TPN Rental Monitor

Tenant performance begins a muted recovery in a battling economy

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In This Edition:

The percentage of total tenants that were recorded as being in good standing with their landlords improved mildly in the 3rd quarter of 2020, following the sharp 2nd quarter lockdown-related weakening. From 73.5% of tenants being in good standing in the 2nd quarter, the percentage increased slightly to 74.57% in the 3rd quarter. The muted recovery to date can be largely explained by an economy battling to recover, translating into a still-weak employment situation. In the 3rd quarter, total employment was still sharply down by -10.3% year-on-year, only marginally less weak than the -13.3% year-on-year drop in the 2nd quarter. This remains a severe situation, and impacts on a portion of the tenant population's incomes.

Weak tenant performance is most pronounced in the lowest rental value band. 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, which was performing virtually as poorly as the R3,000/month segment in the 2nd quarter, has rebounded significantly in the 3rd quarter. But the middle R7,000-R12,000/month segment remains the relative "sweet spot" from a tenant performance point of view.

The Western Cape tenant population continues to be the best performing of the major 3 provinces (the other 2 being KZN and Gauteng). However, it is now some of the smaller provinces whose tenant populations are the best performers overall. The top 4 performing tenant populations are Northern Cape, with 81.46% of tenants in good standing, Mpumalanga with 80.91%, Western Cape with 80.25% and Eastern Cape at 79.98%. Gauteng was the worst performing province in the 3rd quarter, with 71.85% of tenants in good standing.

On a national average basis, TPN's average rental value inflated by a low 0.65% year-on-year in the 3rd quarter of 2020. This represents the 13th 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 estimated national vacancy rate rose sharply to 11.39% in the 3rd quarter of 2020.

TPN's average national gross yields on residential properties continued their multi-year decline, with growth in property values achieving higher rates than sliding rental inflation. The downward pressure on yields is sustained by low interest rates, which have contributed to the home buying market being noticeably stronger of late than the rental market.

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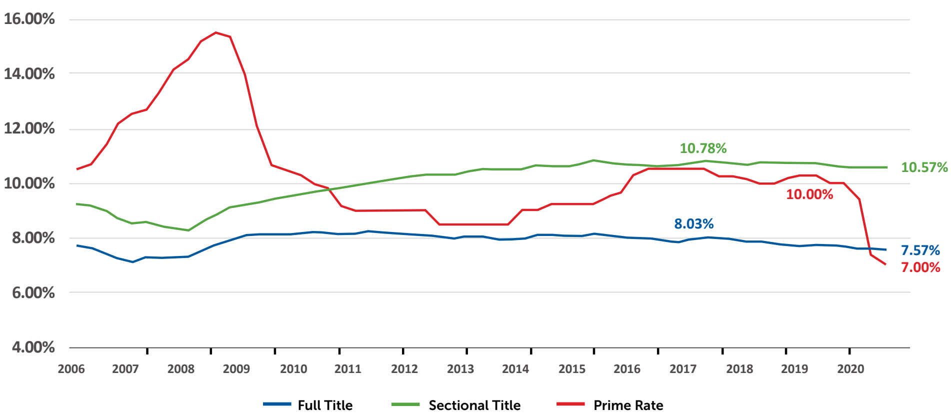
Focus: Residential yields continue to push lower, as lower interest rates keep capital growth ahead of rental growth

Residential gross yields are still on a declining trend, pushed lower by a home buying market that is stronger relative to the rental market, currently, and this is keeping growth in housing values above average rental growth. This relatively stronger home buying market is driven largely, we believe, by 3 percentage points' worth of interest rate cuts this year that has stimulated credit-dependent home buying demand following the end of the hard lockdowns in the 2nd quarter. We believe that this surge in home buying demand is largely for primary residence purposes, while buy-to-let demand likely remains weak in what are uncertain economic times.

The TPN average gross yield on sectional title properties declined slightly from 10.58% in the 2nd quarter of 2020 to 10.57% in the 3rd quarter, continuing a gradual declining trend since a decade high of 10.78% recorded in the 2nd quarter of 2017.

TPN NATIONAL AVERAGE RESIDENTIAL GROSS YIELD
SECTIONAL vs FULL TITLE



The average full title gross yield declined from 7.59% in the 2nd quarter to 7.57% in the 3rd quarter of 2020, continuing a broad downward trend from 8.03% back in the 2nd quarter of 2017.

However, the decline in interest rates in 2020 to date has far exceeded any decline in yields, increasing the attractiveness of credit-driven home buying for many, even despite declining yields on homes.

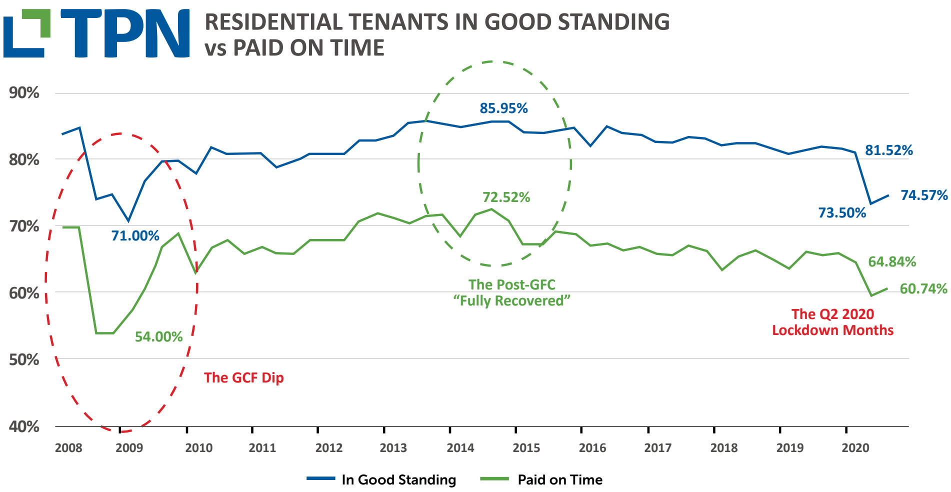
From 10% at the start of 2020, Prime Rate has declined to a lowly 7%, and this year for the 1st time on record (TPN records dating back to 2006), this borrowing rate is now lower than both the average sectional and full title gross yields.

