

RENTAL INDEX

Q2 2017

- + The rental sweet spot
- + Where the living is easy

Average
national rent
breaks through
R7,000



Gender
and the average tenant

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Into the home straight

It's hard to believe we're already more than halfway through 2017! Spring is around the corner and soon we'll be enjoying a well-deserved break.

For now, though, let's get back to reality. This quarter it was announced that South Africa is in a technical recession for the first time since 2009. GDP growth has been lower than population growth for some time now, which means the average person is getting poorer. And it doesn't help that our unemployment rate is at its highest level in 12 years. The truth is, living standards can't improve without economic growth.

The Reserve Bank's Financial Stability Review¹, published in April, looks at the average price-to-rent ratio² as an indication of affordability and the profit potential of owning residential real estate. Recent changes in this ratio indicate that households rent rather than buy – which also reflects low confidence levels noted in the FSR.

All of this indicates that tenants (and the property industry itself) are facing tough times, which is why we do everything in our power to help our clients adapt and overcome challenges in their business.

Our integrated letter of demand is one example – further along in this Index we set out how it can help improve your rent collection at the click of a button.

We hope you find this issue of the PayProp Rental Index useful and insightful. As always, please get in touch to share your thoughts with us.

Meanwhile, sit back, relax and enjoy!



Johette Smuts
Head of Data and Analytics
PayProp South Africa

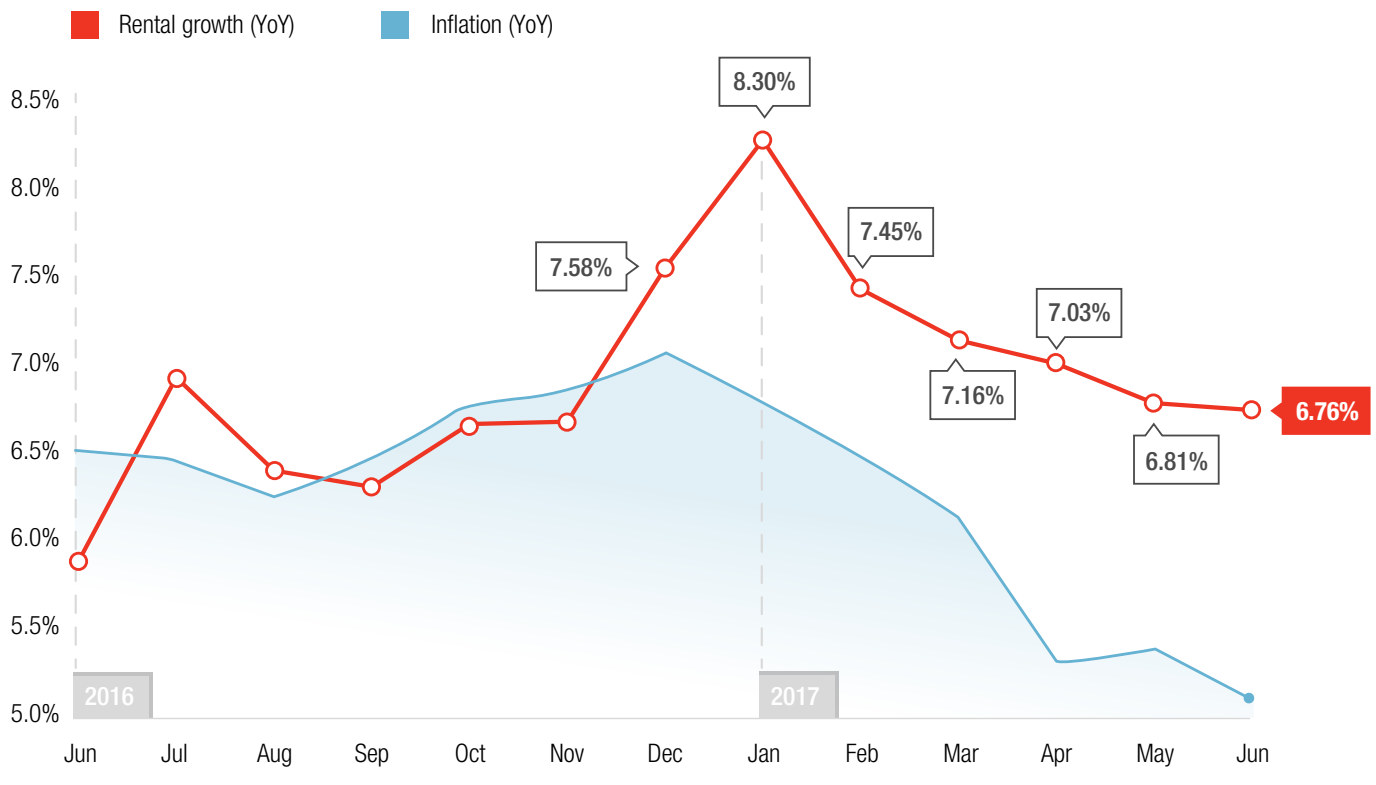


1 South African Reserve Bank Financial Stability Review, April 2017

2 The price-to-rent (P:R) ratio is the expression of the residential real estate value relative to the annual income that it could earn over one year. Similar to the price-to-earning (P:E) ratio for equities, it gives an indication as to whether the market is fairly valued.

