
2022Q4
TPN RentalMonitor
from MRI Software
Well positioned property investments expected to show improved rental returns

TPN from MRI Software

IN THIS EDITION

Published by
TPN Credit Bureau
Bradenham Hall, 1st Floor
7 Mellis Road, Rivonia 2128
Gauteng, South Africa
Telephone: 0861 876 000
Website: www.tpn.co.za
Email: info@tpn.co.za

Aggressive interest rate hikes are expected to slow down residential property value growth

The latest interest rate hike came as a surprise to most South Africans given that inflation appeared to have slowed down.

The 50 basis points increase took interest rates to 11.25%, a high that was last seen after the global economic crises of 2008 when interest rates peaked at 15% in the second and third quarters. Consumers were granted some consolation with a small drop in the price of fuel at the end of last year, resulting in a 22% decrease in fuel inflation. Food inflation, on the other hand, hit double digits during the same period.

PAYING MORE: PRODUCTS FELT THE BRUNT OF INFLATION AT DIFFERENT POINTS IN 2022
Headline consumer inflation was the lowest in February (5.7%) and the highest in July (7.8%). Red indicates the highest rates, green the lowest.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
CPI Headline		5.7%					7.8%					
INFLATION PEAK EARLY IN YEAR												
New vehicles				6.0%				5.1%				
Wine					7.9%			4.9%				
Beer						8.0%		4.3%				
INFLATION PEAK MIDDLE OF THE YEAR												
Fuel							56.2%					22.8%
Oil & fats			19.8%					37.6%				
Public transport	10.0%							23.6%				
INFLATION PEAK LATER IN THE YEAR												
Cold beverages	2.7%										7.1%	
Hot beverages	-1.7%											14.6%
Bread & cereals	1.5%											20.6%
Used vehicles	6.5%											16.0%
Meat	8.2%										10.5%	

Source: Consumer Price Index (CPI), December 2022

The increased cost of food items, combined with aggressive increases in electricity prices, rates and taxes and building costs are placing households with property debt under immense pressure. Additional rate hikes may negatively impact these households' ability to meet their obligations.

According to FNB's House Price Index, house price inflation (HPI) slowed considerably at the end of 2022 to 2.9% with demand inhibited by rising interest rates. Rental escalations, however, started entering the economy.

Although rental escalations were not yet at pre-pandemic levels in the fourth quarter of 2022, they are expected to continue climbing for various reasons. One of the most significant factors driving rental escalations is

Top end payment performance slips, while upper to mid-level brackets record their best good standing ever

National OVERVIEW

increased demand as households take up rental stock as opposed to buying. The increased cost of maintenance and improvements is another deterrent to home ownership which on the other end of the ecosystem, drives rental prices up.

Data released by Stats SA regarding new residential buildings completed in January 2023 reveals that year-on-year value decreased 11% at current prices. Flats and townhouses experienced the largest decrease of 34.1%. Given that sectional title is traditionally in high demand as it offers both improved security and improved building and occupancy efficiencies, this decrease in supply will impact on rental prices. The decrease is also an indication of confidence in the economy, consumer demand and cost of debt outlook.

