PROPERTY INSIGHTS
– Residential Rental Market Environment

A desire to rent may become more widespread in the near term, and rental home supply could be more constrained….but will this lead to a stronger rental market? Mildly at best, perhaps.

28 September 2018

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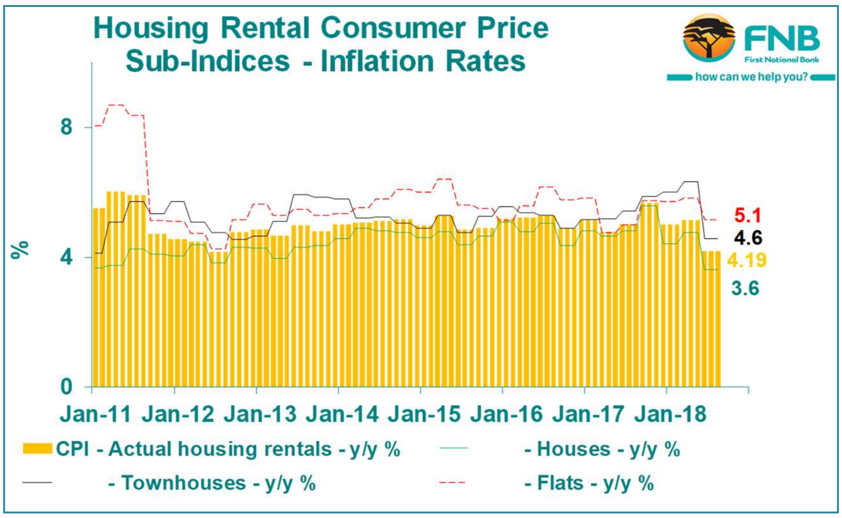
For some years, we have been expecting slightly more in terms of residential rental market strength, and this to date has not materialized on a national average basis. Of late, however, our housing market surveys have begun to point to a possible greater desire to rent amongst a certain group, as well as possible greater rental home supply constraints approaching. Simplistically, this should lead to lower vacancies and stronger rental inflation. But will this be the case in the currently weak economic environment?

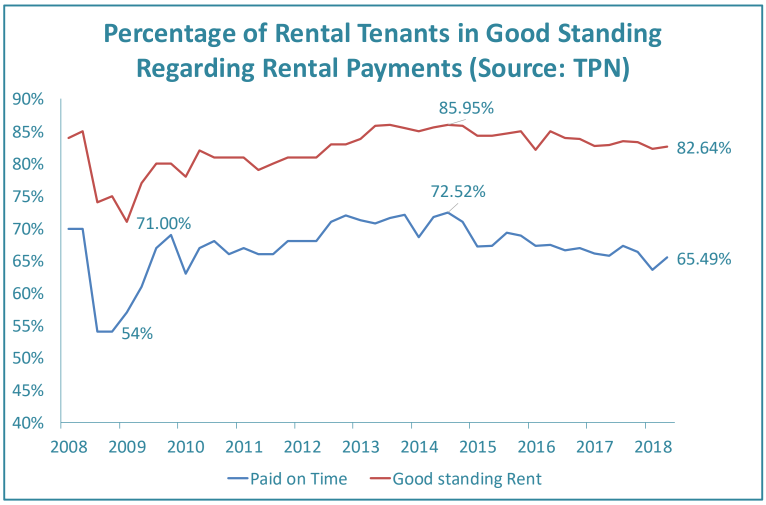
In recent months, according to StatsSA CPI (Consumer Price Index) data for residential rentals, we have seen a slowing in actual rental inflation. From a multi-year high inflation rate of 5.68% year-on-year in the September 2017 CPI survey, the rental inflation rate has tapered off to 4.19% as at the June 2018 survey. The CPI for Flat Rentals, the most affordable rental home category, outperforms House and Townhouse rental inflation, but at 5.1% year-on-year rate in this category is also off its recent inflation highs.

The mediocre rental inflation has been good news in terms of containing overall CPI inflation, thus playing a role in keeping interest rates relatively low.