For some aspirant investors, therefore, sharply lower lending rates of late may still make residential investment attractive despite declining yields. And for a portion of tenants who may be aspirant buyers, a far lower bond instalment on their desired home compared to 2019 has improved the attractiveness of home buying relative to renting.

Not surprisingly, therefore, we have seen a relatively strong home buying/ownership market in the post-lockdown months, but a relatively weak rental market on the other hand, as a group of would be tenants head for home ownership instead.

Tenant performance edges its way slowly back out of the lockdown dip

The percentage of total tenants that were recorded as being in good standing with their landlords rose marginally in the 3rd quarter of 2020, after having dropped sharply in the 2nd "lockdown" quarter of 2020. From 73.5% of tenants being in good standing in the 2nd quarter, the percentage rose mildly to 74.57% in the 3rd quarter. However, the level remains well-below the pre-lockdown 1st quarter percentage of 81.52%, a reflection of the lagged impact of the massive financial knock felt by the tenant population from the 2nd quarter lockdown and resultant severe economic contraction. As we had anticipated, the recovery post-lockdown appears to be stacking up to be a long and slow one.

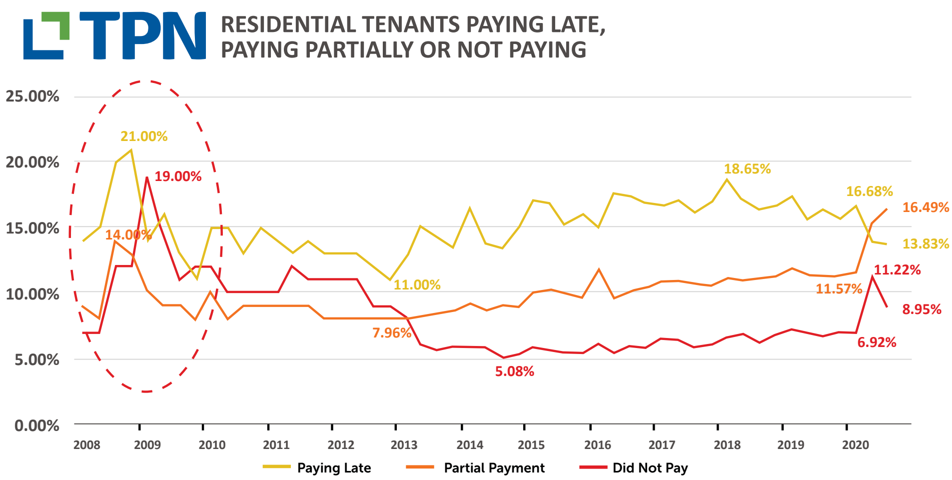


Those tenants that paid on time (those who paid late and those with grace periods making up the rest of the tenants in good standing) amounted to 60.74% of total tenants, which is slightly up from the 2nd quarter's 59.48%, but still down from 64.84% of the 1st quarter.

Examining the breakdown of those tenants that are battling to keep up with payments is insightful.

The percentage not paying at all declined in the 3rd quarter, from 11.22% in the 2nd quarter to 8.95%, as did the percentage paying late, from 16.68% to 13.83% over the same 2 quarters.

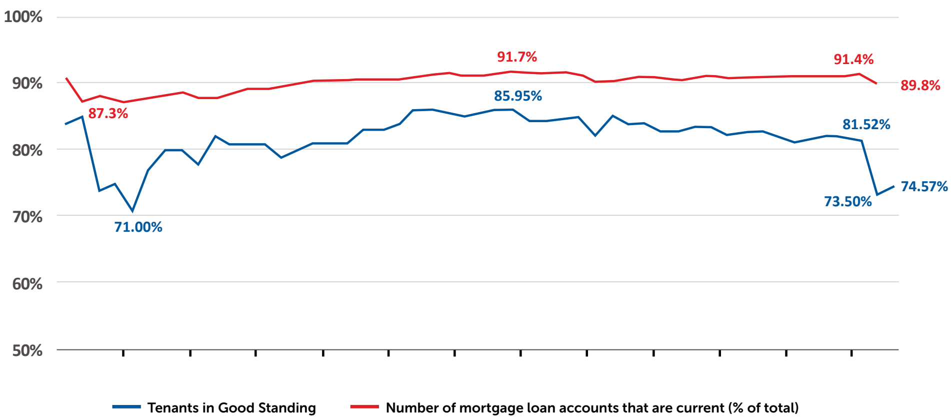
But those making partial payments continued to increase, from 15.28% to 16.49% over the 2 quarters. Partial payments are the largest component of the 2 categories of tenants not in good standing (the other category being those who did not pay at all).



The tenant market has suffered more through COVID-19 than the mortgaged home owner market to date

The tenant population of the residential market is arguably more sensitive to economic trends, which have an impact on employment and income, than the mortgage part of the home owner market. The latter also feels the impact of job loss, but is more sensitive to movements in interest rates.

TPN RESIDENTIAL TENANTS IN GOOD STANDING vs MORTGAGE LOAN ACCOUNTS THAT ARE CURRENT



Therefore, in the 2nd quarter of 2020, the percentage of rental tenants in good standing with their landlords dropped far more significantly that did the percentage of mortgage borrowers whose accounts were current (up to date with instalment payments).

Whereas the percentage of tenants in good standing with landlords dropped from 81.52% in the 1st quarter to 73.5% in the 2nd quarter of 2020, the percentage of mortgage accounts that were current dropped more mildly from 91.4% to 89.8% over the same 2 quarters, according to NCR data.

