PROPERTY BAROMETER

Residential Property Affordability Review

The Housing Affordability picture continued its broad deterioration in the 4th quarter of 2015

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MARKET ANALYTICS AND SCENARIO FORECASTING UNIT

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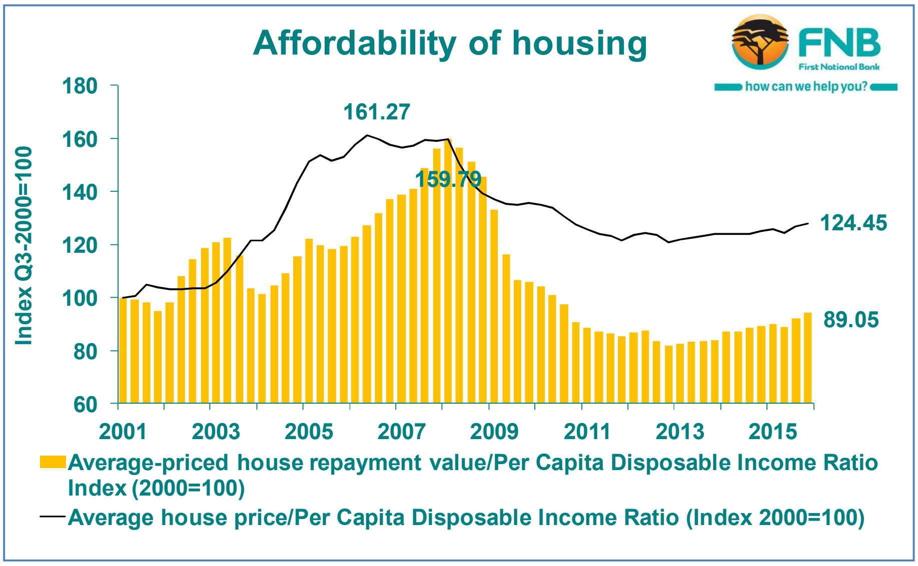
THE MAIN HOME AFFORDABILITY RATIOS

The home affordability picture deteriorated further in the 4th quarter of 2015, continuing a gradual deteriorating trend that began back around 2013.

Of our 2 main affordability measures, the 1st measure, namely the "Average House Price/Per Capita Disposable Income ratio Index", rose (deteriorated) slightly further by +1% in the 4th quarter of 2015 compared to the level for the previous quarter.

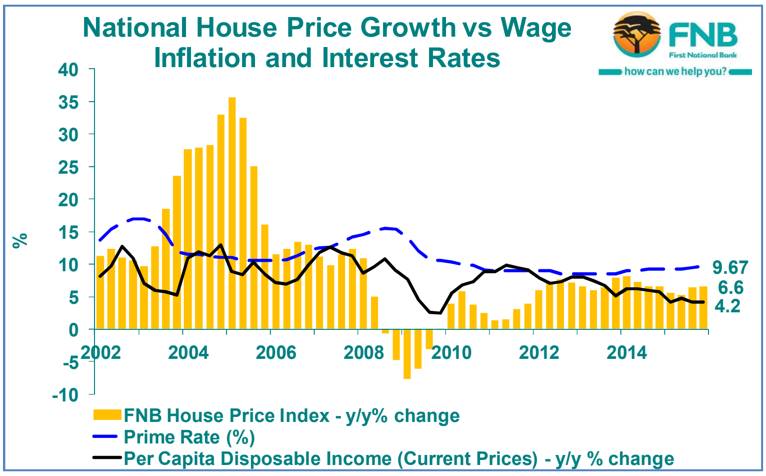
The 2nd measure, namely the "Installment Value on a new 100% Bond on the Average Priced House/Per Capita Disposable Income Ratio Index", also rose (deteriorated) by a slightly higher +2.1% in the 4th quarter.