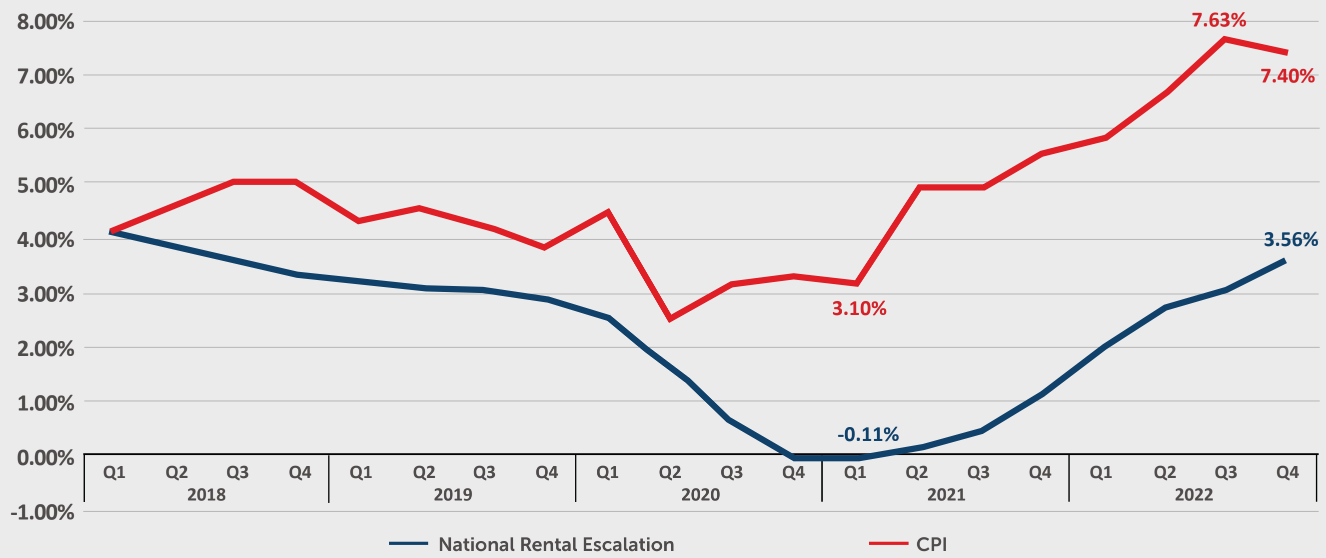
Interestingly, the number of completed houses increased by 1% during the same period. Longer term, however, the future of dwelling supply appears weak as the number of building plans approved decreased 52.6% in value between January 2022 and January 2023 with Gauteng and KwaZulu-Natal experiencing the largest decrease year on year at 43.8% and 71.8% respectively.

Taking building cost inflation into account, the adjusted real value of residential building plans approved was down 55.1% in January 2023 compared to January 2022. This goes some way in explaining why the perceived supply of rental stock has decreased from 59.19 points in the fourth quarter of 2022 to 57.75 points in the first quarter of 2023, according to the TPN Credit Bureau Vacancy Survey.

Shifts in the property investment landscape

Properties classified as investments have increased by 3% from 28.13% in 2010 (Stats SA 2010) to 31.14% (TPN Credit Bureau 2022). The provinces with the largest increase in investment properties is Limpopo, followed by the Eastern Cape, Mpumalanga, and KwaZulu-Natal. In total, 32.4% of KwaZulu-Natal residential properties are now classified as investment properties, up from 26.6% in 2012.

RESIDENTIAL RENTAL ESCALATION COMPARED TO HEADLINE INFLATION (CPI)



In 2010, 34.6% of residential properties in Gauteng were classified as investments, followed by North West at 31.6%. By the end of 2022, Gauteng dropped to 28.6%, the lowest percentage of investment properties of the major provinces (only the Free State and Northern Cape has a lower percentage of investment properties). The Western Cape, on the other hand, grew from 28.7% to 33.7% of properties classified as investment vehicles.

The number of households renting - according to the General Household Survey by Stats SA - increased by 7.5% between 2020 and 2021 (the 2022 results are expected to be released in May 2023). The largest decline in rental households was in the Eastern Cape and Mpumalanga while KwaZulu-Natal grew its number of rental households by 22% and the Western Cape by 18% between 2020 and 2021. These changes in household numbers are supported by the improved demand rating for KwaZulu-Natal and the Western Cape, both above 70 points (50 points is considered neutral).

National OVERVIEW

Between the third and fourth quarters of 2022, rental escalations increased from 3.02% to 3.56%

Although rental escalation has not kept up with the consumer price index (CPI) since 2018, property owners can expect rental growth to continue its upward trajectory in 2023 and 2024 if interest rates remain high and until new supply volumes enter the market. This is likely to also be reflected in single digit vacancy levels for the first three quarters of 2023.

