TPN Rental Monitor

Residential tenant performance dips sharply in Q2

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In This Edition:

The percentage of total tenants that were recorded as being in good standing with their landlords dropped sharply in the 2nd quarter of 2020. From 81.52% of tenants being in good standing in the 1st quarter, the percentage declined to 73.5% in the 2nd quarter, a decline of 8 percentage points.

The weakening tenant performance since 2014/15 has seen the lowest rental value band segment leading the way. This is not surprising, given that the "Less than R3,000/month" segment is populated by the most financially fragile tenant population, with significantly fewer financial "buffers" with which to weather any storms that translate into income loss, or those unexpected household expenses that arise periodically. However, the highest R25,000+/month segment has suddenly caught up to the lowest segment's weakness.

The Western Cape tenant data continues to outperform the other 2 major provinces, namely Gauteng and KZN, despite also seeing a considerable 2nd quarter drop in the percentage of tenants in good standing. From 86.88% in the 1st quarter of 2020, the Western Cape's percentage of tenants in good standing dropped to 80.86% in the 2nd quarter. By comparison, Gauteng dropped from 79.81% to 71.1%, while KZN fell from 79.15% to 70.83%. Therefore, while the Western Cape cannot avoid the severe impact of lockdown entirely, it continues to show a resilient tenant population relative to the other major 2 provinces.

On a national average basis, TPN's average rental value inflated by 1.63% year-on-year in the 2nd quarter of 2020. This represents the 12th consecutive quarter of slowing year-on-year inflation. The pace of slowing inflation has also picked up speed in recent quarters, declining from 2.61% in the 1st quarter of 2020. This slowing continues a broad trend from a multi-year high of 5.49% in rental inflation as at early-2015.

The weakening rental inflation nationally is explained by an increasing supply of rental space relative to demand, as shown in a rising national average vacancy estimate. The estimate emanates from a TPN survey of letting agents. From a 7.47% rate in the 1st quarter of 2020, the estimate national vacancy rate rose sharply to 11.39% in the 3rd quarter of 2020.

Tenant performance dips sharply in the 2nd quarter as lockdown turns up the financial heat

The percentage of total tenants that were recorded as being in good standing with their landlords dropped sharply in the 2nd quarter of 2020. From 81.52% of tenants being in good standing in the 1st quarter, the percentage declined to 73.5% in the 2nd quarter, a decline of 8 percentage points.

Those tenants that paid on time (those who paid late and those with grace periods making up the rest of the tenants in good standing) amounted to 59.48% of total tenants in the 2nd quarter, down from 64.84% in the previous quarter.

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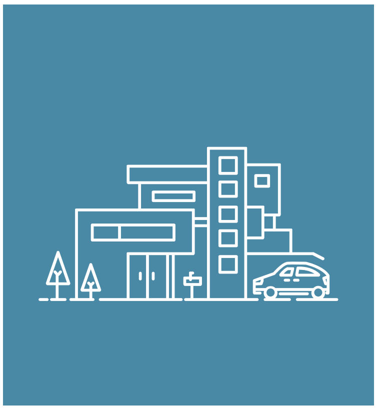
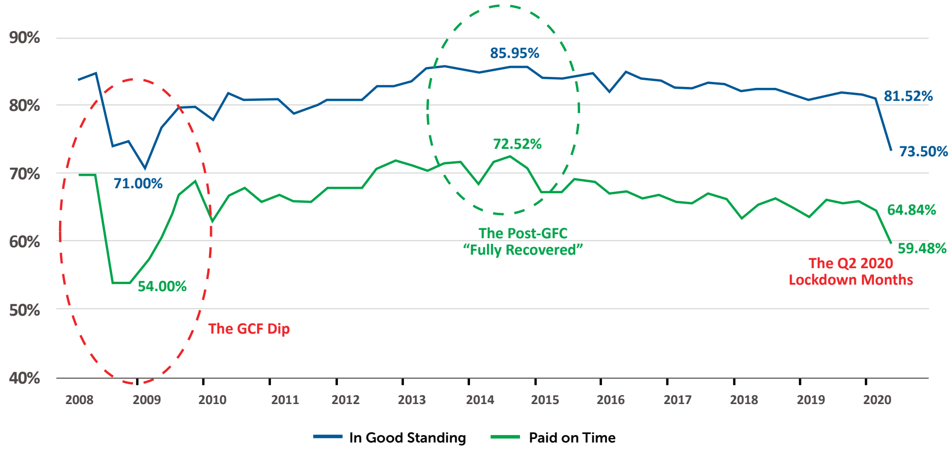


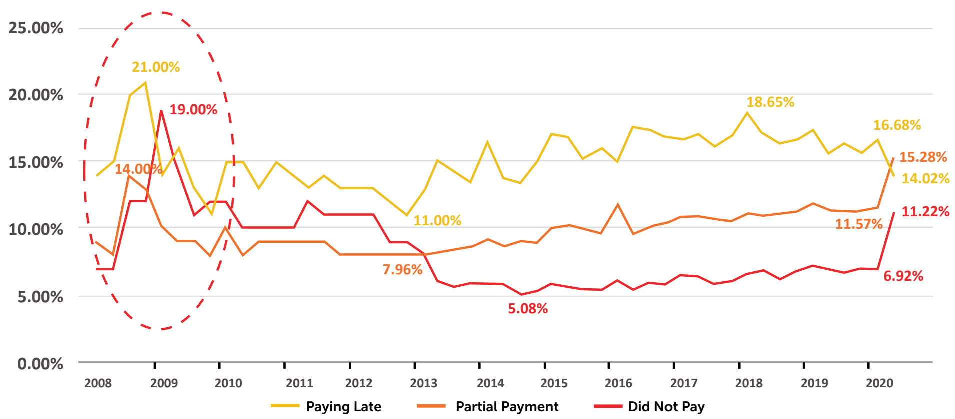
RESIDENTIAL TENANTS IN GOOD STANDING vs PAID ON TIME



This all translates into quarterly increases in the percentage of tenants “partially paying” or “not paying at all”. Interestingly, though, is that the percentage paying late remained on the decline in the 2nd quarter.