However, this rental market “mediocrity” has not been wonderful news for landlords, but is perhaps understandable with hindsight. We did have rising interest rates from the early-2014 to early-2016, and rate hiking cycles do normally mean a stronger rental market, as a portion of aspirant home buyers postpone the buying decision. However, the reality was that this rate hiking cycle was tame, totaling a mere 2 percentage points’ worth of rate hiking in total. At the end of the cycle, interest rates still remained relatively low by SA standards.

In addition, a gradual broad economic growth stagnation since around 2012 has been gradually applying the pressure on the existing tenant population, limiting landlord ability to increase rentals.

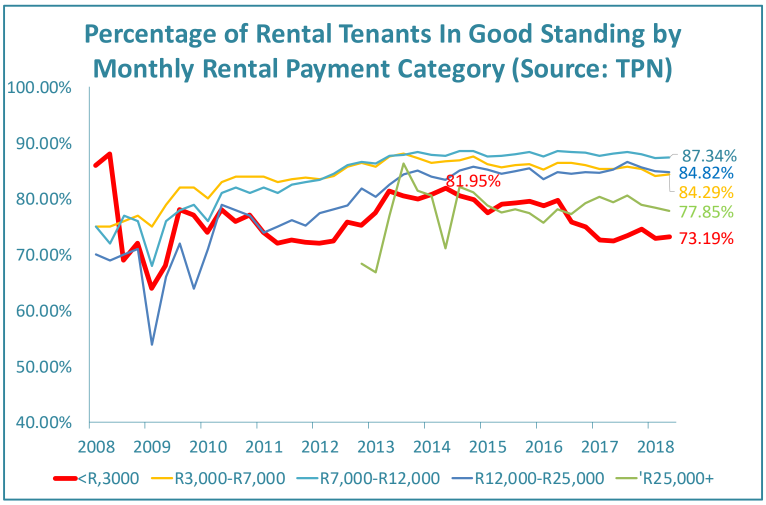




The gradually increasing pressure on tenants can be seen in TPN's data regarding the percentage of tenants "in good standing" with their landlords regarding rental payments.

From a high of 85.95% of total tenants being tenants "in good standing" as at the 3rd quarter of 2014, the percentage has gradually declined to 82.64% as at the 2nd quarter of 2018.

Tenants in good standing have not all paid on time, some paying but paying late. The financial pressure can be seen in an increased portion paying late, too, meaning that the percentage of tenants paying on time has dwindled by a more significant 7 percentage points from 72.52% as at the 3rd quarter of 2014 to 65.49% by the 2nd quarter of 2018.



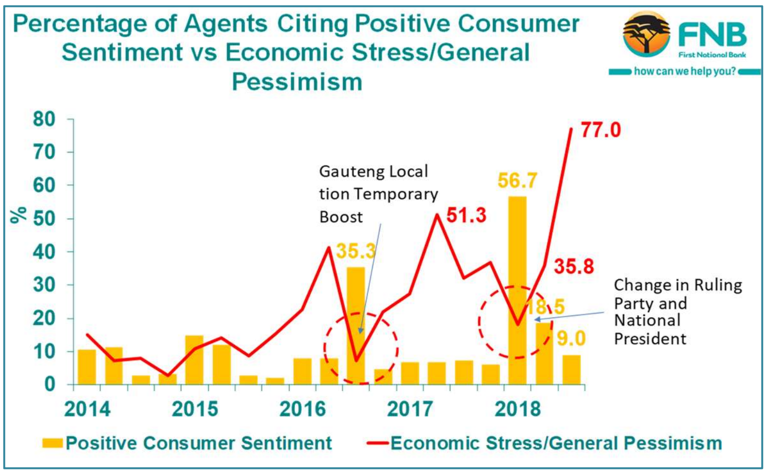
As is to be expected, the lowest income groups are hardest hit by weak economic conditions, so the most noticeable decline in the percentage of tenants in good standing has taken place in the "Below R3,000/month" Rental Category, where the percentage of tenants in good standing has dropped by a significant 8.8 percentage points from 81.95% back in 2014 to 73.19%, and is now the poorest performing rental category.