Back to normal

In the last Index, we looked at the correlation between weighted average national rent growth and inflation. Let's start this quarter's review by revisiting that graph with updated figures:



Weighted average year-on-year rental growth rates vs. year-on-year inflation rates

Sources: PayProp, Statistics South Africa

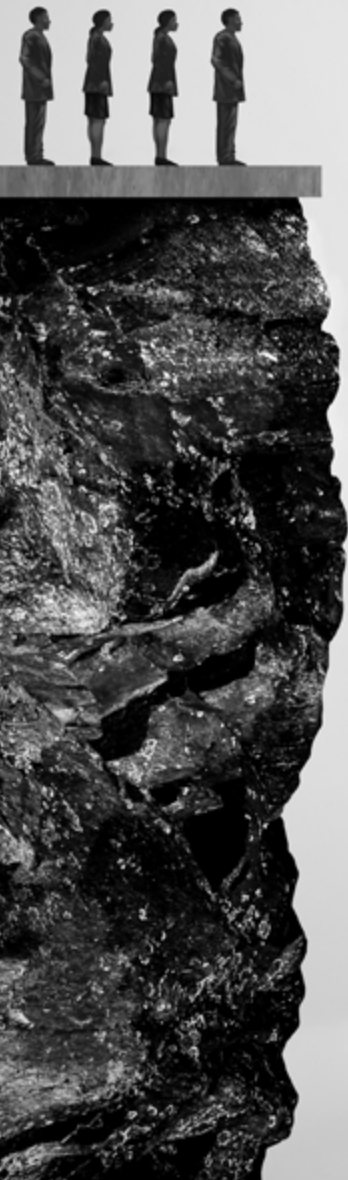
The spike in rental growth noted towards the end of 2016 has turned out to be temporary. Holiday rentals may well have played a role in causing it, but it is also very likely that financial pressure on tenants and lower inflation rates have been the reason for more stable rental growth rates since then.

Looking ahead, the current recession will probably reduce inflationary pressures, but it also means demand for rental properties could rise due to low confidence levels and affordability pressures, especially for first-time buyers.

The 6% inflation expectation for the end of 2017 that we mentioned in the previous Index has since been revised downwards, to around 5.6%.

Consequently, if our gut feeling is correct, the recession may cause the gap between inflation and rental growth to widen even more towards the end of the year. ■

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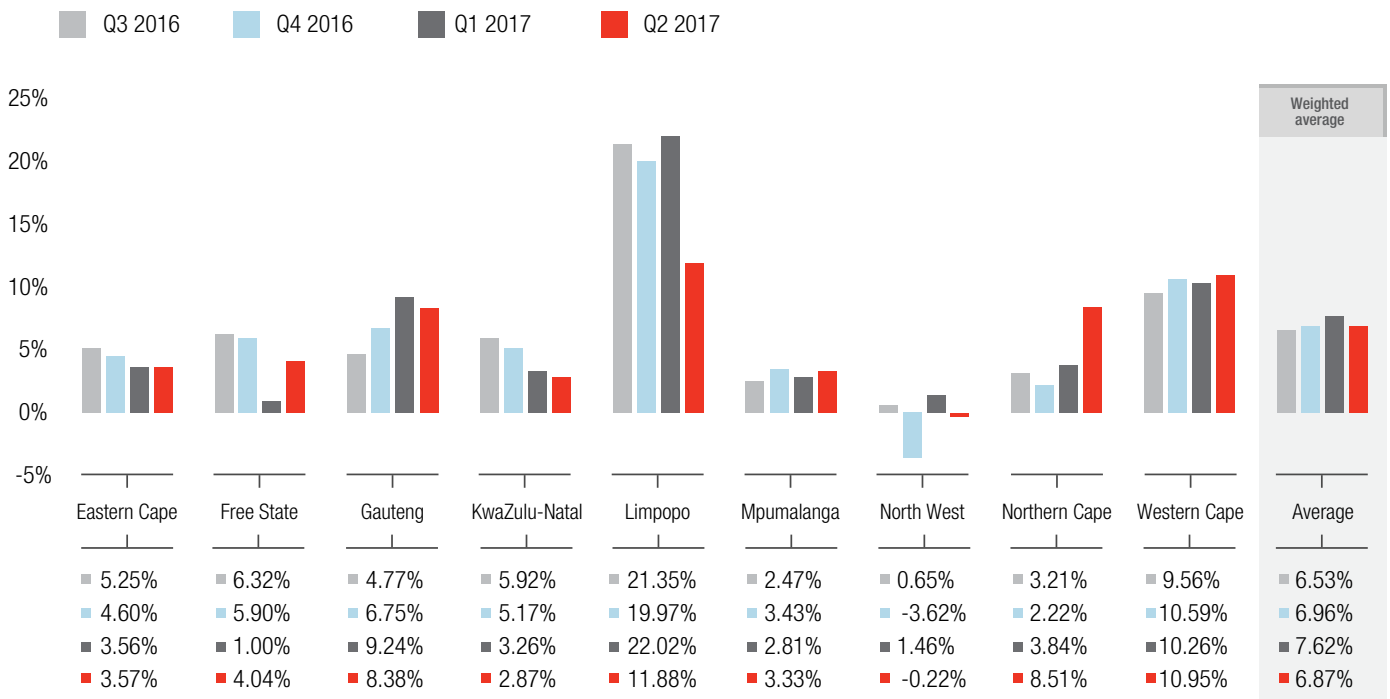


PROVINCIAL GROWTH RATES

Up, down and up-and-down

While a few provinces have had their 'ups and downs', some show definite directional trends in their year-on-year growth over the past four quarters.