From 11.57% in the 1st quarter, the percentage of tenants making a partial payment jumped to 15.28%. The percentage who did not pay also rose from 6.92% to 11.22% over the same 2 quarters. However, the percentage paying late declined from 16.68% to 14.02% after having been on decline from a few preceding quarters.

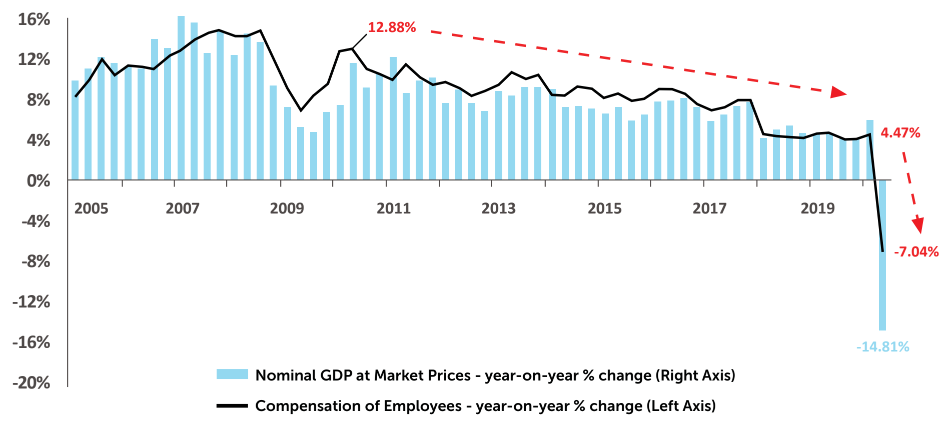
RESIDENTIAL TENANTS PAYING LATE, PAYING PARTIALLY OR NOT PAYING



The sharp weakening in tenant performance is strongly related to the COVID-19 lockdowns, the most severe lockdown months being in April and May. These widespread business shutdowns likely saw many tenants lose either part or all of their income, especially amongst those employees with more flexible remuneration arrangements, for example casual labour and those that are commission based.

In addition, the tenant population went into the lockdown period already under some heightened financial pressure, caused by a long term stagnation in South Africa’s economy, its economic growth having broadly slowed from around 2011/12 to 2019. By the 2nd half of 2019 and early-2020, the country was already in mild recession even without any lockdowns. Economic stagnation had been taking its toll on tenants, and we had already seen a multi-year decline in the percentage of tenants in good standing, from a decade high of 85.95% back in 2014 to 81.52% in the 1st quarter of 2020, prior to the lockdown.

NOMINAL GDP GROWTH vs WAGE BILL GROWTH

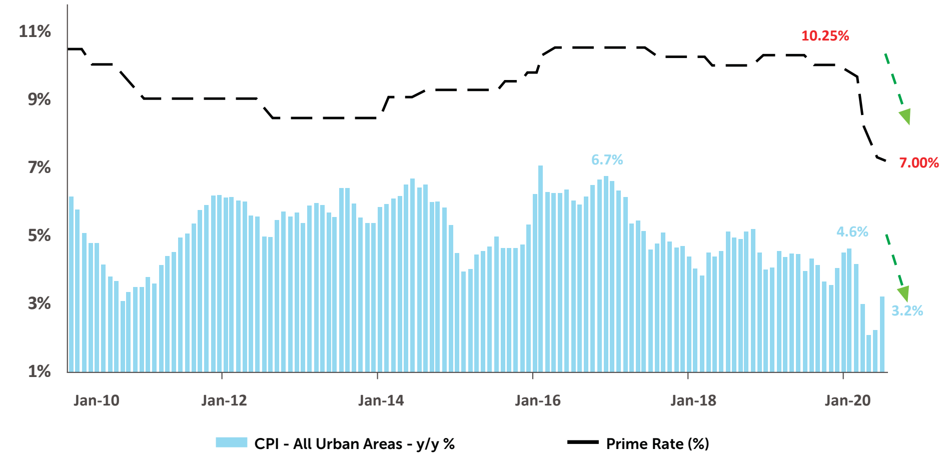


The gradual tightening financial squeeze on the Household Sector since 2012 can be seen in StatsSA Domestic Wage Bill data, whose year-on-year rate of increase slowed from a decade high of 12.88% in the 2nd quarter of 2010 to 4.47% by the 1st quarter of 2020, a growth rate by then battling to keep ahead of the rising cost of living.

Then came the 2nd "lockdown" quarter, which saw a decline of -7.04%, driven lower by a Nominal GDP decline of -14.81% year-on-year. This slowdown in wage bill growth has been a key influence in slowing Household Disposable Income growth over a similar period.

Some macroeconomic factors have assisted the tenant population in part though, and although not fully offsetting the economic weakness of recent years, the situation could have been far worse if it had not been for these partial financial "cushions".