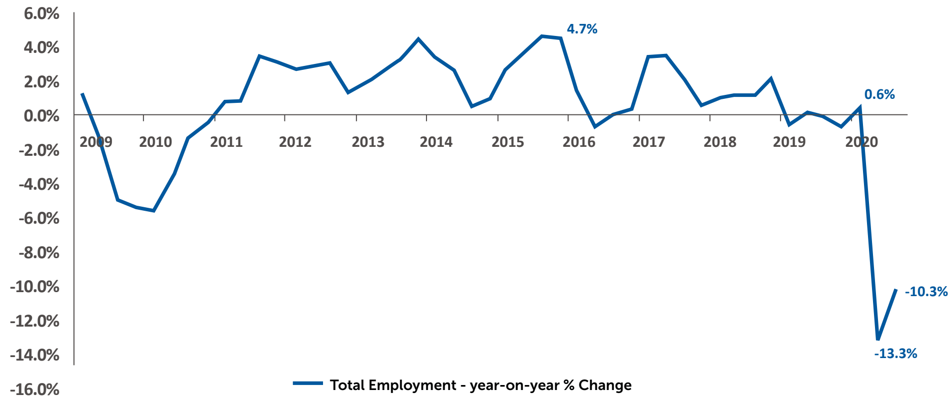
Home Mortgage Advances payment performance has typically shown greater stability over the past decade than rental tenant payment performance. This can be due to greater financial barriers to entry to the home ownership translating into, on average, a financially stronger group of households than in the case of the tenant market.

But also to home owners benefit in 2020 has been a sharp drop in interest rates from a Prime Rate of 10% at the start of the year to 7% currently, which formed part the SARB's stimulus response to the economic crisis unfolding as a result of COVID-19.

It must be acknowledged that it is too early to assess the full impact of the economic shock on either the residential mortgage lending market or the rental tenant market. But to date it would appear that the more credit-dependent and interest rate sensitive home mortgage market has been less affected by the COVID-19 Crisis than has the rental tenant population.

Economic recovery appears "partial" to date, likely explaining rental tenants' slow recovery

TOTAL EMPLOYMENT GROWTH (StatsSA)

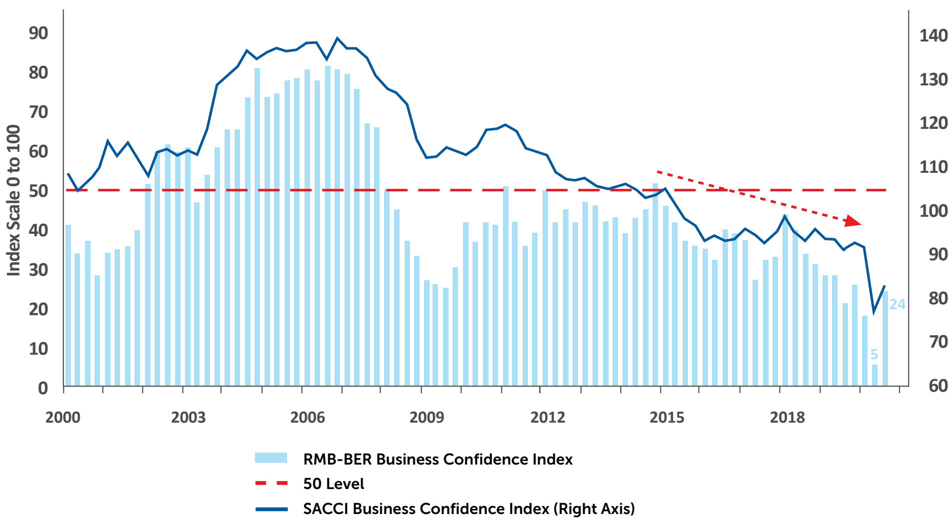


The muted improvement to date in the residential tenant population's payment performance is arguably best explained by South Africa's employment statistics for the 3rd quarter of 2020.

A sharp decline in Real GDP (Gross Domestic Product) in the 2nd quarter, caused largely by hard lockdowns, explains most of the sharp 13.3% decline in total employment in that same quarter.

Hard lockdowns were lifted, and much of the economy is free to do business once more. But while we don't have a 3rd quarter GDP number yet, the 3rd quarter employment data from StatsSA points to a weak economic improvement at best, with employment still -10.3% down year-on-year. And it is employment and income streams of households that strongly influence tenant ability to pay rent.

RMB-BER BUSINESS CONFIDENCE INDEX AND SACCI BUSINESS CONFIDENCE INDEX

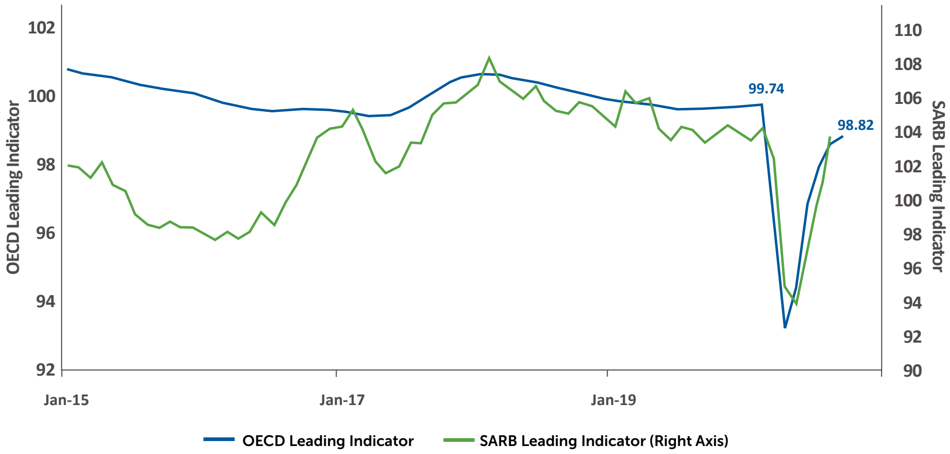


And judging by an array of economy-related indicators, the ongoing weakness in employment data in the 3rd quarter reflects an economy still battling to recover.