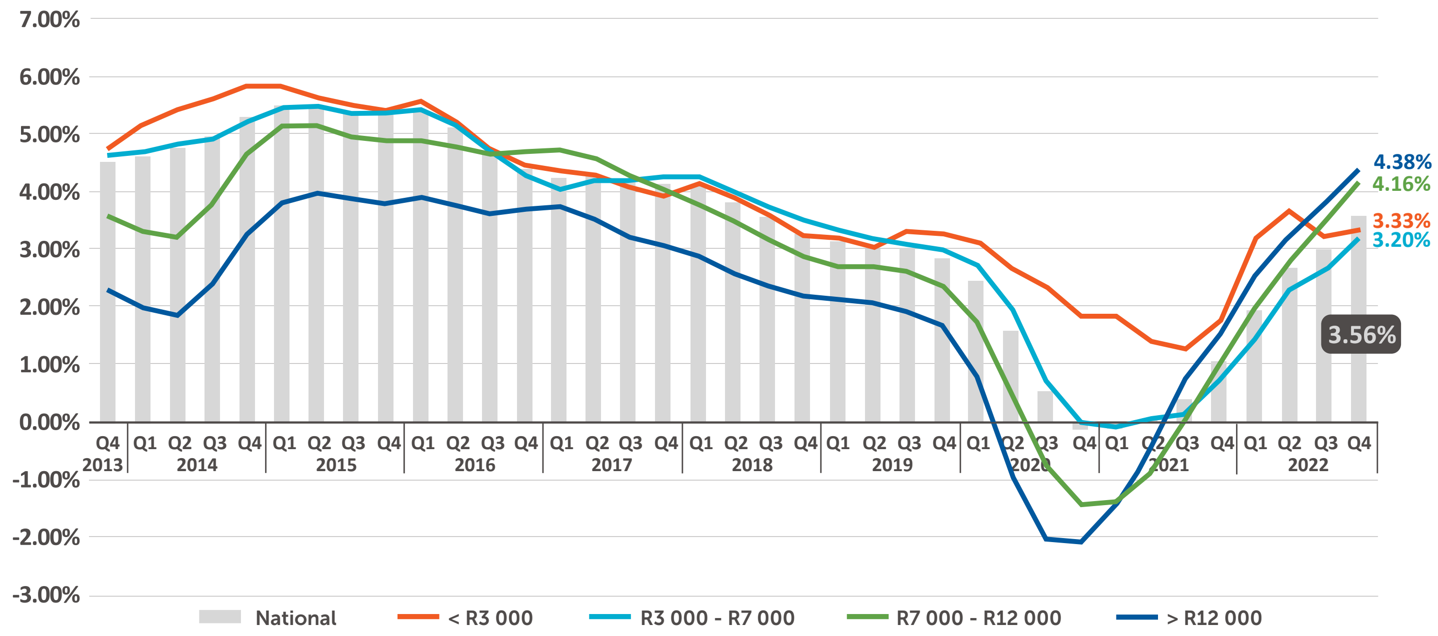
Higher rental brackets are seeing enhanced rental growth. Properties with rentals of more than R12 000 a month are seeing escalations of 4.38% followed by rentals between R7 000 and R12 000 per month which are growing at 4.16%. The national average at the end of 2022 was 3.56%. The lower end of the rental market - properties priced at between R3 000 and R7 000 per month - escalated at 3.2% while tenants paying less than R3000 per month saw escalations of 3.33%.

Provincially, Gauteng's rental prices are growing at the lowest pace at 2.33%, followed by the Eastern Cape. The Eastern Cape's escalations fell from 4.57% in the second quarter to 3.85% in the fourth quarter and is the only province that is not seeing an upward trend in terms of rental growth. The Western Cape's rental stock is achieving a rental growth of 5.61%, followed by KwaZulu-Natal at 5.29%. Although the Western Cape's escalation is the highest of all provinces, it is not yet at the levels experienced during 2016 where escalations peaked at 8.25%.