Both indices were driven higher by the average house price inflation rate exceeding Per Capita Disposable Income growth in a deteriorating economy. This relative outperformance in house prices has been in place for most of the 2013-2015 period, although recently house price inflation is off the highs of late-2014/early-2015. The Loan Instalment/Per Capita Disposable Income Ratio has had the additional upward pressure from slowly rising interest rates since early-2014, and indeed there was a further 25 basis point rate hike during the 4th quarter of last year..

The cumulative result of house price growth outperforming per capita income growth since 2013, has been a +5.9% deterioration (rise) in the Average Price/Per Capita Disposable Income Index from the final quarter of 2012 to the 4th quarter of 2015. Add to that the past 2 years of interest rate hikes, and over the same period, the Instalment/Per Capita Disposable Income Index has risen (deteriorated) by a more significant +15.9%

Whilst the 2 affordability measures are still vastly improved (down) on their late-boom highs around 2006-2008, the Average House Price/Per Capita Disposable Income Index is still 27.8% above the 1st quarter 2001 level. But keeping property still "temporarily" affordable has been a period of abnormally low interest rates in recent years, which has meant that the Loan Instalment/Per Capita Disposable Income Index is actually 5.8% below (more affordable than) the 1st quarter 2001 level.



Whereas the Residential Market has remained well balanced, translating into average house price inflation of 6.6% year-on-year for the 4th quarter of 2015, which is still mildly positive in real terms, a deteriorating economy had seen Nominal Per Capita Disposable Income growth slow to 4.2% by that stage.

In short, slowing Per Capita Disposable Income growth, which has under-performed house price inflation, along with rising interest rates, has led to a continuation in the deteriorating trend in our 2 main housing affordability measures.

THE HOME RUNNING COST-RELATED AFFORDABILITY PICTURE

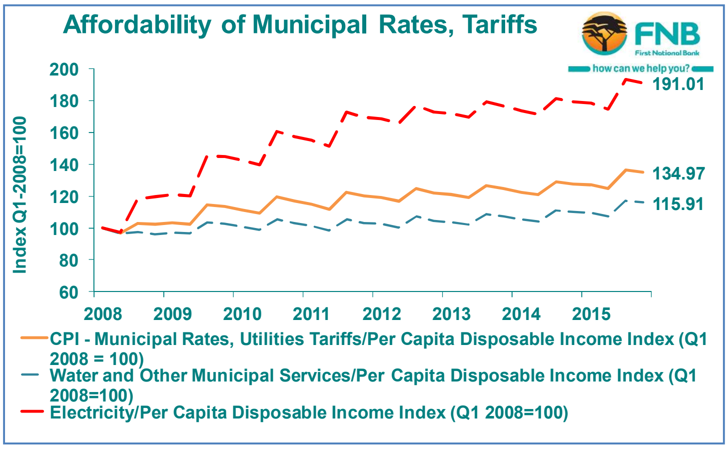
Estimates of home running cost-related affordability

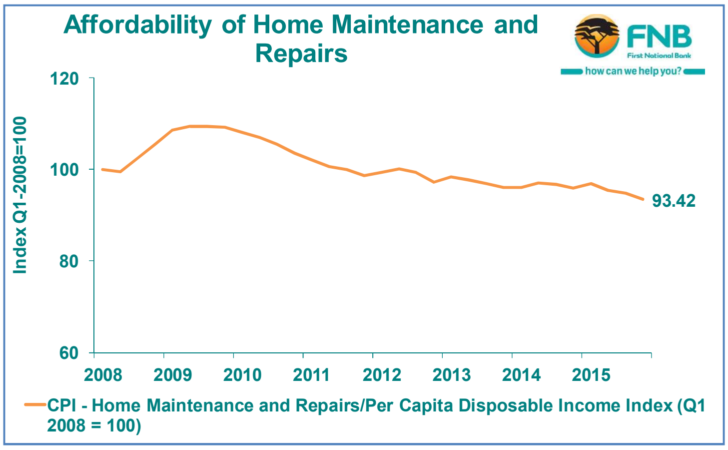
Next we consider measures of affordability that are related to the home, i.e. those that are running cost related, and to this effect we use components of the CPI (Consumer Price Index) to construct an affordability index for Municipal Rates and Tariffs, along with an index for Maintenance and Repairs Costs.