The RMB-BER Business Confidence Index for the 3rd quarter of 2020 improved to 24, on a scale of 0 to 100, which remains very weak despite being up from the 5 reading in the 2nd quarter.

As at September, the volume of Manufacturing Production had clawed its way back from April's sharp -48.7% year-on-year decline to be a lesser -2.6% down year-on-year. Mining Production in September was a similar -2.8% down year-on-year, while Electricity Consumed (a good indication of economic activity) was also still down to the tune of -3.3% year-on-year in the same month.

OECD AND SARB (South African) LEADING BUSINESS CYCLE INDICATORS



A more up to date leading economic indicator (incorporated in the SARB Composite Leading Business Cycle Indicator) is that of New Passenger Vehicle Sales, which declined by 25.4% down year-on-year.

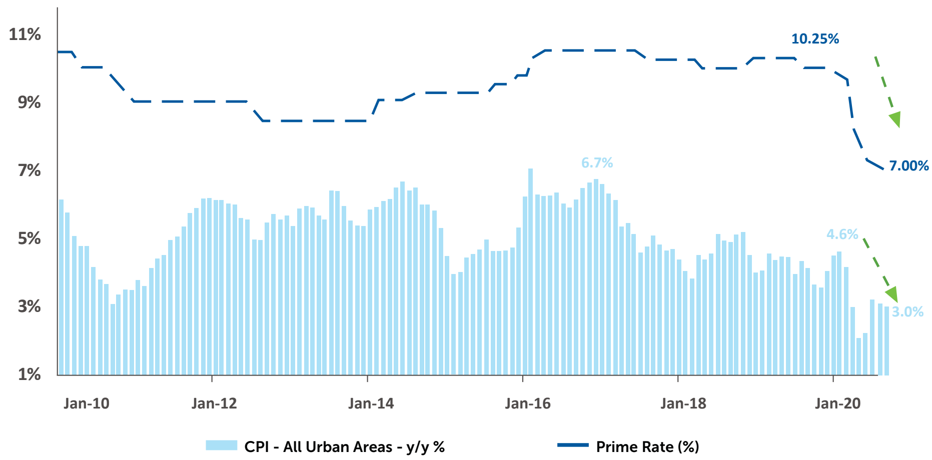
And on the topic of the Composite Leading Business Cycle Indicator, the OECD Leading Indicator for South Africa, while sharply improved by September was still down -0.8% year-on-year, while the SARB's own version was -0.5% down year-on-year as at August. These leading business cycle indicators can be useful leading indicators of economic performance in the near term, and like other high frequency data they too point to an "improved but still weak situation".

Against this soft economic growth and employment backdrop, however, weak inflationary pressures, and resultant very low interest rates, do provide something of a financial cushion for the Household Sector.

The situation could have been far worse if it had not been for the low interest rate "cushion". In this weak economic environment, consumer inflationary pressures have been subdued as the pricing power of many suppliers in the economy diminishes. As at September, CPI (Consumer Price Index) inflation was a mere 3% year-on-year, which is the bottom end of the SARB's 3-6% target range, thus allowing the Bank to remain highly accommodating regarding interest rates, and there thus exists little pressure on it to lift rates from the current level where Prime Rate of commercial banks is set at 7%. This is sharply down on the 10% level as at the start of 2020.

While lending rates may be more relevant to mortgage-dependent home buyers and owners than to tenants, many tenants would have other forms of household-related debt, and would thus still benefit from the low interest rate environment.

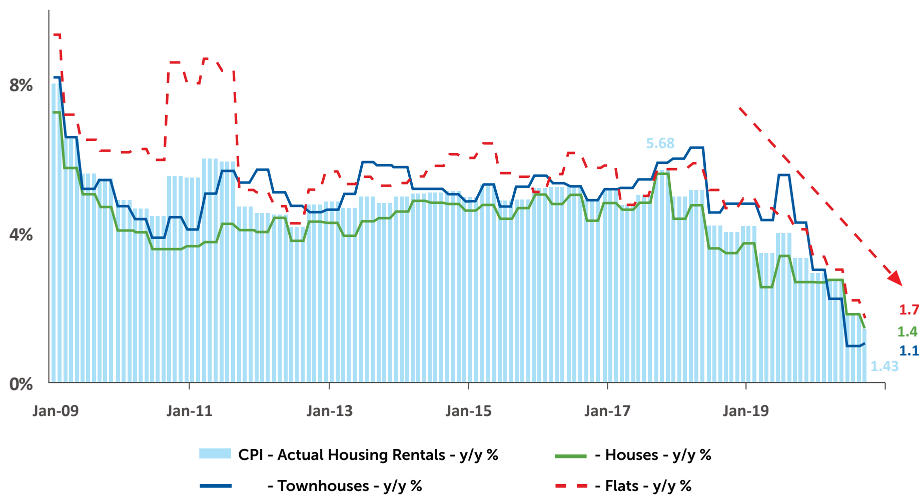
CONSUMER PRICE INFLATION AND PRIME RATE



Assisting in pushing CPI inflation lower has been 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 1.43% as at June 2020 according to StatsSA.

This weakening in rental inflation not only contributes to the low interest rate environment, but has also contained direct rental inflationary pressure on rental households' finances.

