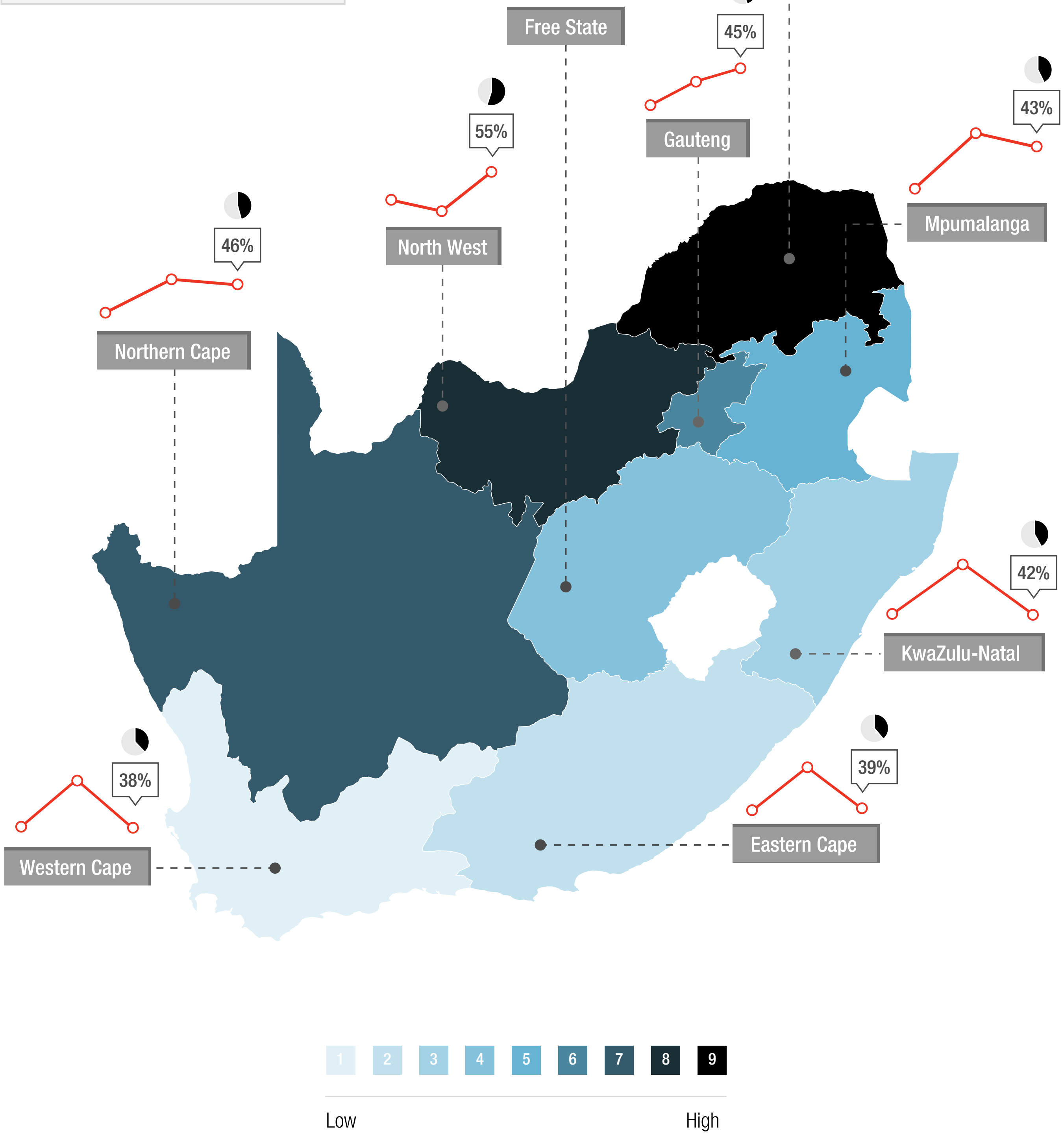




PROVINCIAL DATA

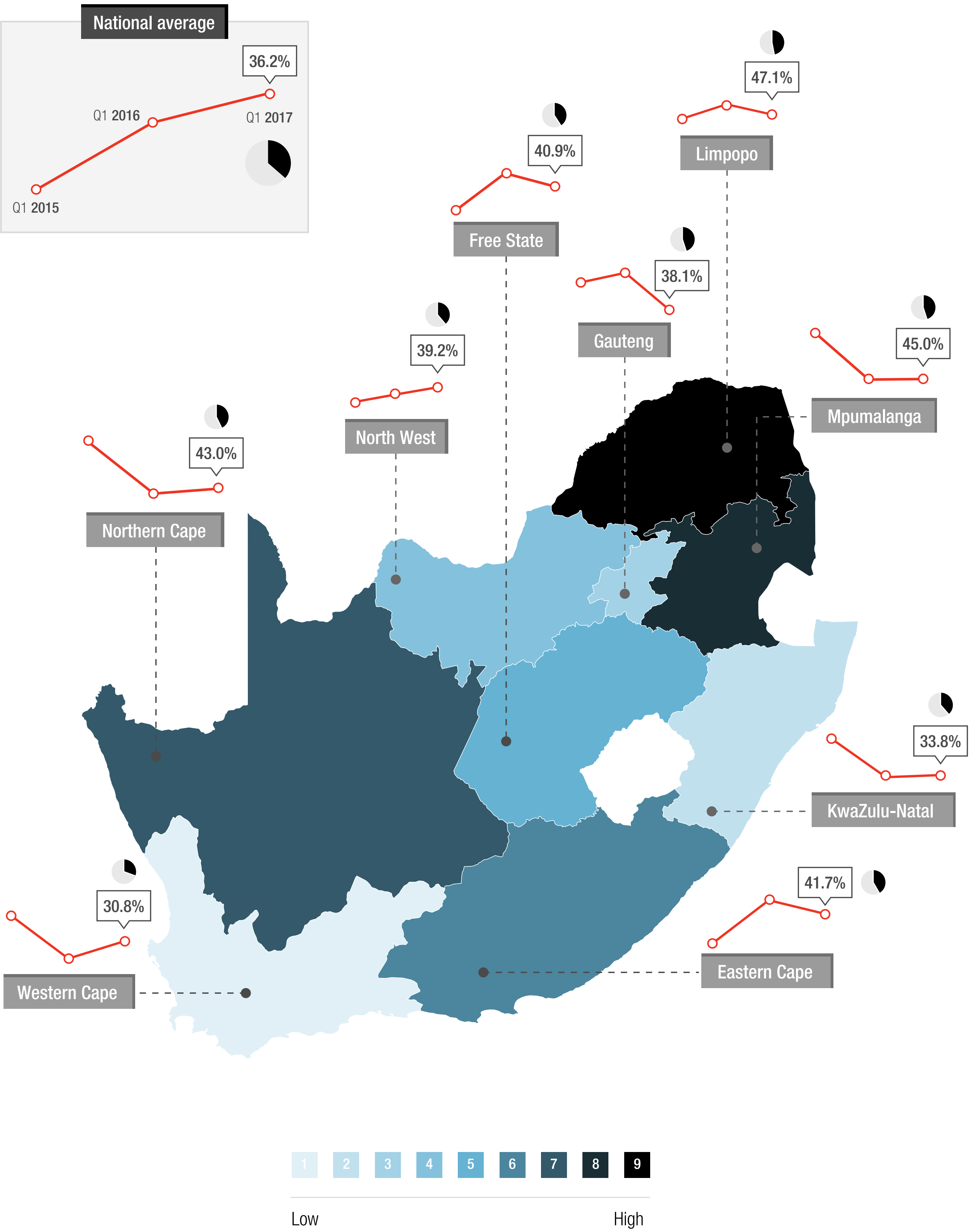
Average debt-to-income ratio





PROVINCIAL DATA

Percentage of high-risk tenants



IN SUMMARY

There's strength in numbers

More is always more where data is concerned...

- We've seen that a group of statistics can tell a better story than one number in isolation, and that longer-term trends are more insightful than short-term ones. Including these in your letting agents' data armoury is a crucial part of adding value for landlords.
- Provincial rental growth rates are relatively low and we are not predicting massive increases in the near future. The outliers are the Western Cape, where growth continues at around 10% year-on-year, and Gauteng, which has started to show signs of recovery.
- Overall, tenant health is stable, except in Limpopo, the North West and the Free State, where it is deteriorating.
- Think local, but keep an eye on the national context – what is happening in your province vs the national average? Understand and be able to explain any deviation.
- Something to look out for – understand cause and effect, meaning what is driving the rental market in your province or area over the short-term and long-term. More on this in future indices!

PayProp

PayProp Rental Index

The PayProp Rental Index is a quarterly guide outlining trends in the South African residential rental market, and is compiled from 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 2017.

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