The "Municipal Rates and Tariffs/Per Capita Disposable Income" Index has moved higher through the entire 2008-15 period. This affordability measure has deteriorated (risen) by 34.97% from beginning of 2008 to the 4th quarter of 2015.

Major upward pressure has been exerted on this index by high inflation in the area of electricity tariffs, but moderated in part by less extreme Municipal Rates and Non-Electricity Tariffs cost inflation. The Electricity Affordability component is the troublesome part of the Rates and Tariffs bill, and its affordability index has escalated by a massive 91.01% since the beginning of 2008. It looks set to experience more upward pressure, as Eskom continues to annually press for more above-inflation tariff hikes, as its electricity sales revenues decline.

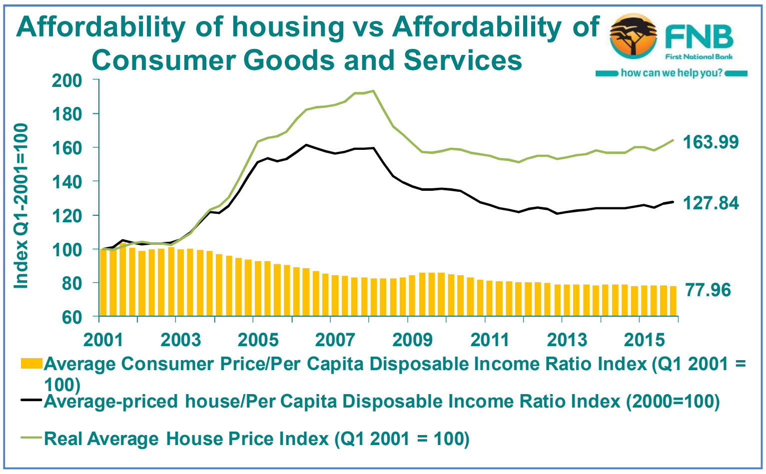
The Water and Non-Electricity Tariff/Per Capita Disposable Income Index has risen by a more moderate 16.5% from 2008 to 2015, while the Home Maintenance and Repairs/Per Capita Disposable Income Index has actually declined 4.9% over the period.





"Competitor Product" Affordability

It is also important to consider the "price competitiveness" of housing versus consumer goods and services that in part compete with it for a share of household disposable income.



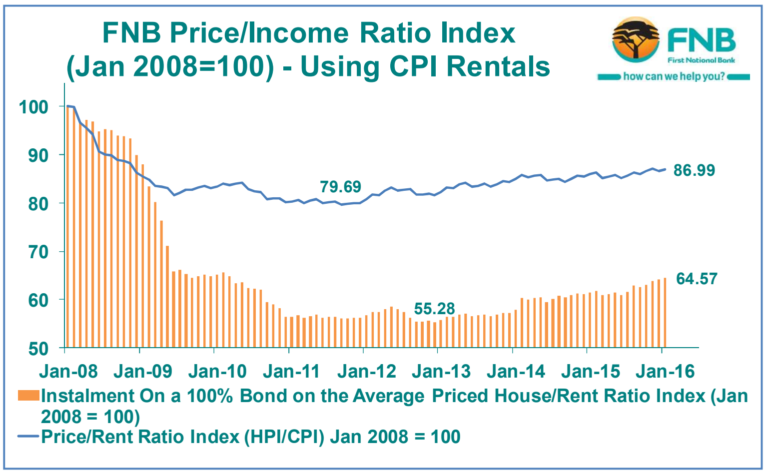
Relative to where we started back in 2000, at the start of the housing and consumer booms, housing is significantly worse off today. Limited housing supply back in those boom years, when demand surged, led to massive house price growth and resultant affordability deterioration. By comparison, affordability of consumer goods and services continued to improve throughout the boom years, with especially the importable consumer goods not experiencing major supply constraints and resultant price inflation surges during demand booms.