HOUSING RENTAL CONSUMER PRICE SUB-INDICES - INFLATION RATES



Low end tenants are currently the segment with the weakest rental payment performance, and they are likely to be the group that will recover the slowest

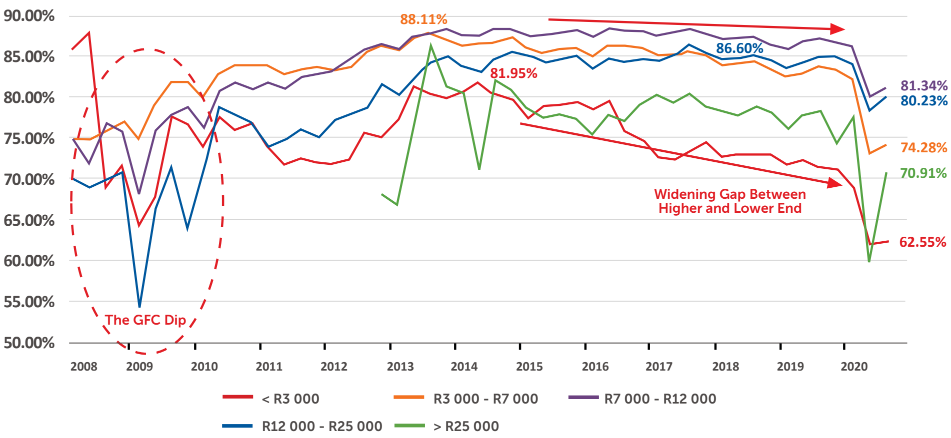
The "Less than R3,000/month" rental segment is populated by the most financially fragile tenant population, with significantly fewer financial "buffers" with which to weather any storms that translate into income loss, or those unexpected household expenses that arise periodically. Therefore, it was not surprising to see this segment lead the tenant market weaker in years of economic stagnation prior to 2020, nor is it surprising to see this segment's tenant performance being the weakest of all the segments of late.

From a lowly 62.12% in the 2nd quarter of 2020, the percentage of tenants in good standing in the “Less than R3,000/month” rental segment improved only marginally to 62.55% in the 3rd quarter.

By comparison, the 2nd weakest performing segment, i.e. the high end R25,000+ /month segment, rebounded off its 2nd quarter low far more strongly, from 60% of tenants in good standing in the 2nd quarter to 70.91% in the 3rd quarter. This segment nevertheless remains the 2nd-most poorly performing segment.

The gap between the lowest rental segment’s performance and the higher ones is now sharply wider than what it was back around 2014 in better economic times.

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

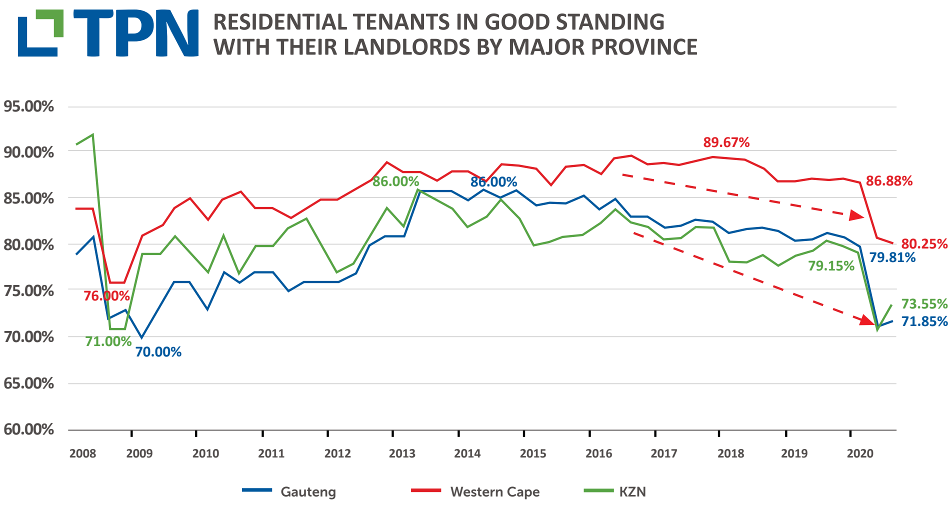


At the top end of the performance spectrum in the 3rd quarter of 2020 was the very solid R7,000-R12,000/month rental segment. This segment has been known as the top performer from a tenant population point of view since 2013, and it has retained the relative “outperformer status” that it has held since around 2013, in the 3rd quarter of 2020, improving slightly from 80.23% of tenants in good standing in the 2nd quarter to 81.34%.

The R12,000-R25,000/month segment was the 2nd best performer, with the percentage of tenants in good standing improving slightly from 78.51% in the 2nd quarter to 80.23% in the 3rd quarter, while the R3,000-R7,000/month segment also improved mildly from 73.15% to 74.28% over the same 2 quarters.

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.

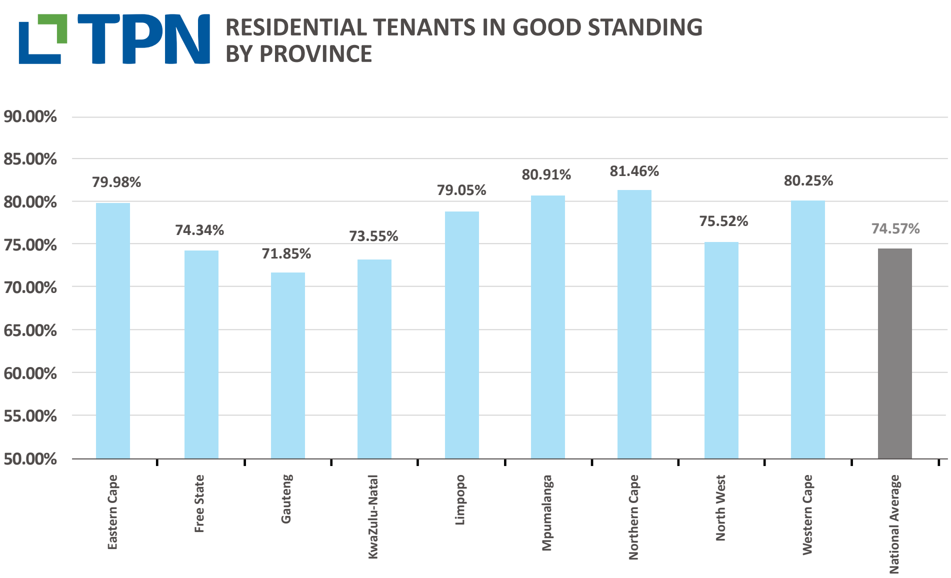
Gauteng and KZN show slight 3rd quarter improvement, but Gauteng has the weakest tenant performance of all 9 provinces



The Western Cape tenants continue to outperform the other 2 major provinces, namely Gauteng and KZN. However, the latter 2 provinces showed some very slight improvement in the 3rd quarter, after the sharp 2nd quarter drop, whereas the Western Cape showed further weakening.