Trends illustrating movement over time can be useful when forecasting future performance, while current growth rates compared to the average provide a more immediate but less contextual snapshot of what is currently happening.




Quarterly year-on-year growth rates per province for the last four quarters

Source: PayProp

We note that the weighted average year-on-year growth rate in Q2 (6.87%) is lower than in Q1 (7.62%), and more in line with previous growth rates. This can be clarified at the hand of the abovementioned spike in monthly year-on-year growth between December and February. It naturally resulted in a higher quarterly growth rate for Q1, and the subsequent correction resulted in a more stable, lower growth rate for Q2.

Looking at growth rates over time, we see downward trends in the Eastern Cape, Free State and KwaZulu-Natal. All three these provinces (along with Gauteng) also show below-average growth in the damage deposit-to-rent ratio that landlords charge (known as the damage deposit ratio). This could indicate an oversupply in rental properties in those areas. ►►

- 
- ▶ The Western Cape is the only province with a (slight) upward trend over the past four quarters. This province is seeing a 'semigratory' influx of people from other provinces, especially Gauteng, which has increased demand, leading to higher rental prices in the region. We expect this trend to continue and Western Cape rents to continue their double-digit growth, at least in the short term.

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PROVINCIAL RENT LEVELS

Where the living is easy... (and where it's not)

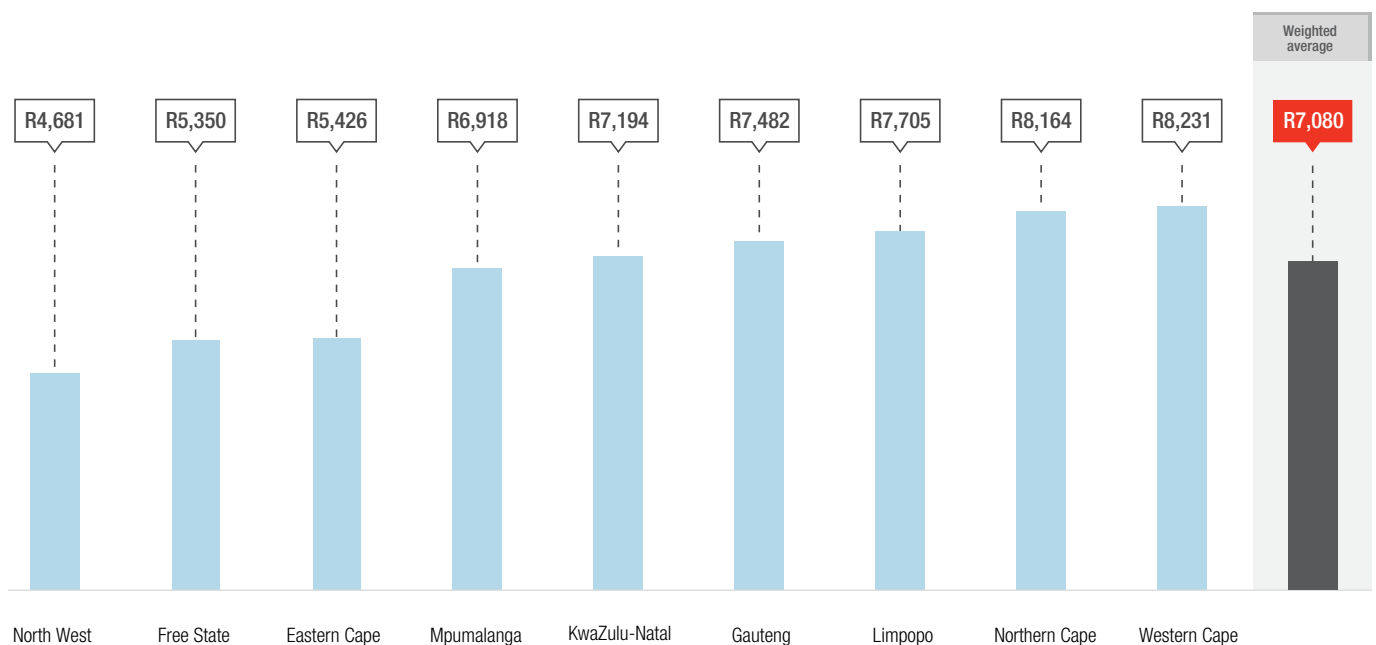
The average rental value per province is a useful indicator of the cost of living in that area. It can also help keep landlords' expectations in check.

From the graph we can extrapolate that the Western Cape is (once again) the most expensive province to live in South Africa, as it attracts the highest rents. And when we compare rental averages to income, we see that tenants there spend almost 28% of their net income on rent. In the North West, this figure is only 16%. Admittedly, there are two other provinces where a bigger percentage of income is spent on rent – in Limpopo, tenants spend on average 28.4%, and in the Northern Cape, it is 30%.

Income data originates from Tenant Assessment Reports generated by PayProp Capital for our clients in respect of tenants. Net income is not necessarily verified, and the percentage of income spent on rent is not the only determinant of the cost of living in a province.