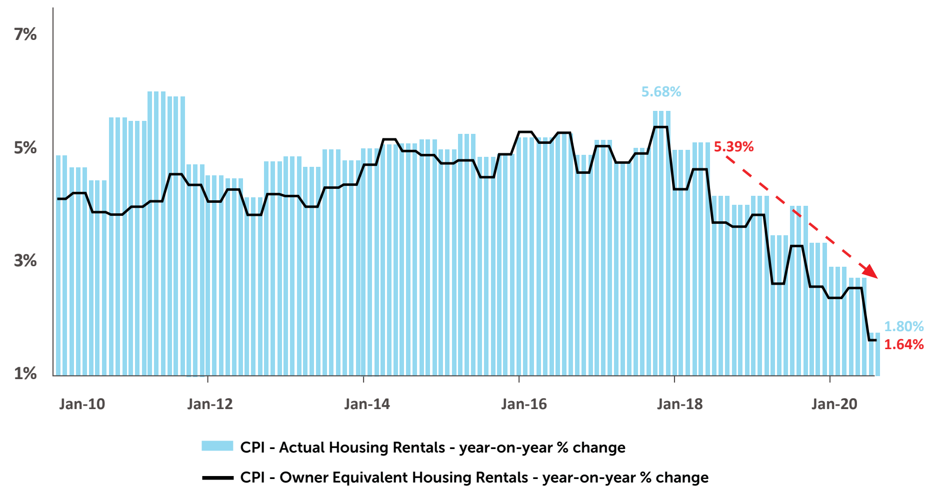
CONSUMER PRICE INFLATION AND PRIME RATE



In this weak economic environment, consumer inflationary pressures have been subdued as the pricing power of many suppliers in the economy diminishes.

Besides being a direct financial "cushion" to households, this has also given the Reserve Bank (SARB) ample scope to lower interest rates in a time where significant short term support was required for businesses and households through a severe recession.

HOUSING RENTAL CPI INFLATION



Assisting with taking CPI inflation lower and slowing rental inflation, as witnessed in the CPI for Actual Rentals as well as in the CPI for Owner Equivalent Rentals, two indices which make up a significant weighting in the overall CPI. From a high of 5.68% year-on-year in late-2017, actual rental inflation has slowed to 1.8% as at June 2020 according to StatsSA.

This weakening in rental inflation has not only assisted in bringing interest rates down, but has also contained direct rental inflationary pressure on rental households' finances.

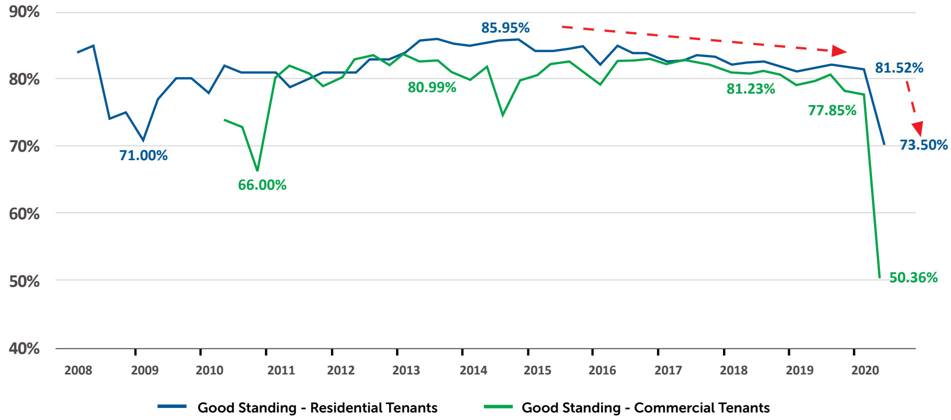
The COVID-19 crisis economic shock less severe on residential tenants than commercial tenants

Comparing the Commercial Tenants in Good Standing Percentage with the Residential Tenants in Good Standing Percentage, we see a far more severe shock to commercial tenants. Whereas the residential tenant percentage dropped by 8 percentage points to 73.5%, the commercial percentage fell far more sharply from 77.85% to 50.36%.

This may or may not have implications for the residential market. It is possible that the 2008/9 Global Financial Crisis impact was more even between the 2 markets, although we can't say for sure because TPN commercial tenant data only started in 2010. We believe this because the 2008/9 shock was more of a demand shock to the economy, export demand weakening on the back of a global recession and interest rate hiking slowing credit demand and ability to repay. All through that crisis, businesses were open, with demand levels being their main challenge.

The COVID-19 crisis was a supply shock, where Government forced a large part of the economy to shut down altogether, i.e. in some cases, 100% of sales income lost. All this time, interest rates remained low and were actually cut aggressively. The initial hard