From 80.86% of tenants in good standing in the 2nd quarter of 2020, the Western Cape saw further slight decline to record 80.25% in the 3rd quarter.

KZN, by comparison, saw its percentage increase slightly from 70.83% to 73.55% over the same 2 quarters, while Gauteng's lowly 71.1% 2nd quarter level rose slightly to 71.85% in the 3rd quarter.



This now makes the Gauteng tenant population the weakest performing group of all 9 provincial rental regions.

Certain of the smaller provinces have seen their tenant payment performances hold up better through the 2020 lockdown period.

These include Limpopo, Mpumalanga, North West and Northern Cape, while the Eastern Cape remains a relatively good performer despite having weakened significantly.

The top 4 performing tenant populations are Northern Cape, with 81.46% of tenants in good standing, Mpumalanga with 80.91%, Western Cape with 80.25% and Eastern Cape at 79.98%.

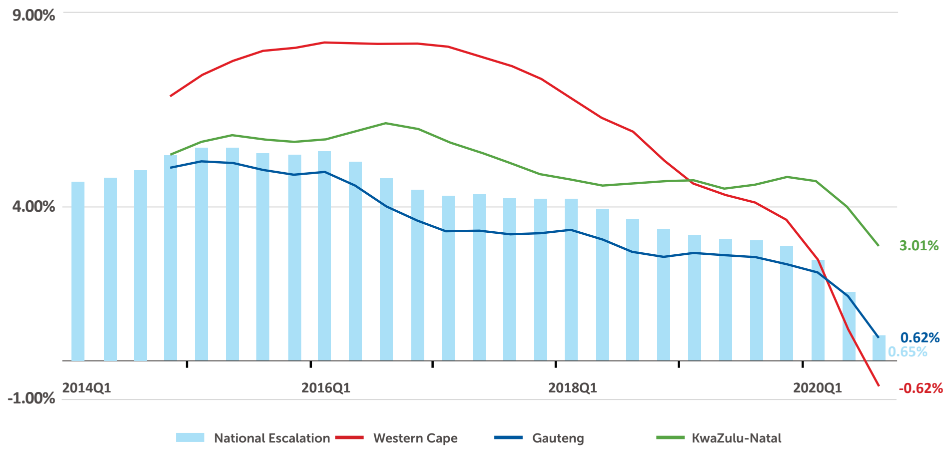
However, when examining how many percentage points lower the good standing percentages were in the 3rd quarter compared to the 1st quarter of 2020, in order to assess the lockdown impact, we find the provinces with the smallest declines in the percentage of tenants in good standing were North West (-1.3 percentage points lower), Mpumalanga (-2.4 percentage points lower), Limpopo (-4.1 percentage points down) and Northern Cape (-4.6 percentage points lower).

We are of the opinion that certain of these minor provinces may have experienced less of a negative impact on their economies emanating from the lockdown period than the large economic regions, and that this may make the difference for their tenant populations. 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 may thus have had less disruption to their economies, and possibly less household income loss as a result.

Rental Inflation Slows, With Deflation Territory Getting Closer

Average rentals across South Africa saw their inflation slow again in the 3rd quarter of 2020.

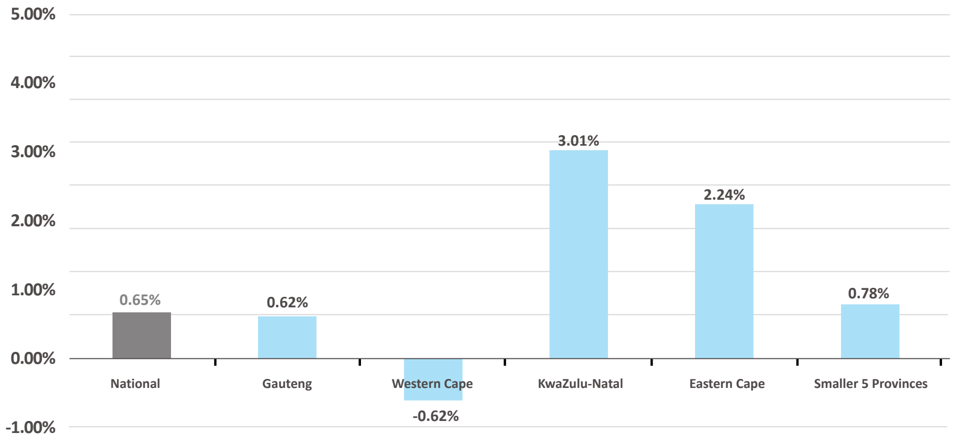
TPN RENTAL ESCALATION BY PROVINCE



On a national average basis, TPN's average rental value inflated by 0.65% year-on-year in the 3rd quarter of 2020. This represents the 13th consecutive quarter of slowing year-on-year inflation. The pace of slowing inflation has become more significant in recent quarters, from 2.62% in the 1st quarter of 2020.