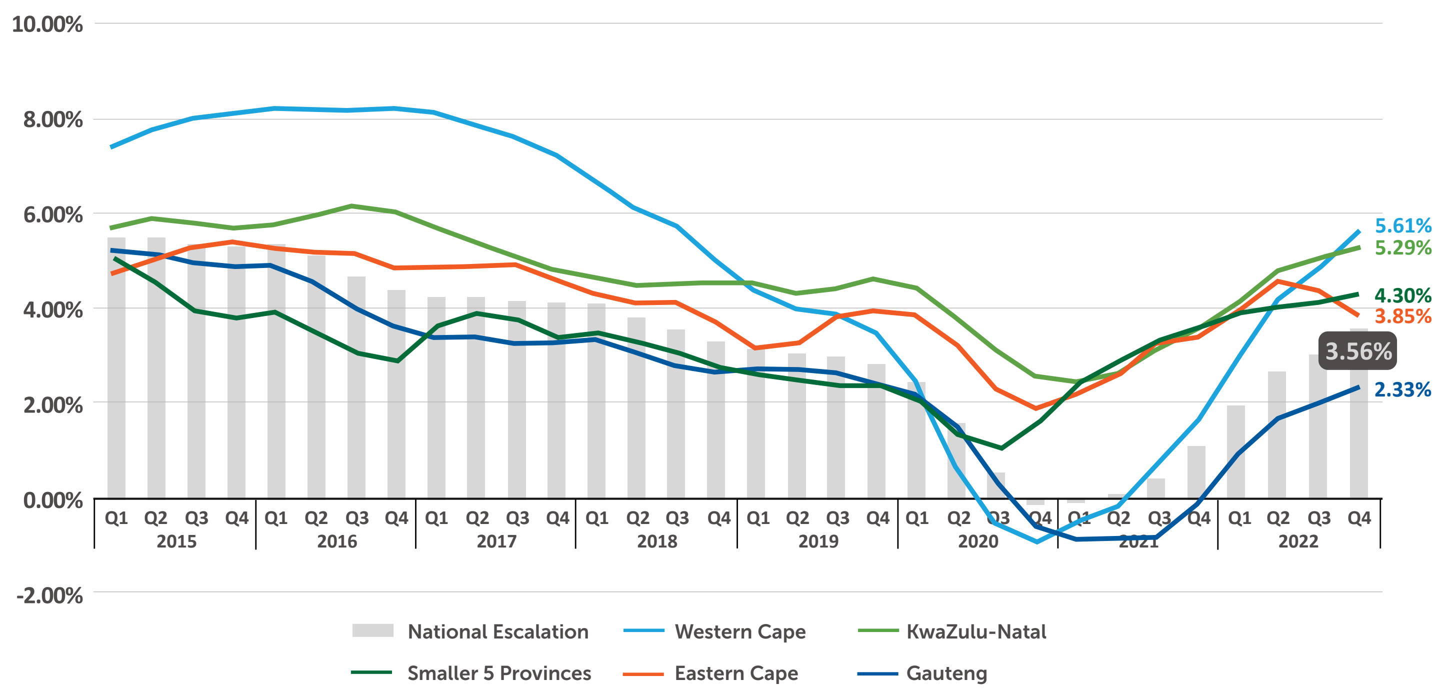
The average rental for sectional title properties with less than two bedrooms at the end of 2022 was R5 329 per month. Two-bedroom units realised an average rental of R6 815 while those with more than two bedrooms achieved an average rental of R9 769 per month.

Freehold properties with less than three bedrooms achieved an average rental income of R6 019 per month, a three-bedroom property achieved R9 493 and larger freehold properties, with more than 3 bedrooms, achieved R13 150 per month.