RESIDENTIAL TENANTS IN GOOD STANDING vs COMMERCIAL TENANTS IN GOOD STANDING



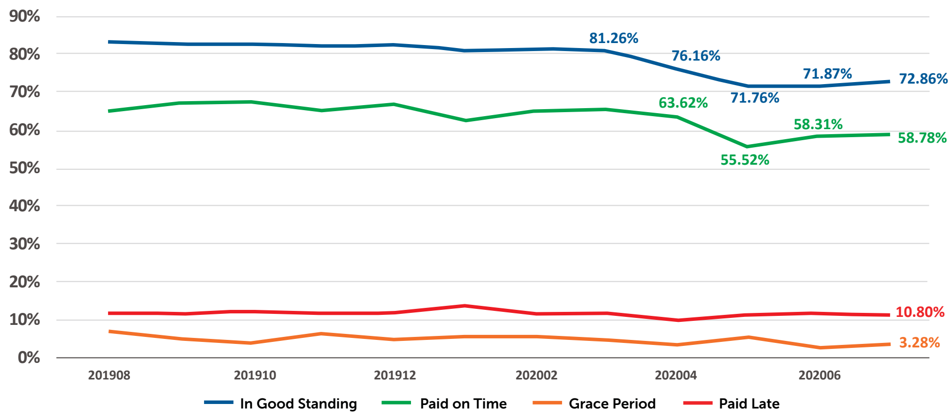
impact from this lockdown was on the commercial sector, and later the impact would be felt by the Household Sector in terms of job and income loss. The question now is how much of the impact has the Household Sector felt to date? Is there significantly more job shedding still to come? We can't easily quantify this, but the very weak state of commercial tenants is ominous and poses a significant risk to job security should the recovery not be swift. That, in turn, poses some risk to the Residential Rental Market.

Provisional monthly data to July shows some stabilisation in tenants in good standing post-lockdown

While the 2nd quarter average percentage of tenants in good standing dropped sharply from the 1st quarter, broken up on a monthly basis there is some indication of stabilisation and mild improvement heading into the 3rd quarter. From 81.26% in March, the monthly percentage of tenants in good standing fell to a low point of 71.78% by May, but actually improved marginally to 72.86% as at July. This data is preliminary data and could be revised over time. It does however suggest that the fall has been halted as lockdown has eased.

We will have to wait and see if there are any lagged negative impacts still to come from the sharp 2nd quarter economic contraction.

RENTAL GOOD STANDING

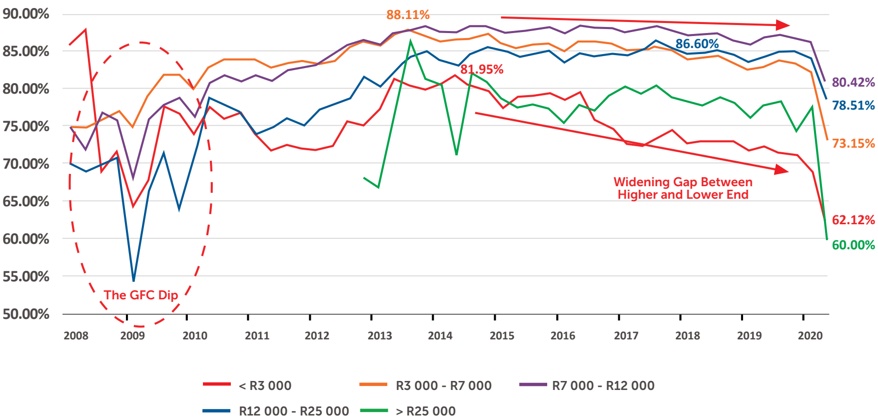


Low end tenants led the market as weakest in term so of payment performance, but the highest value segment has recently caught up

The weakening tenant performance since 2014/15 has seen the lowest rental value band segment leading the way. This is not surprising, given that the “Less than R3,000/month” segment is populated by the most financially fragile tenant population, with significantly fewer financial “buffers” with which to weather any storms that translate into income loss, or those unexpected household expenses that arise periodically. However, the highest R25,000+/month segment has suddenly caught up with the lowest segment’s weakness.

Up until the 1st quarter of 2020, the performance gap between this segment’s tenants and the higher rental value segments had been steadily widening, all segments having seen their percentage in good standing declining since around 2014/15 but the others declining by far less.

TPN PERCENTAGE OF RESIDENTIAL TENANTS IN GOOD STANDING WITH LANDLORDS BY SEGMENT - RENTAL VALUE



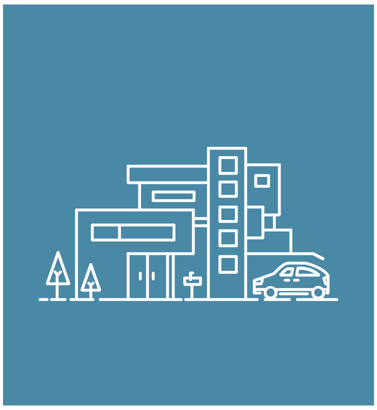
At the other end of the performance spectrum was the very solid R7,000-R12,000/month rental segment. This segment has been known as the top performer from a tenant population point of view since 2013, and it has retained the relative “outperformer status” in the 2nd quarter of 2020 despite also having declined quite significantly.

From 86.3% of tenants in good standing in the 1st quarter of 2020, the R7,000-R12,000/month segment’s percentage dropped to 80.42% in the 2nd quarter.

The R12,000-R25,000/month segment was the 2nd best performer, with the percentage of tenants in good standing dropping from 84.28% in the 1st quarter to 78.51% in the 2nd quarter, while the R3,000-R7,000/month segment fell from 82.39% to 73.15% over the same 2 quarters.

The big “race to the bottom”, however, was between that “Less than R3,000/month” low income end and the least affordable R25,000+/month top end, the former dropping from 69.23% to 60% over the 2 quarters, and the latter dropping all the way from 78% in the 1st quarter to 62.12% in the 2nd quarter.