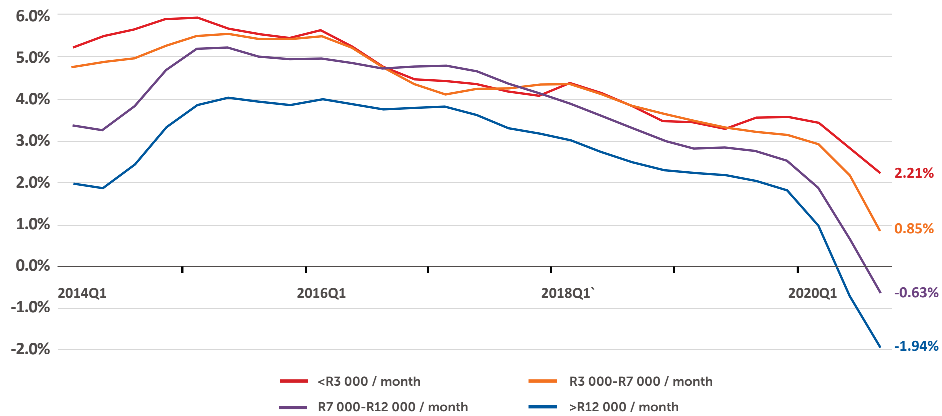
This slowing continues a broad trend from a multi-year high of 5.49% in rental inflation as at early-2015.

AVERAGE RENTAL BY PROVINCE Q3 2020 YEAR-ON-YEAR PERCENTAGE CHANGE

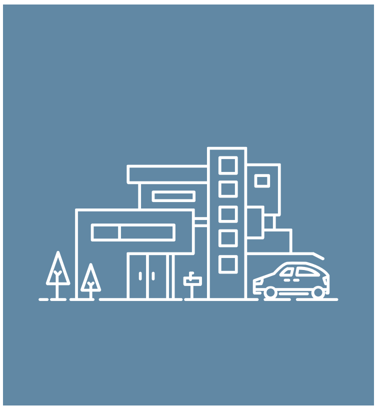


The previously high-flying Western Cape market recently moved into rental deflation, the 1st major region to do so. Although the Western Cape has relatively strong tenants in terms of their rental payment performance, affordability may be curbing that province's demand for rental homes more than the other major provinces. Up until 2018 the Western Cape had far higher rental inflation compared to Gauteng and KZN, translating into a far more significant affordability deterioration at the time. As at the 3rd quarter of 2020, the Western Cape's rental deflation measured -0.62% year-on-year, its 1st quarter of deflation since TPN provincial rental data began back in 2015.

RENTAL ESCALATION BY RENTAL VALUE BAND

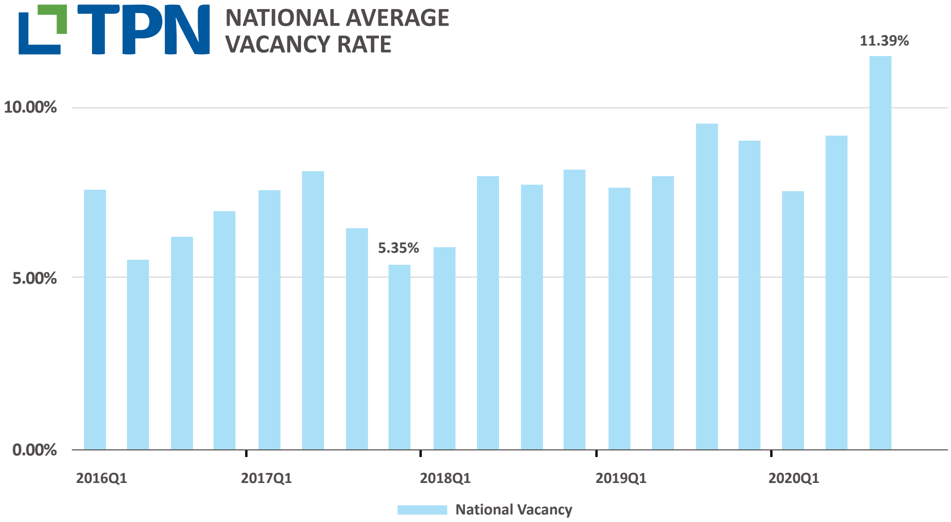


Interestingly, by rental/month value bands, the "Less Than R3,000/month segment has the highest rental inflation at 2.21% year-on-year, while the highest (for rental inflation purposes) value segment of R12,000+/month has the lowest, moving into negative territory to the tune of -1.94%. One should probably expect these relative positions to change in the near term, given that the lowest segment has 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

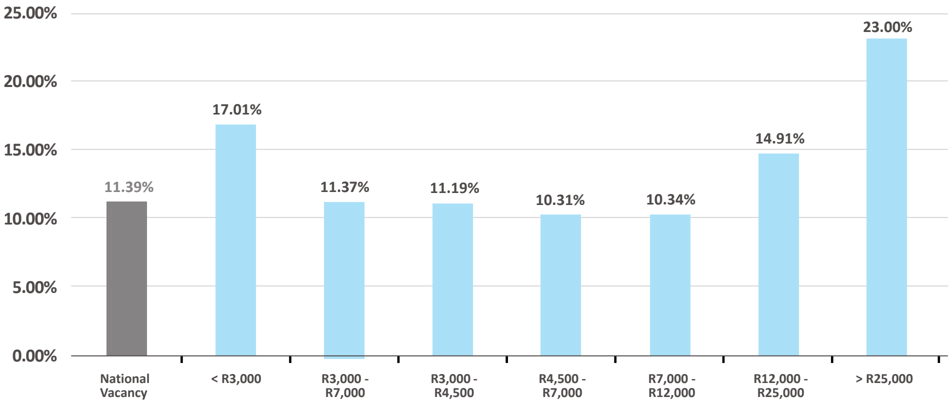
NATIONAL AVERAGE VACANCY RATE



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.