It is further worth noting that the weighted average national rental exceeded R7,000 for the first time this quarter, after just falling short in the previous quarter. This figure breached the R6,000 mark in Q4 2014. ■

The weighted average national rental exceeded R7,000 for the first time this quarter



Average rent levels for Q2 2017

Source: PayProp

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RENTAL PRICE BANDS

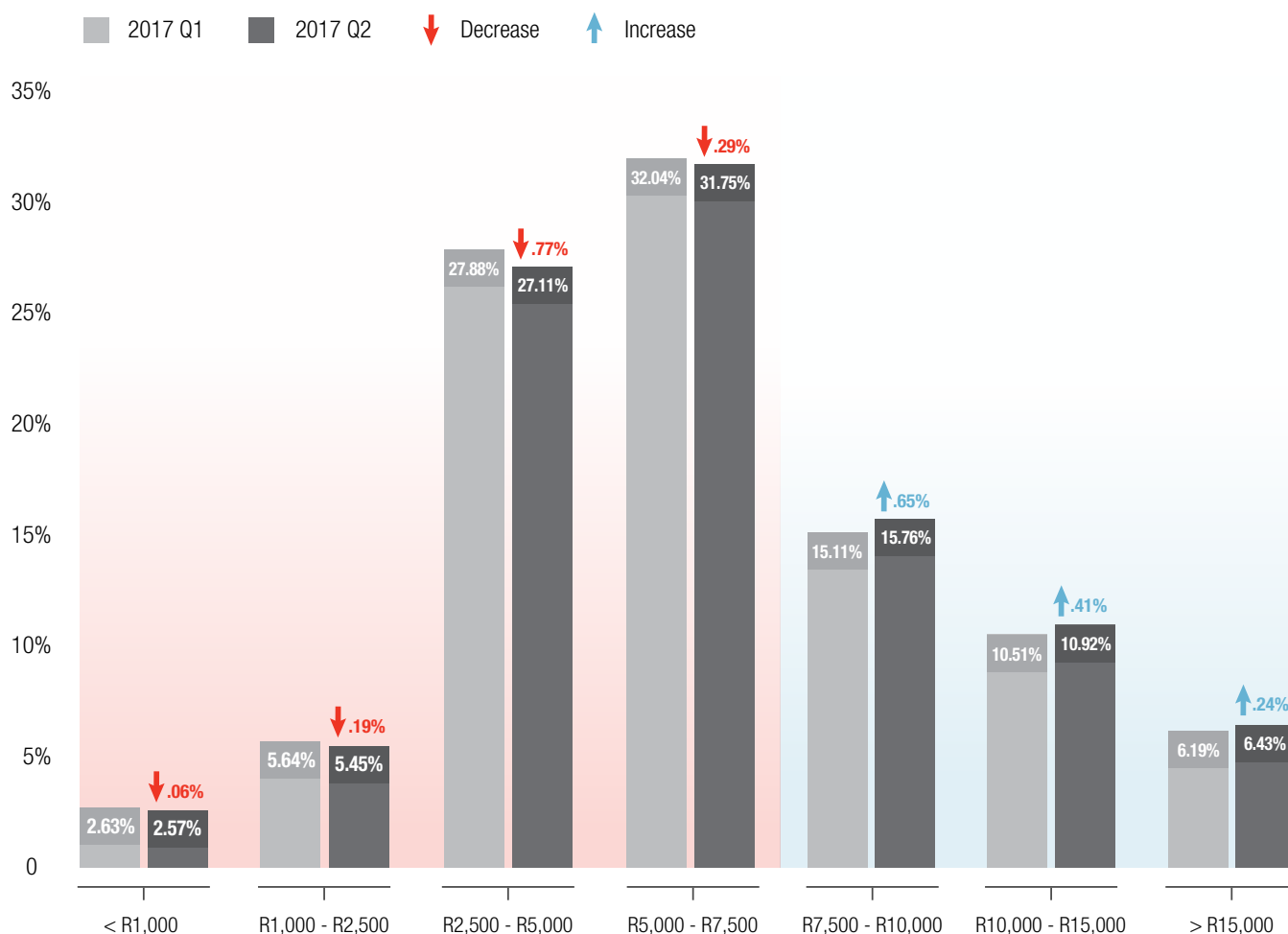
The sweet spot

We've said for some time that the sweet spot for rentals is the R5,000 – R7,500 band. Of course, this won't always be the case, but for the past three and a half years it has held true, with the percentage of rentals in this band varying minimally between 29% and 32%.

As rental prices move upward, we expect the fraction of rentals in the more expensive categories will, too. Between the first and second quarters of this year, there was a slight decrease in the percentage of rentals within this band.

As rental prices move upward, we expect the fraction of rentals in the more expensive categories will, too.

More importantly, this was the first time that the percentage of rentals per category decreased for all bands below R7,500, while increasing for all bands above R7,500 between Q1 and Q2. ■



Percentage of rentals per rental band for the first two quarters of 2017

Source: PayProp

RENTAL PRICE BANDS

The law of averages

Interestingly enough, the average rent per rental category has not changed more than 3% in either direction over the past three years. For example, the average rent in the R2,500 - R5,000 band in the second quarter of 2014 was R3,841 – an increase of just R57 (or 1.5%) in three years!