Therefore, despite the Average House Price/Per Capita Disposable Income Index (Q1 2001 = 100) being significantly down on its 2008 high, by the 4th Quarter of 2015 it still sat at 127.84, while the Average Consumer Price/Per Capita Disposable Income Index(Q1 2001 = 100) had dropped as low as 77.96, having never really risen in the boom years of 2000-2007.

Thus, over the boom years, housing lost major ground on consumer goods and services in terms of relative affordability, and never fully "recovered". So, when we use the PCE (Private Consumption Expenditure) Deflator to deflate house prices into real terms (with Q1 2001=100 for the Real House Price Index), we see that the Real FNB House Price Index is still a massive 63.99% higher than in early-2001, as at the 4th quarter of 2015. The Real House Price Index is also mildly elevated from its end-2011 relative low point, to the tune of +8.2%.

Therefore, housing's "price-uncompetitiveness", when compared with consumer goods and services price levels currently, continued its slowly deteriorating trend which started back in 2012. We would expect a slowing in house price growth in the near term, helped lower by rising interest rates and a weakening economy, to bring this trend of rising real house prices to an end in 2016.

Rentals and the House Price-Rent Ratio

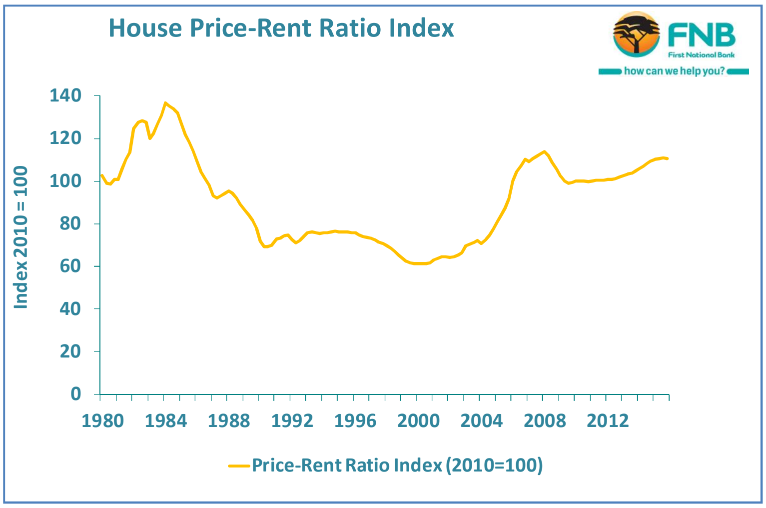


The CPI for Rentals was not surveyed in January, only being surveyed every 3 months. But based on the December 2015 CPI Rental Index (whose value is used in the January CPI), there was a further rise in the Residential Average Price-Rental Ratio Index in January. Whereas the year-on-year Actual Rental Inflation rate was 5.2%, the Average House Price Inflation Rate in the FNB House Price Index was still higher at 6.5%.

Therefore, the CPI Rental figures continue to show the residential rental option broadly becoming more attractive compared to the relatively expensive home buying option. At an index level of 86.99 (Jan 2008 = 100), the Residential Price-Rent Ratio in January was a mere 13.01% below the January 2008 level, and the January 2008 level is believed to have been at or near to a multi-decade high. The Price-Rent Ratio therefore remains high, and this index has risen by 9.2% on its September 2011 Post-Recession low point.

What keeps time home buyer numbers high at this stage then? A relatively low prevailing interest rate level, which translates into a far lower level in the Instalment Repayment on the Average Priced Home/Rent Index. In January, this index was 35.4% lower than the level at January 2008, having been driven sharply down by big interest rate cuts around 2009.

However, more recently this Index has also risen, by 15.3% since a low in September 2011, thus also making the home buying option gradually less attractive relative to the rental option.