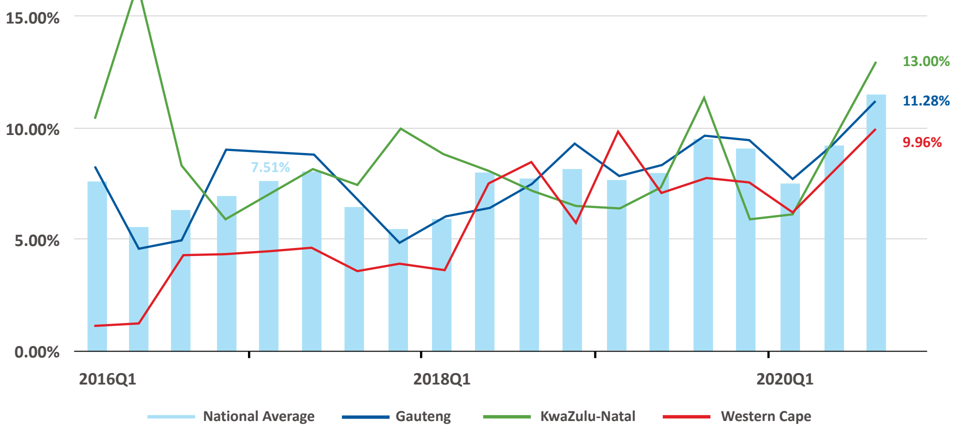
From a 7.47% rate in the 1st quarter of 2020, the estimate national vacancy rate rose sharply to 11.39% in the 3rd quarter of 2020.

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.

VACANCY RATE
BY MAJOR PROVINCE

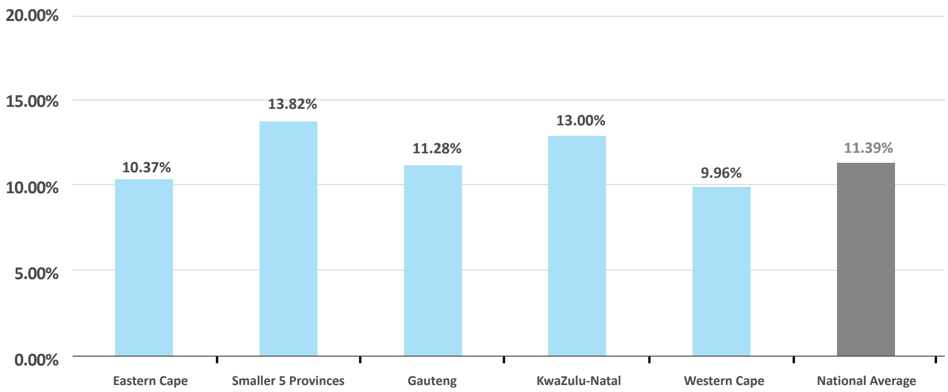


By major province, KZN has the highest estimated average vacancy rate in the 3rd quarter, to the tune of 13%, followed by Gauteng's 11.28% and Western Cape's 9.9%.

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's having the most significant rental inflation slowdown in recent years off the highest base.

AVERAGE VACANCY
BY MAJOR PROVINCE Q3 2020

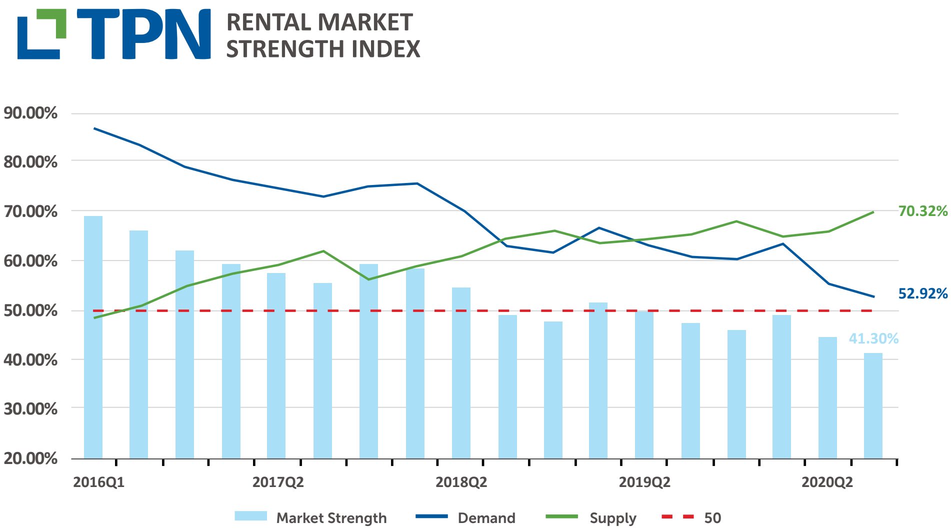


The rental market strength index continues to decline, pointing to supply outstripping demand, and further slowdown in rental inflation to come

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 short, the recent set of TPN indicators point to a muted improvement in the payment performance of the residential tenant population, but to the continued weakening of the Residential Rental Market.

Tenant payment performance did improve mildly in the 3rd quarter, following the major lockdown-related weakening of the 2nd quarter, but it remains a weak situation.

TPN average rental inflation continued to slow in the 3rd quarter, and at 0.65% year-on-year is moving further into negative territory in "real terms", i.e. when adjusted for economy-wide inflation. Average rental deflation now appears likely in the near term.

Low rental inflation, however, does contribute significantly to the low CPI inflation rate of 3%, along with a weak economy that keeps demand-side inflationary pressures weak. This in turn keeps the pressure off the SARB in terms of interest rates. The 7% Prime Rate, 3 percentage points below the 10% as at the start of 2020, looks set to remain in place for the time being, therefore, and this does give the Household Sector some financial relief.

However, low interest rates appear to have been responsible for a surge in home buying, with 1st time buying being fairly strong of late. A portion of 1st time buyers were likely rental tenants previously, which leaves something of a gap in the rental market. Strong home buying activity is thus seen as a partial contributor to the ongoing rental market weakness in the 3rd quarter, along with ongoing economic and employment weakness.

The TPN Market Strength Index continued to point to an increasing excess supply over demand in the 3rd quarter, while the average vacancy rate rose noticeably again in the 3rd quarter and is now in double-digits.