Average rental per category in Q2 2017





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DAMAGE DEPOSIT DATA

It's all relative

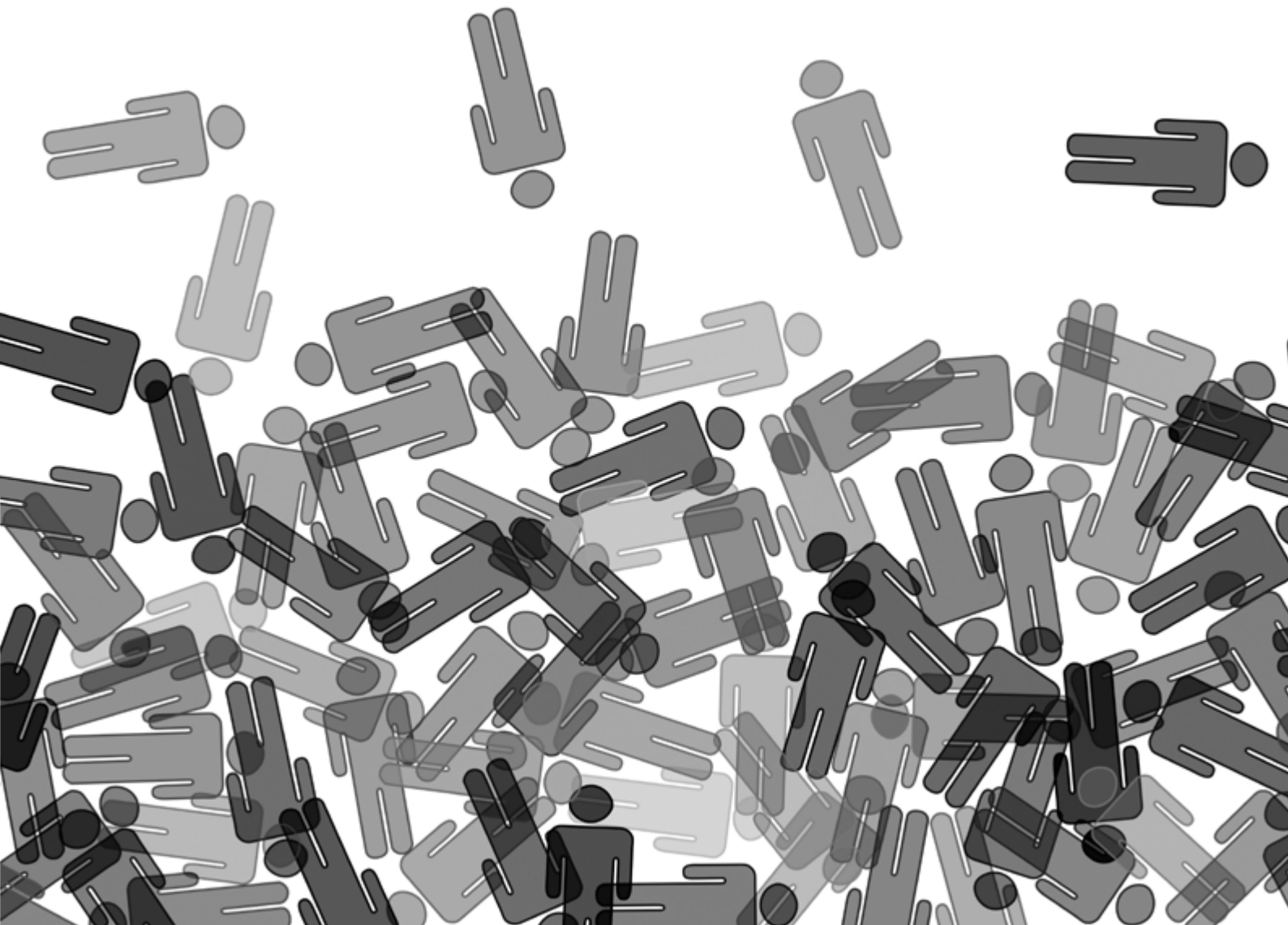
$$\text{The damage deposit ratio} = \frac{\text{average damage deposit held}}{\text{average rental invoice}}$$