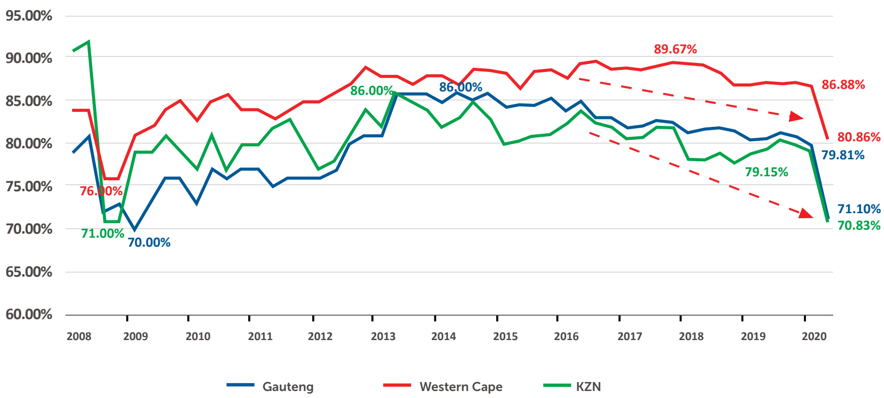
Therefore, the middle segment of the 5 rental value segments remains the relative outperformer of the 5, with the very low end and the very high end showing the weakest tenant performances. At the very low end we believe it is due to this group having few if any financial buffers to weather economic and financial storms, while at the very high end it is more likely to be financial over-commitment.



Western Cape still the best provincial performer

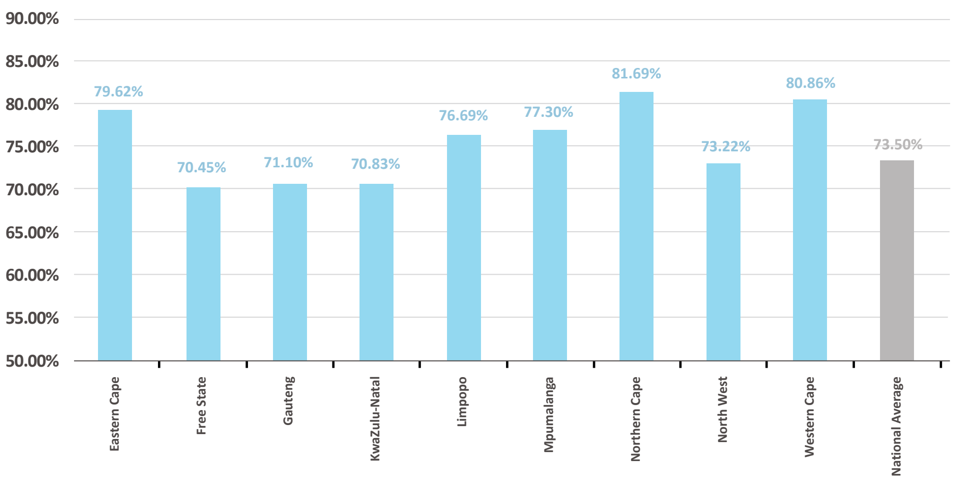
The Western Cape tenants continue to outperform the other 2 major provinces, namely Gauteng and KZN, despite also seeing a considerable 2nd quarter drop in the percentage of tenants in good standing. From 86.88% in the 1st quarter of 2020, the Western Cape's percentage of tenants in good standing dropped to 80.86% in the 2nd quarter. By comparison, Gauteng dropped from 79.81% to 71.1%, while KZN fell from 79.15% to 70.83%. Therefore, while the Western Cape cannot avoid the severe impact of lockdown entirely, it continues to show a resilient tenant population relative to the other major 2 provinces.

TPN RESIDENTIAL TENANTS IN GOOD STANDING WITH THEIR LANDLORDS BY MAJOR PROVINCE



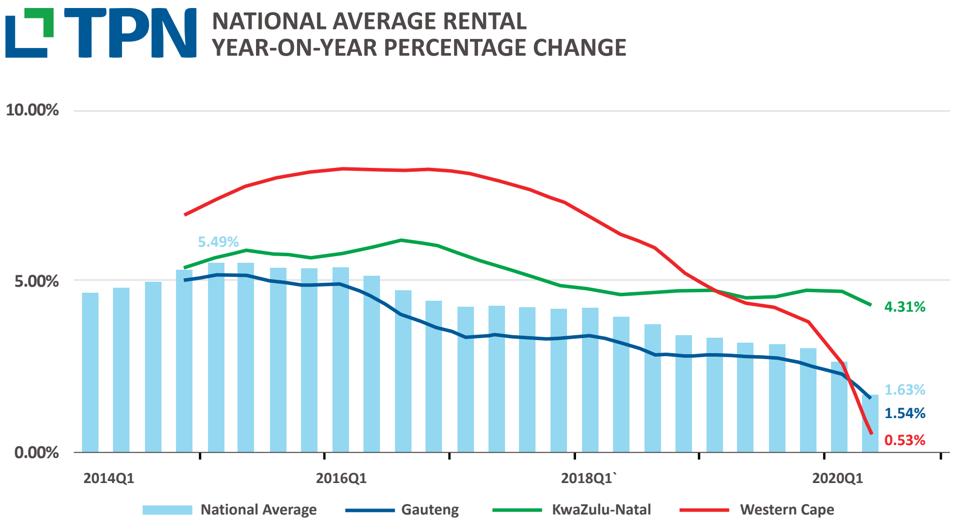
In fact, the Western Cape outperformed all but the smallest province, the Northern Cape, during the 2nd quarter, the latter having a smaller 2nd quarter decline in the tenants in good standing percentage than the Western Cape. That certain minor provinces may have experienced less of a negative impact on their economies and tenant populations in the 2nd quarter would not come as a surprise. The smaller provinces have a significantly greater share of Agriculture in their GDP than the provinces that have major metros in them, and Agriculture was a far less affected industry in terms of being locked down. Many of the more rural regions thus had less disruption to their economies, and possibly less household income loss as a result.