RESIDENTIAL RENTAL ESCALATION BY VALUE BAND



RESIDENTIAL RENTAL ESCALATION BY PROVINCE



National OVERVIEW

Rental yields turn as escalations improve and property values stabilise

Property demand, driven by cheaper debt and developing trends such as semigration and work from home which resulted in households looking for more space, have pushed values up. The home has become a multi-functional asset required to cater for a wider range of activities, including home offices, gyms, classrooms and entertainment areas.

A low interest rate environment in 2020 and 2021, saw new entrants to the property market seeking to fulfil these needs, further motivated by additional disposable income not spent on travel and entertainment due to lockdown restrictions. These factors combined to provide consumers with the confidence to purchase property. However, as the economy restarted and global economic stresses pushed inflation up, interest rates were hiked and living costs started to exceed income growth.

There are already signs of growth in property value slowing down in 2023 and 2024. Rental yields, on the other hand, are starting to show improved growth, albeit slowly as the two main market factors (rental income and property value) move into sync. Sectional title properties offer the highest rental yields at 10.18%. Freehold properties are generating rental returns of just under 7%.

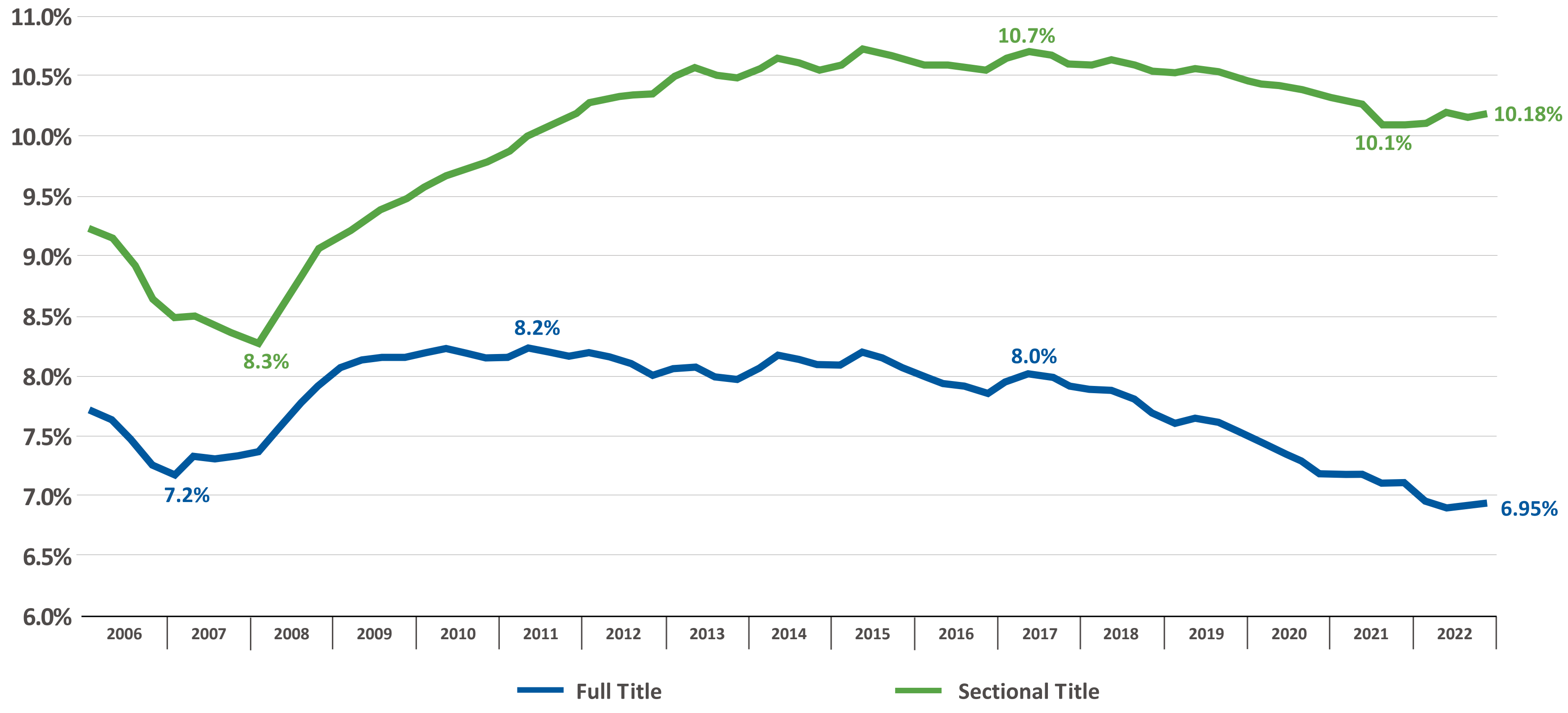
Improved rental escalations should not be viewed in isolation as households are under huge financial strain. The impact of tenants not being able to pay rent will become more noticeable over time. As a result, more consideration needs to be given to 'effective yields' taking tenant delinquency into account. TPN's effective yield, however, paints a very different picture compared to average yield, especially considering provincial performance.