The "sweet spot" for landlords remains the R7,000-R12,000/month category, with its percentage of tenants in good standing the highest at 87.34%, having shown no noticeable decline in recent years.

WHERE TOO FROM HERE FOR THE RENTAL MARKET?

We are of the impression that a significant increase in the numbers of "aspirant" rental tenants will come about in the near term, along with a more constrained supply of rental stock. However, landlords will probably still be challenged to identify the strong tenant from the financially pressured ones as the economy continues to apply pressure on households in general.

In FNB's Estate Agent Survey, in the various questions regarding agent expectations of home buying market activity, a high percentage of agents now point to "Economic Stress and General Pessimism", with not only a recessionary economy making some households more cautious in their spending but also concerns around the longer term political and policy future.



From a relative low of 18% of total survey respondents citing "Economic Stress and General Pessimism" as a key factor in their market in the 1st quarter of this year, this percentage has risen sharply to 77% of total respondents by the 3rd quarter 2018 survey.

Simultaneously, the percentage of agents perceiving "Positive Consumer Sentiment" in their market has dropped from 56.7% in the 1st quarter of 2018 to 9% in the 3rd quarter.

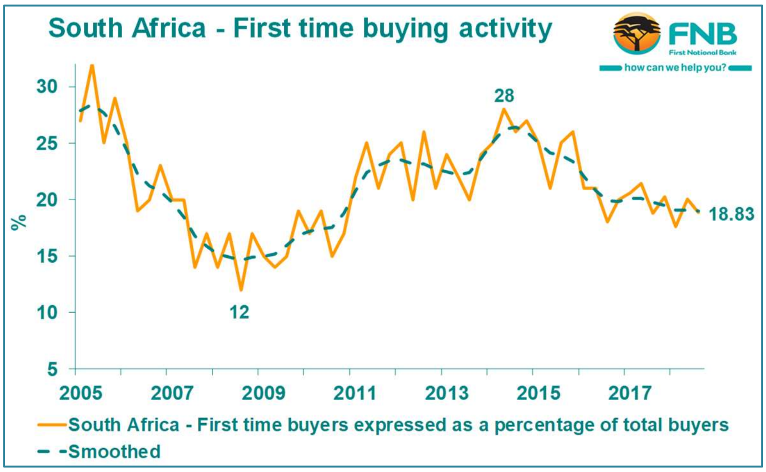
Such negative sentiment can have 4 major impacts:

1. It could very likely slow the rate of entry in to the home ownership market, which could imply a higher portion of aspirant 1st time buyers "hanging out" in the rental market for longer, boosting rental demand.
2. It could also encourage a greater portion of home sellers not to buy another home, but to opt for the rental market.
3. It could discourage buy-to-let buying, constraining rental home supply
4. It could encourage investment home owners to sell their rental properties in greater numbers, further constraining supply.

The above 4 factors, should they play out, could exert downward pressure on home values but upward pressure on rentals.

THE EVIDENCE

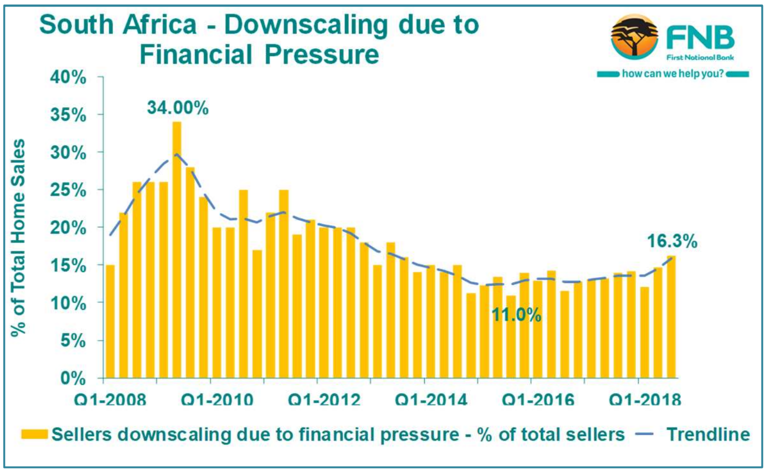
1. 1st Time Buying has been gradually stagnating