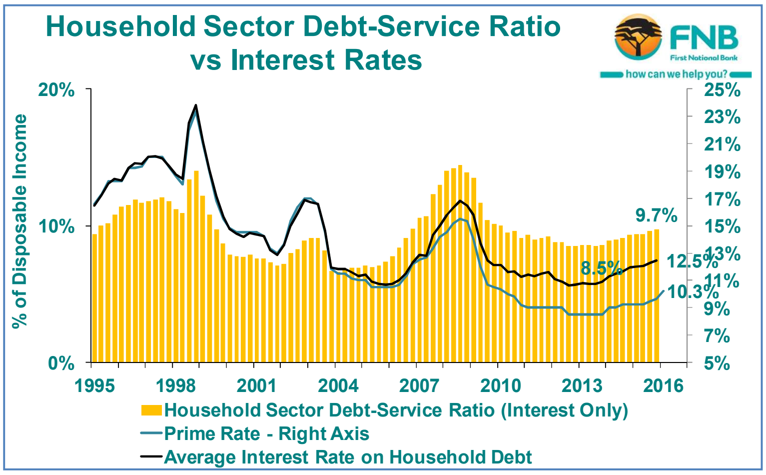
In order to give a longer term perspective of the level of the Price-Rent Ratio, we have used 2 different quarterly series, namely our FNB Long Term House Price Index and a long term rental estimate using SARB Household Consumption data.

A multi-decade high was reached late in 2007 at the back end of the boom period, and the most recent levels look very similar.

Credit Affordability

Finally, there is the matter of credit affordability, which is a function of the value of credit outstanding, the level of disposable income, and of course the prevailing level of interest rates.

The best measure of the affordability of Household Credit is the Debt-Service Ratio (The cost of servicing total household sector debt, expressed as a percentage of Household Disposable Income).



The SARB's "interest only" version of this ratio, after ending its downward trend in 2013, began to rise late in 2013, from 8.5% in the 3rd quarter of that year to 9.7% by the 4th quarter of 2015, lifted in part by the SARB's 1.25 percentage points' worth of repo rate hikes, but in part by a partial shift by households toward greater utilization of higher priced non-mortgage credit. The further 2 rate hikes in the 1st quarter of 2015 are almost certain to have lifted this ratio still further.

CONCLUSION

Therefore, the home affordability picture in recent times continued to be one of gradual deterioration.

House price inflation is far from strong, but has still outpaced slowing Per Capita Disposable Income growth in recent times. This has led to further recent deterioration (rise) in the Average House Price/Per Capita Disposable Income Index as well as the Instalment on a 100% Bond on the Average Priced House/Per Capita Disposable Income Ratios.

There appears to be no end to above-general inflation electricity cost increases, and Municipal rates and Tariff increases also running above income inflation. Therefore, the Home Running Cost-related Affordability Measures also continue their multi-year deterioration. The exception here is Home Maintenance and repairs Affordability, which has actually improved since 2008.

Comparing house prices to those of “competitor” products, i.e. consumer goods and services (who compete with property for household spend) and rental properties (the alternative to buying a home), housing continued to become less competitively priced in 2015, out-inflating both consumer goods and services as well as rentals.

The interest cost on household debt relative to disposable income also continued to rise (i.e. affordability deterioration) in 2015, due to interest rate hiking along with the higher-priced consumer-related forms of household credit still growing faster than the cheaper home loans category.

Looking forward, the broadly deteriorating Residential Affordability picture looks set to continue in 2016. Interest rates are expected to tick up gradually further, while is seems unlikely that Municipalities and Utilities will stop their above-inflation tariff and tax increases, with General Government finances on a long run deteriorating trend. In addition, the Household Debt-Service Ratio is expected to rise further too, driven higher by further interest rate hikes.

But we are of the belief that not all of the measures of affordability will continue to deteriorate this year. While we would expect rising interest rates to lift the Bond Instalment/Per Capita Disposable Income Ratio higher next year, expected slowing house price growth could possibly end the rising trend in the Average House Price/Per Capita Disposable Income Ratio, as we get into the anticipated real house price correction phase. This may also conceivably end the rising Price-Rent Ratio.