Nationally, at the end of 2022, sectional title effective yield was 8.33% and full title was 5.68%. In Gauteng, sectional title average yield was 10.92%, dropping to 8.7% effective yield. In KwaZulu-Natal, the average yield was 9.9%, dropping to 7.58% while the Western Cape's average sectional title yield was 8.75%, dropping to 7.4% effective yield.

Full title effective yields also reveal a very different picture to average yields. In Gauteng, full title average yields of 6.51% dropped to 5.19% effective yields. KwaZulu-Natal's average yield of 6.66% dropped to 5.1% effective yield and the Western Cape's average yield of 7.1% dropped to 6%.

Poor paying tenants will therefore have an impact on the ability of investors to show returns as collection cost, vacancy and opportunity cost will have an impact on yields. Returns will remain under pressure due to the increased cost of maintenance, rates and taxes, insurance and security expenditure to safeguard residents and assets. Economies of scale could help to keep costs down coupled with an established network of cost-effective suppliers. While larger property investors may be able to benefit from economies of scale, smaller investors could leverage a network and the experience of property practitioners specialising in managing rentals to realise reduced costs.

NATIONAL GROSS YIELD - RESIDENTIAL RENTALS



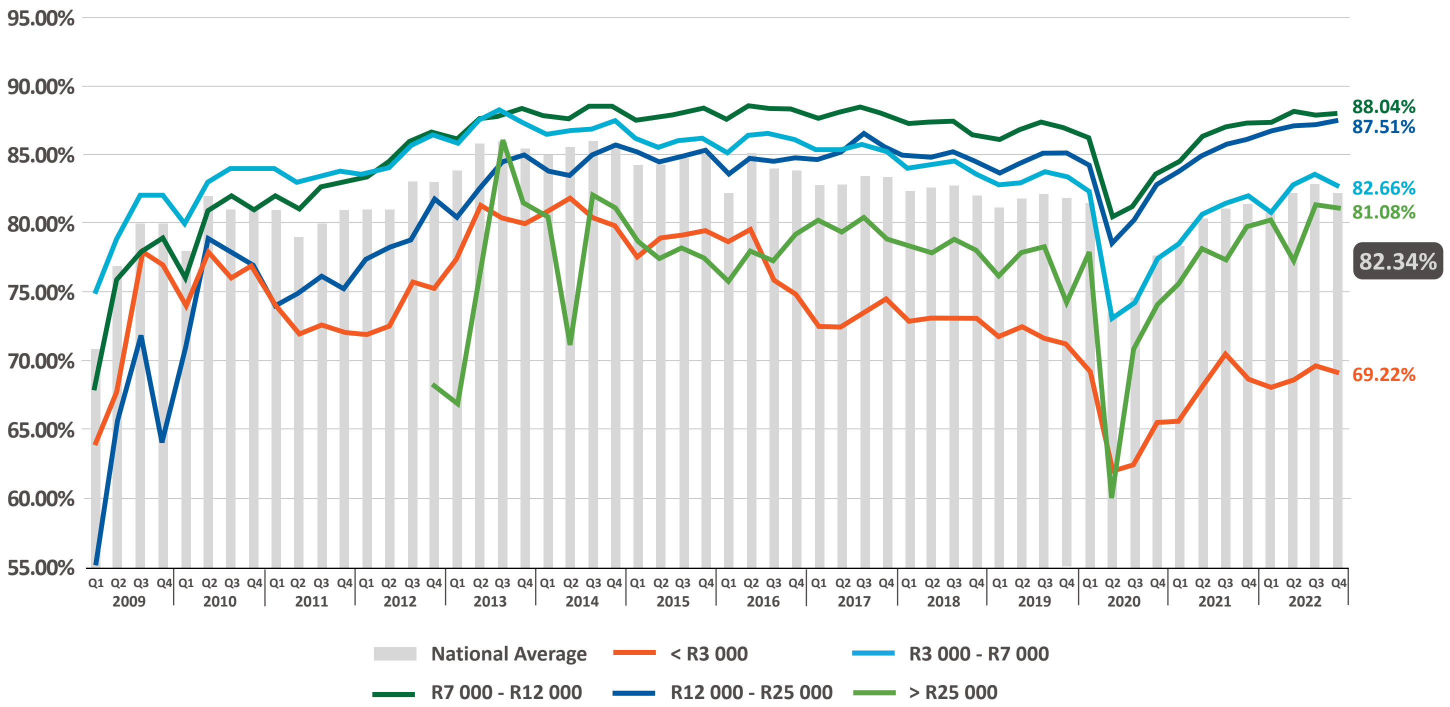
Tenants in good standing decreased slightly from 82.9% in the third quarter to 82.34% in the fourth quarter of 2022

National OVERVIEW

Overall, the number of tenants in good standing decreased slightly from 82.9% in the third quarter to 82.34% in the fourth quarter of 2022. The marginal change in the number of tenants in good standing between the third and fourth quarters is consistent with a seasonal trend observed in historical data (but excluded during 2020's hard lockdown). This suggests that there may be factors such as holidays, financial obligations, or other seasonal patterns that impact the ability of tenants to make timely rental payments during this time of the year.

KwaZulu-Natal and Gauteng had the highest percentage of tenants who did not make rental payments in the fourth quarter of 2022, with 8.54% and 7.4% respectively, compared to the national average of 6.71%.