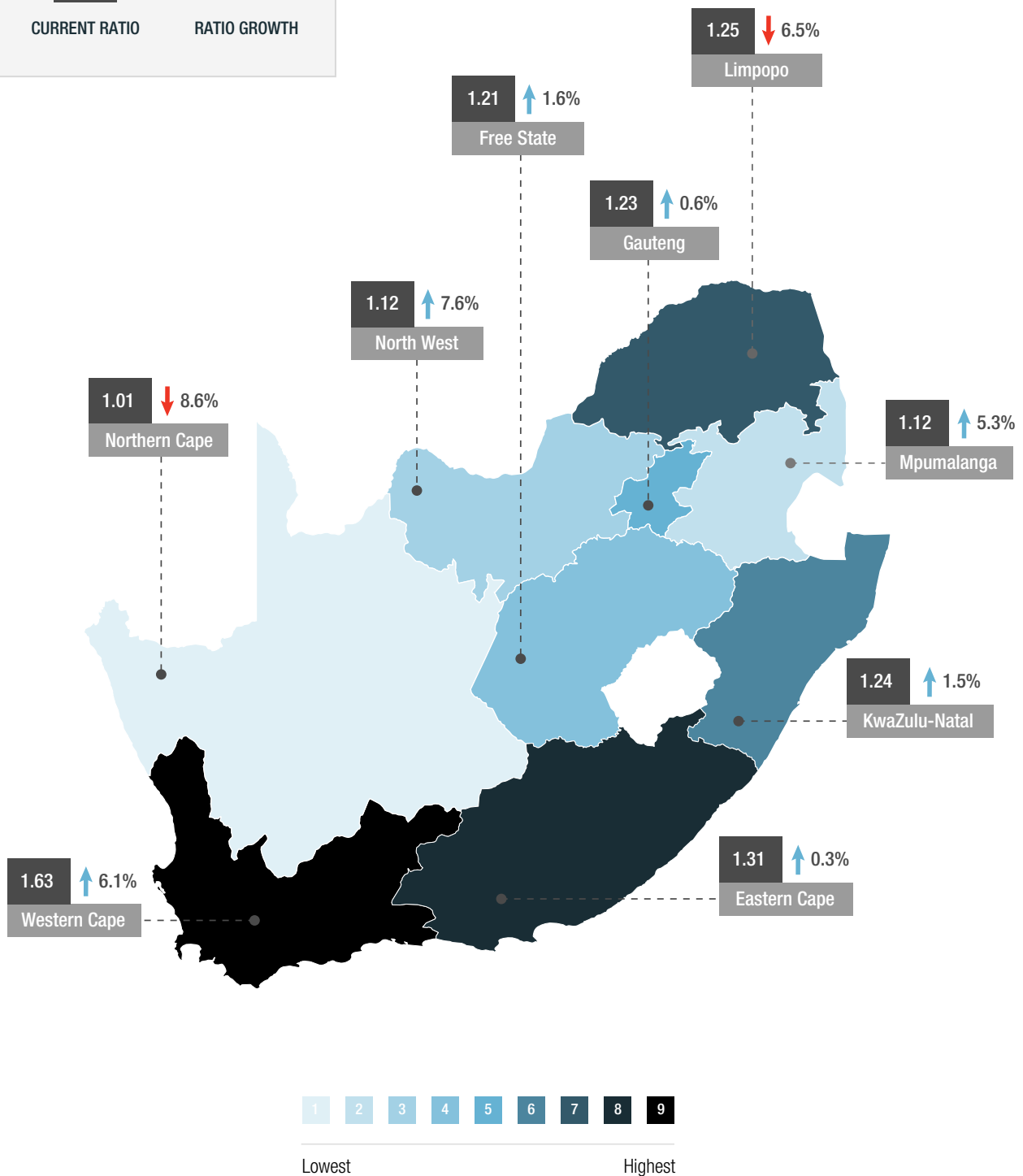
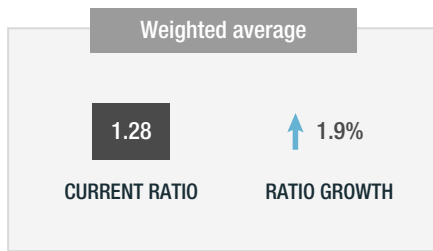
The weighted average damage deposit ratio has been increasing slowly over the years – though faster for some provinces than others. Supply and demand dynamics for rental property play a big part in this, but so does a tenant's ability to pay for this extra expense.

The size and direction of adjustments in the damage deposit ratio in turn depend on the relationship between rental growth and damage deposit growth. If the former is greater, the ratio decreases, and the reverse also holds true.

As a result, a province can have a fast-growing rental market and still have a decreasing damage deposit ratio. Or two provinces can have similar increases in the damage deposit ratio but very different rental growth rates.

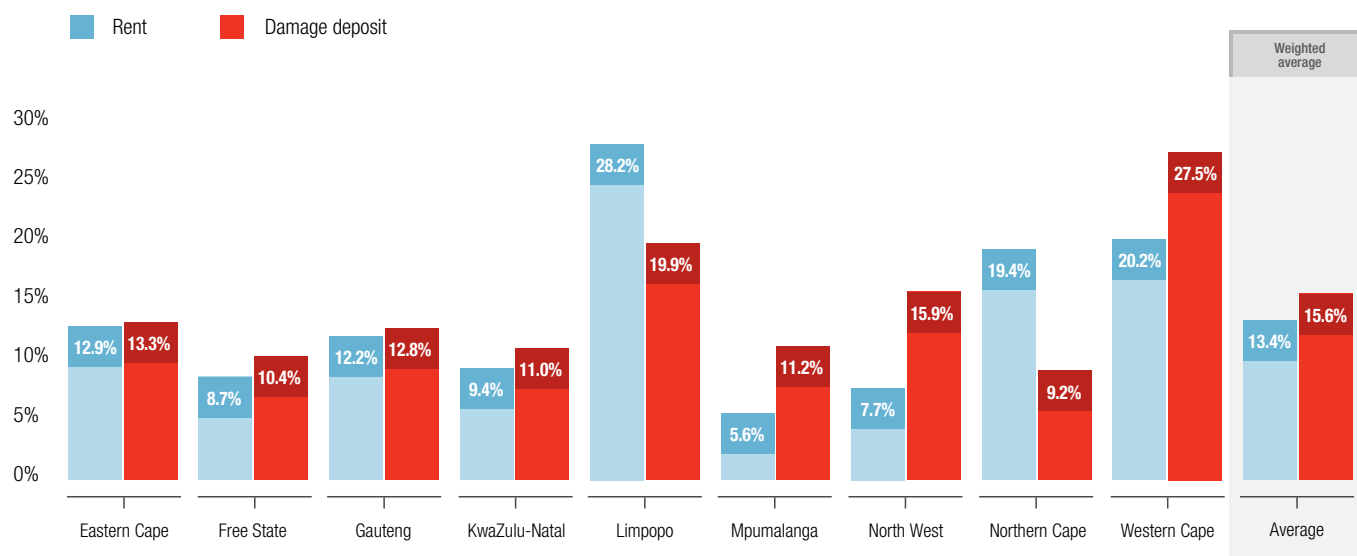
With that in mind, let's look at the changes in provincial damage deposit ratios over the past two years before we unpack the respective drivers behind it. ►►