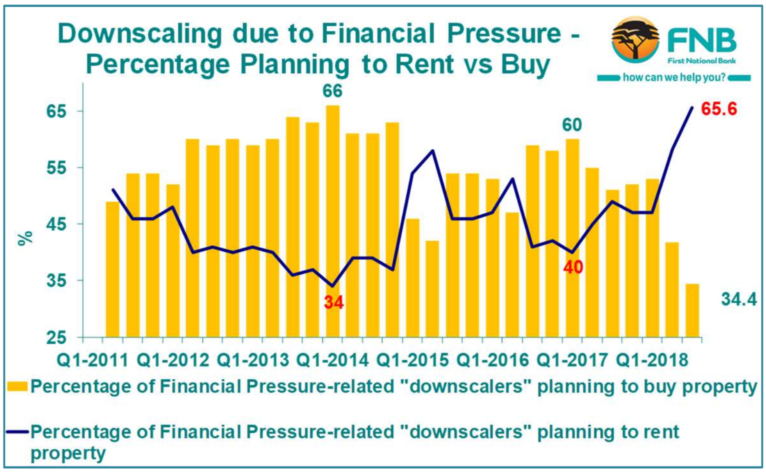


According agents surveyed, 1st time buying has declined marginally as a percentage of total home buying of late. The 3rd quarter survey returned an 18.3% 1st time buyer estimated, down on the 20.03 estimate in the previous quarter. However, quarter to quarter data can be volatile. Nevertheless, recent quarter's estimates are well down on the 28% peak reached early in 2014, and the smoothed trendline remains on a downward path.

Therefore, the evidence does suggest a gradually rising portion of aspirant 1st time buyers holding off on buying, compared to 4 years ago, which can be supportive of rental demand relative to back then.

2. Sellers aspiring to rent – signs of increased aspirations at least amongst financially pressured sellers





The only survey question relating to sellers aspiring to move into the rental market relates to the financially-pressured group of home sellers.

However, the trend in their own rental aspirations may suggest something about those of non financially pressured sellers too.

The estate agents surveyed in the FNB Estate Agent Survey suggest that SA's long economic "slow puncture" is slowly taking its toll on the Household Sector, with the 3rd quarter estimate for sellers "selling to downscale due to financial pressure" reaching 16.3%, the highest percentage since 2013.

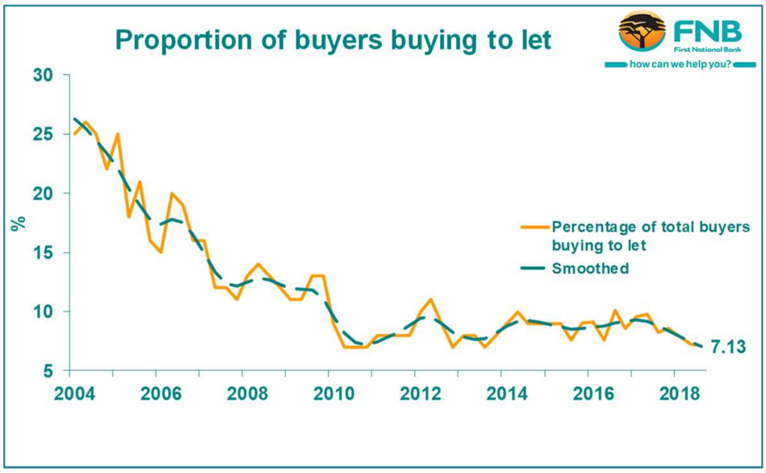
In a follow up question, we ask agents to estimate the percentage of these financially pressured sellers who intend to "rent down" versus those intending to "buy down"

The recent results have been significant, with those believed to be moving into the rental market having risen from 40% as at the 1st quarter of 2017 to 65.6% of the total as at the 3rd quarter of 2018 survey.