TPN RESIDENTIAL TENANTS IN GOOD STANDING BY PROVINCE



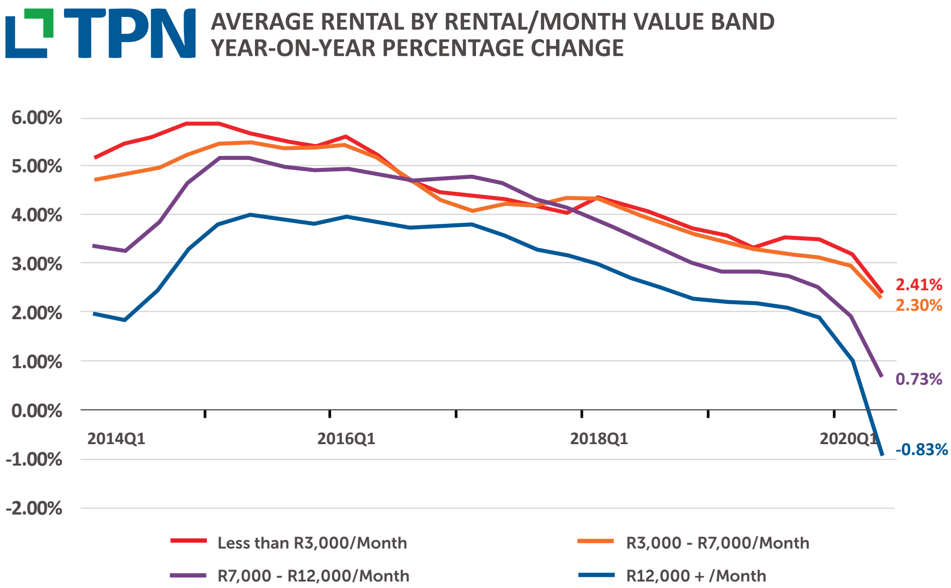
Rental inflation slows, with deflation territory getting closer

Average rentals across South Africa saw their inflation slow again in the 2nd quarter of 2020.



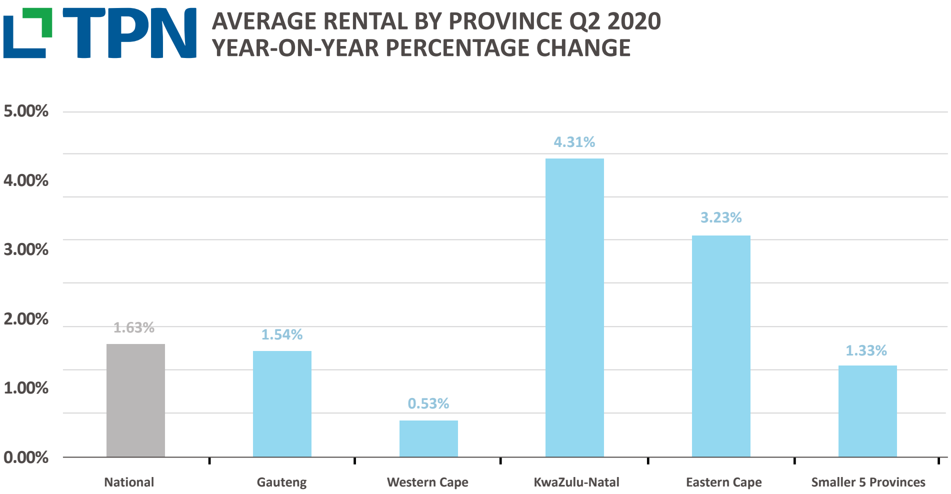
On a national average basis, TPN's average rental value inflated by 1.63% year-on-year in the 2nd quarter of 2020. This represents the 12th consecutive quarter of slowing year-on-year inflation. The pace of slowing inflation has also picked up speed in recent quarters, from 2.61% in the 1st quarter of 2020.

This slowing continues a broad trend from a multi-year high of 5.49% in rental inflation as at early-2015.



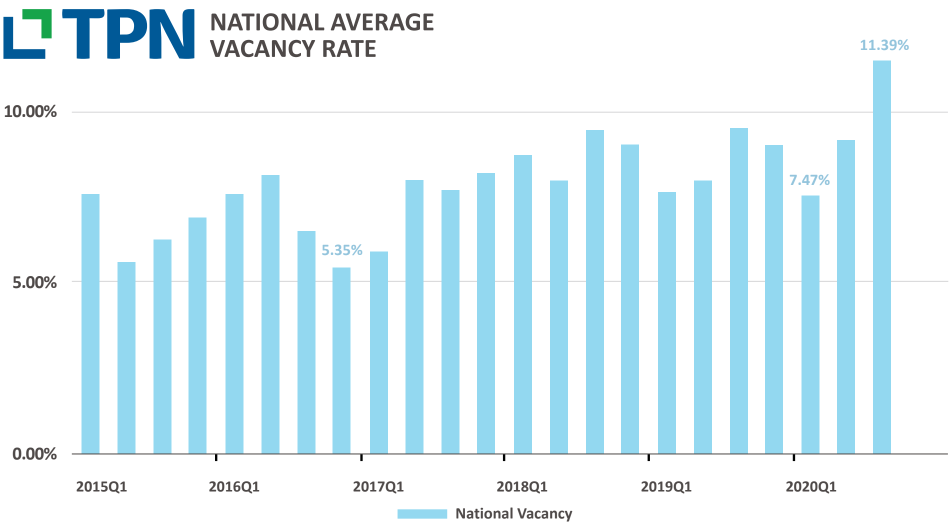
Although the Western Cape has the strongest tenants in terms of their rental payment performance, affordability may be curbing that province's demand for rental homes more than the other major provinces. Up until 2018, the Western Cape had by far the highest rental inflation compared to Gauteng and KZN, representing a significantly sharper affordability deterioration during that period. As at the 2nd quarter of 2020, the Western Cape's rental inflation of 0.53% year-on-year was coming very close to negative territory.