Damage deposit ratio for Q2 2017 and the two-year cumulative growth rate in damage deposits
Source: PayProp

- ▶ Comparing Gauteng's ratio to Limpopo's, for example, we see that current ratios are quite similar, but they're pulling in opposite directions. The reason for this can be found in the graph below:



 Cumulative rental and damage deposit growth rates from Q2 2015 to Q2 2017
Source: PayProp

The fact that damage deposit growth is higher in Limpopo than in Gauteng (19.9% vs. 12.8%) is irrelevant to Limpopo's dropping damage deposit ratio – the real reason being that rental growth there has been higher than damage deposit growth over the two-year period.

The dynamics in the Western Cape and Gauteng are interesting to watch as well. The effects of supply and demand are clear in both: In the Western Cape, rents have been increasing by around 10% per annum for some time, but still we see rapid increases in the (already high) average damage deposit and damage deposit ratio, indicating a shortage in rental stock and oversupply of tenants. Rental agencies can therefore afford to be picky and 'shop around' for tenants who can afford the damage deposit.

Rental agencies are now up against developers, which often value quantity over quality and require a very low deposit – or none at all.

In Gauteng, it is tenants who can afford to be picky, as there seems to be an oversupply of rental properties in that province. This is evident in the decrease of the average damage deposit ratio in the province over the last year – by 2.1%. The drop is in part due to large development companies holding on to their stock and managing rentals themselves, instead of through traditional rental agencies. This means rental agencies are now up against developers, which often value quantity over quality and require a very low deposit – or none at all. ■

TENANT DATA

Battle of the sexes

In the previous Index, we revealed the vital credit metrics of the average tenant. This time, we've split this persona into male and female groups to delve into any potential differences in credit profiles.

The biggest difference by far is in average income – men have a 30% higher net income than women, based on our credit check data. The Eastern Cape reports the lowest difference in income (22%), but also the lowest income for both men and women. The good news is that, over the past year, incomes in the region have increased the most out of all the provinces for both men and women.

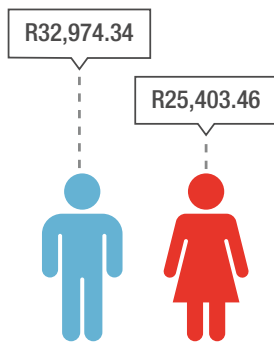
Despite the big disparity in income, men spend on average only 11% more on rent than women. In relative rental values, men rent properties that are priced slightly above the national average, while properties rented by women are very much in line with the average national rental.

Because the average income for men is so much higher, they spend a smaller percentage of their net income on rent – on average 23.8% compared to the 27.7% of women. ►►

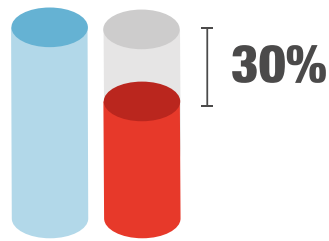
Tenant data, including income data, originated from Tenant Assessment Reports generated for our clients. The data is not weighted or necessarily indicative of the average tenant currently occupying a property.