This reflects a growing caution amongst this group of sellers, fueled perhaps by increasing economic and future policy uncertainty over and above rising financial pressure.

This financially pressured group of sellers is not necessarily the "sweetspot" for landlords in terms of future ability to pay rent on time, but it may say something about other groups of sellers too, such as the massive group of ageing homeowners downscaling due to life stage, or the growing group of aspirant emigration-related sellers who may be looking for short term rentals. It is possible that the other groups of sellers are also becoming more cautious in uncertain times, and that this rise in rental aspirations amongst the financially pressured sellers is to an extent indicative of the trend in the broader seller population.

3. Buy-to-Let Buying

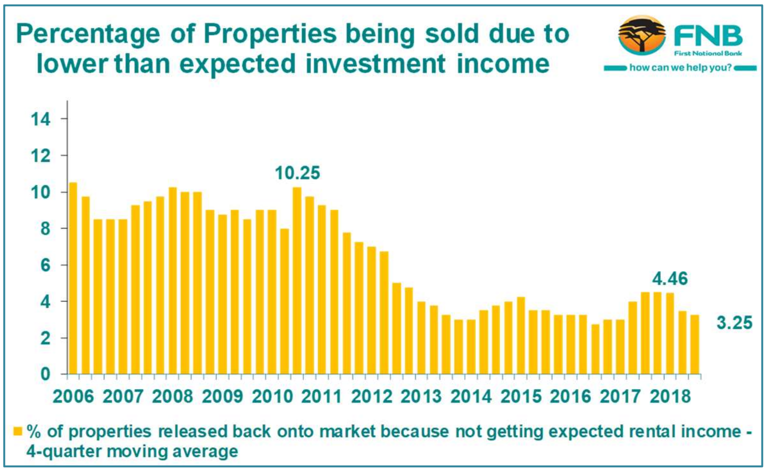


The one key indicator of future rental home supply is the FNB Estate Agent Survey's estimate of the kevel of buy-to-let buying.

As a percentage of total home buying, buy-to-let buying has dwindled to 7.13% by the 3rd quarter of 2018. This is a slide from 9.77% as at the 2nd quarter of 2017, and the lowest estimate since 2013.

It stands to reason that tougher and more uncertain economic and policy times should constrain non-essential buy-to-let buying, and that's what appears to be taking place.

4. Selling off of investment properties



We would also expect some increase in the selling of investment properties, given greater financial pressure on a certain portion of the landlord population, as well as weaker expectations regarding the future performance of the asset class.

However, while hearing rumours to this effect periodically, to date we have not seen noticeable evidence of this in the FNB Estate Agent Survey.

We ask agents for an estimate of the percentage of properties put on the market that are investment homes being sold due to owners not getting the expected rental income.

Using a 4-quarter moving average to smooth what can be a volatile data series, we see that for the 4 quarters up to the 3rd quarter of 2018 the estimate is a lowly 3.25%, actually lower than the 4.46% estimate as at the 1st quarter of the year.

IN CONCLUSION

In a nutshell, there are some emerging signs that the rental market could be in for a mildly better run in the near term. Tough economic times, with perceived uncertainty in the political and policy environment, can put the brakes on 1st time buyer levels, a portion of aspirant 1st time buyers typically choosing instead to wait it out in the rental market. In addition, a greater portion of sellers can choose to rent after selling as opposed to buying again, and we do see agents pointing strongly to such trends at least amongst a growing group of financially pressured sellers.

On the rental home supply side, we are seeing indications of declining levels of buy-to-let home buying, but not yet of rising investment home selling in the Estate Agent Survey.

Rising rental demand, and more constrained new supply of rental homes, could conceivably see rental inflation picking up mildly, outperforming lowly house price inflation in the next few years, and translating into gradually rising yields on residential properties.

But it remains tough to predict, and we certainly wouldn't expect any rental market "boom". Rather, a moderate and gradual strengthening at best. Important to remember is that levels of financial stress/pressure on households is rising, and a significant portion of the aspirant tenant population won't necessarily be financially strong.