Interestingly, by rental/month value bands, the "Less Than R3,000/month segment has the highest rental inflation at 2.41% year-on-year, while the highest (for rental inflation purposes) value segment of R12,000+/month has the lowest, moving into negative territory to the tune of -0.83%. The relative outperformance of the lowest segment appears unlikely to last, as this segment has some of the most severe tenant financial pressure along with a high estimated vacancy rate.



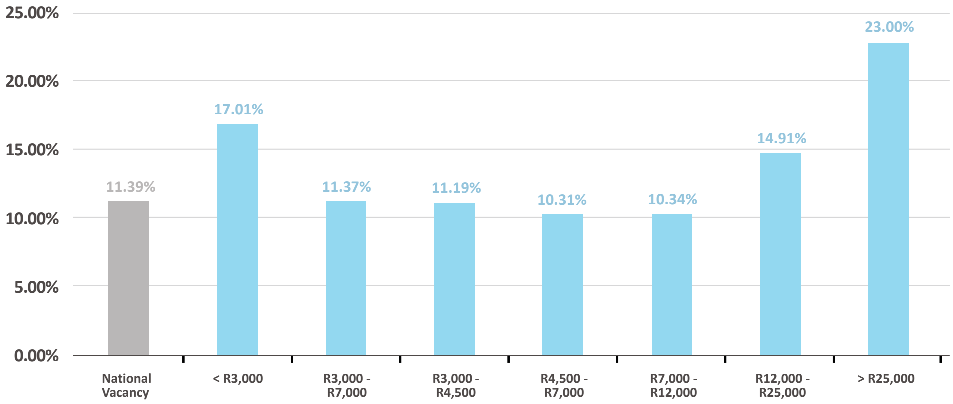
A rising vacancy rate into the 3rd quarter points to further slowdown in rental inflation to come

The weakening rental inflation nationally is explained by an increasing supply of rental space relative to demand, as shown in a rising national average vacancy estimate.



The estimate emanates from a TPN survey of letting agents. From a 7.47% rate in the 1st quarter of 2020, the estimate national vacancy rate rose sharply to 11.39% in the 3rd quarter of 2020.

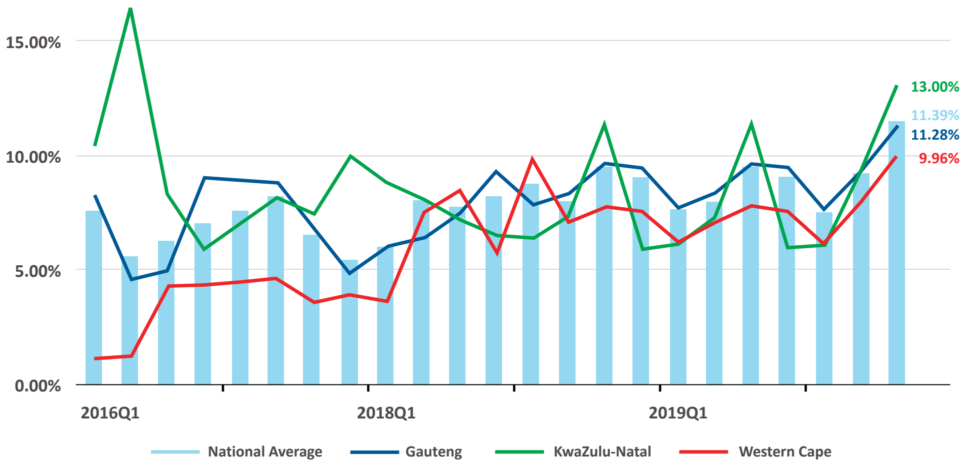
AVERAGE VACANCY BY RENTAL/MONTH VALUE BAND Q3 2020



The 2 segments with the weakest tenant payment performance, i.e. "Less than R3,000/month and R25,000+/month have the 2 highest vacancy rates as well, i.e. 17% and 23% respectively.