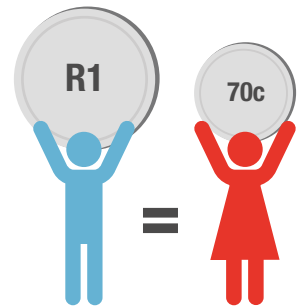
INCOME



AVERAGE SALARY

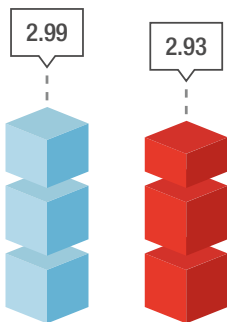


NET INCOME

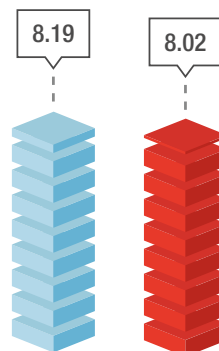


IN RANDS

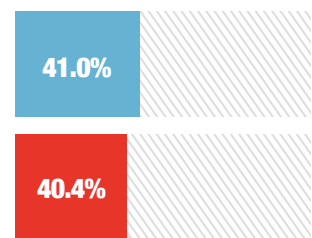
DEBT



NLR ACCOUNTS

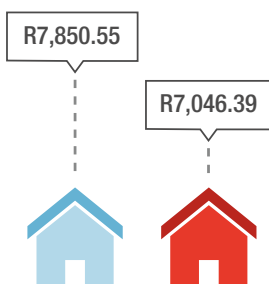


CPA ACCOUNTS

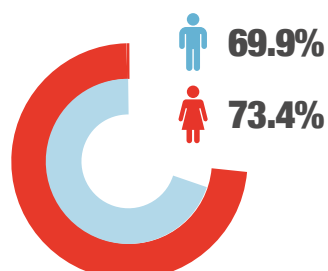


DEBT-TO-INCOME RATIO

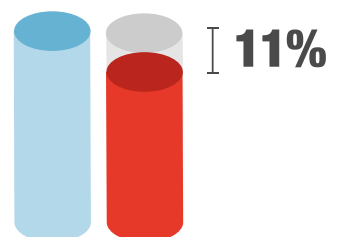
RENT



AVERAGE RENT



AFFORDABILITY



SPEND ON RENT

- ▶ The income gap also affects affordability and disposable income. Affordability is calculated by adding a tenant's total debt repayment to the monthly rent and expressing this sum as a percentage of income. The money that is left over after debt and rental payments is regarded as disposable income. Due to their smaller income, women can claim on average only 26.6% of their salaries as disposable income, while men have 30% available. This situation is not reflected in all provinces, though. In KwaZulu-Natal, Limpopo, Mpumalanga and the Northern Cape, women have better affordability scores than their male counterparts.

Women also have fewer accounts on average than men, and we note that the number of NLR accounts decreased for both men and women from a year ago.

NLR (National Loan Register) accounts are 'bad' debt, so a decrease in the amount of NLR accounts coupled with lower debt-to-income ratios are signs of improved credit behaviour.

Women have higher credit scores in all provinces except in Mpumalanga.

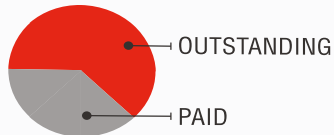
Even though women have lower average incomes, they have a slightly better debt-to-income ratio than men. This ratio also improved more for women than for men over the last year – a year ago, this ratio was 45% for females and 42% for males. This could very well be a big contributing factor to their higher average credit score. Women have higher credit scores in all provinces except in Mpumalanga. Comparing credit scores across the board to the first quarter of this year, though, we see almost all provinces declining slightly, in both male and female categories.

Based on this analysis, one cannot point to any real (consistent) differences between male and female tenants, so it is important to look at each prospective tenant individually when matching them with their perfect property. ■



Take control of your rental portfolio

1 See who has paid and who hasn't, in real time



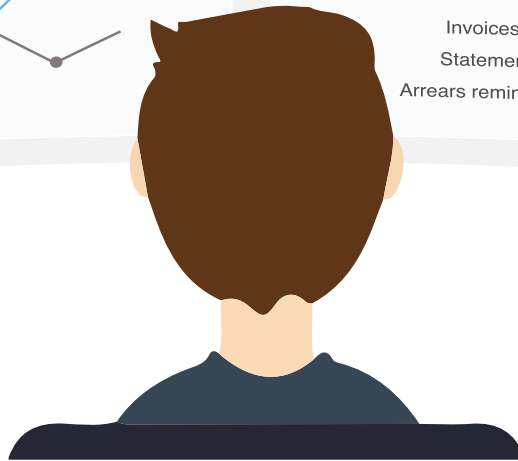
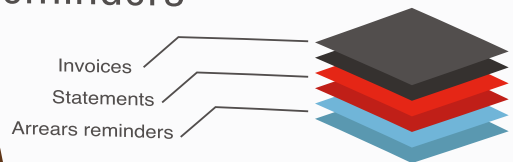
2 Approve bulk payments for commissions, contractors and landlords



3 See your portfolio growth over time



4 Automatic invoices, statements and arrears reminders



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TENANT ARREARS

In high demand

'Collection percentage' seems to be the new buzz phrase in the industry. Having a high collection percentage almost gives you bragging rights – it shows you know how to choose high-quality, reliable tenants, and it means you are keeping your landlords happy. Sound easy enough? Only if you have the right tools!

In June last year, PayProp partnered with Koegelenberg Attorneys to enable our clients to send automated letters of demand to tenants in arrears. Once you've selected your tenants in arrears, the platform sends an SMS as well as an e-mail with a PDF version of the letter attached, informing the tenant that a letter of demand is being generated for delivery and a registered letter is being sent.


Judging by the statistics, it has been a raging success.

Since we launched this feature, 8,000 letters have been sent, resulting in 82.8% of recipients paying in full within 19 business days! A staggering R54 million in arrears have since been collected – all at the push of a button and at no cost to the agent.

Our analysis reveals that the average arrears amount that was paid in full over the last year was just over R8,100, while the average unpaid arrears amount was almost double that, at around R15,100. This highlights the importance of arrears management; once it gets out of hand your chances of recouping outstanding rent diminish substantially. ■

When a letter of demand is sent, the cost of R85 (incl. VAT) is invoiced to the tenant and an automatic payment for that amount is set up to the agency, meaning the agent will be reimbursed for the cost of the letter, once the tenant settles his debt.





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since been collected – all at the push of a
button and at no cost to the agent.



IN SUMMARY

Recessionary woes

- Even though South Africa is now in a recession, not all provinces will feel its effects equally. Affordability and consumer confidence affect rental demand more than the country's economic activity does.
- The gap between inflation and national rental growth is widening because the drivers behind these growth rates are affected by different factors. The recession puts downward pressure on inflation, but not necessarily on rental growth.
- We've been seeing a steady increase in the percentage of rentals in the upper rental bands. This gives an indication of current demand and the trend is also pointing to where future demand will be.
- We've heard that men are from Mars and women are from Venus, but when it comes to tenants, everyone is on the same planet. It is really important to vet each tenant on their own merits.







■ 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 second quarter of 2017.

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