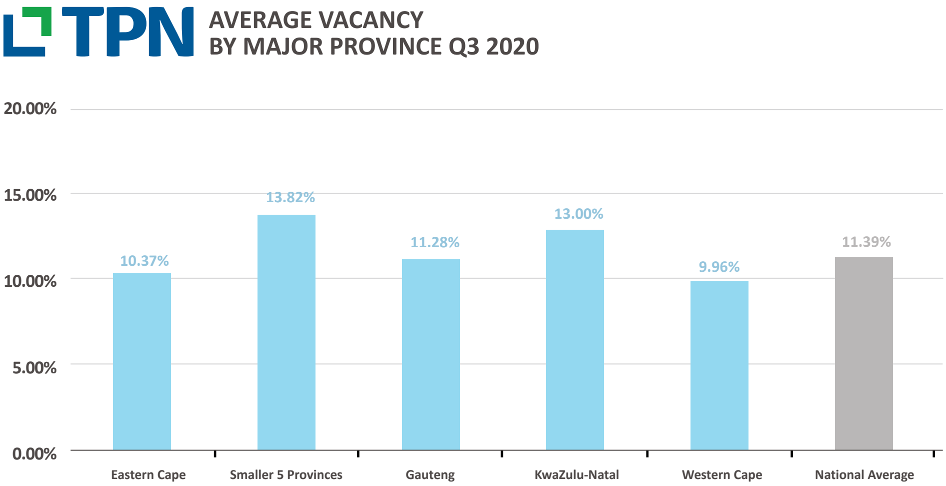
By major province, KZN has the highest estimated average vacancy rate in the 3rd quarter, to the tune of 13%, followed by Gauteng's 11.28% and Western Cape's 9.9%.

VACANCY RATE BY MAJOR PROVINCE



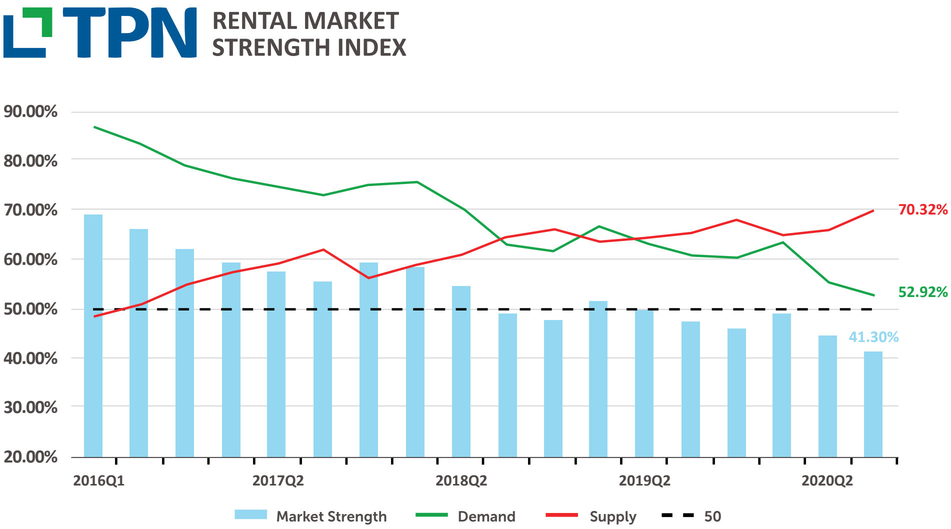
However, while the Western Cape has the lowest vacancy rate of the 3 major provinces, it has had the sharpest vacancy rate increase since early 2014, back then having been a lowly 1.16%.

The sharpest increase in vacancy rate may reflect in that province having the most significant rental inflation slowdown in recent years off the highest base.



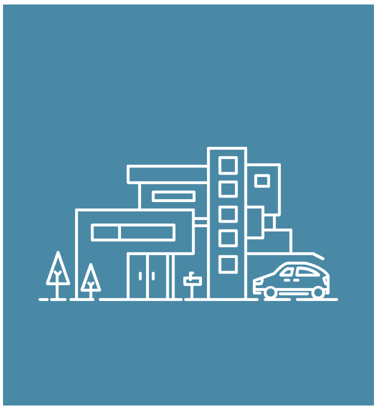
Rental Market Strength Index continues to decline pointing to supply outstripping demand

One of the surveys that TPN does of letting agents relates to their perceptions of rental market strength. In this, agents are asked to give an indication of their perception of both rental home demand as well as supply, providing a simple "weak", "average" or "strong" answer for each. We give a numerical rating to each category, 100 for "strong", 50 for "average" and zero for "weak", the average demand and the average of the supply responses thus being somewhere between 0 and 100.



The Market Strength Index, also on a scale of 0 to 100 reflects the gap between the Supply Rating and the Demand Rating (scaled to 0 to 100) where above 50 reflects demand exceeding supply and vice versa for a rating below 50.

The multi-year weakening in the economy is reflected in a steady decline in the TPN Rental Market Strength Index since its inception in 2016, at which stage it was near to 70, to 41.3 by the 3rd quarter of 2020, where demand is significantly below supply according to the survey respondents.



Conclusion

In a nutshell, the recent set of TPN indicators continued to point to the continued weakening of the Residential Rental Market. The TPN Market Strength Index continued to point to an increasing excess supply over demand, while the average vacancy rate rose noticeably again in the 3rd quarter and is now in double-digits.

TPN average rental inflation continued to slow in the 2nd quarter, and at 1.6% year-on-year is negative in “real terms”, i.e. when adjusted for economy-wide inflation. Average rental deflation is becoming a real possibility. While low rental inflation may seem to be a negative for landlords on the one hand, the positive side of it is that it has contributed to low consumer price inflation (rentals being a significant weighting in the Consumer Price Index), and as such has assisted in taking interest rates lower for the bonded landlords.

Tenant payment performance dropped significantly in the 2nd quarter, driven lower by a sharply negative economic growth rate and the swift loss of household income that it brought about for a portion of tenants.

Encouragingly, though, monthly preliminary tenant payment data points to slight performance improvement in June and July as lockdown eased and the economy started up again. Full recovery back to pre-COVID-19 levels is probably some way off, and such mild tenant performance improvements don’t yet appear sufficient to halt further market weakening.