RESIDENTIAL RENTAL GOOD STANDING BY RENTAL VALUE

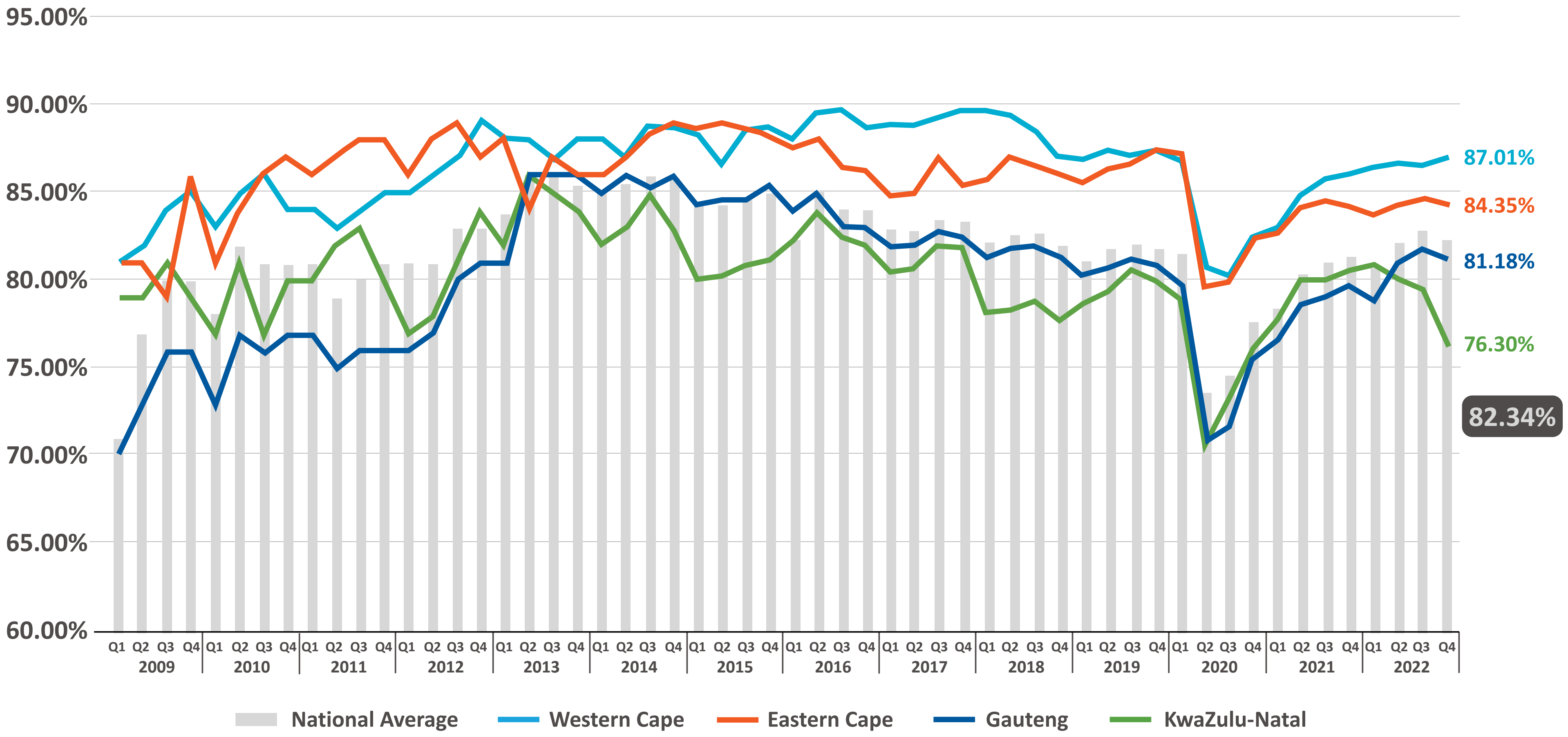


Tenants who paid less than R3 000 per month in rent had the highest percentage of non-payment (16.39%) among all rental brackets. The rental bracket between R7 000 and R12 000 had the highest percentage of tenants paying their rent on time and in accordance with their lease agreement - with 75.6% of tenants paying their rental on time and an overall good standing rate of 88.04%, these tenants are showing a commitment to paying landlords on time and in full. Tenants paying between R12 000 and R25 000 were the second-best paying tenants, with a good standing rate of 87.51%.

National OVERVIEW

> **"Tenants who paid less than R3 000 per month in rent had the highest percentage of non-payment (16.39%) among all rental brackets."**

RESIDENTIAL GOOD STANDING BY PROVINCE



The Western Cape was the only province that saw an improvement in the number of tenant accounts in good standing, with a 0.5% increase between the third and fourth quarter of 2022. KwaZulu-Natal had the biggest decline, dropping from 79.54% in the third quarter to 76.3% in the fourth quarter, mainly due to the number of tenants not making rental payments. Gauteng had a marginal decline of 0.64% between the third and fourth quarters, while the Eastern Cape remained largely flat compared to the national average.

Conclusion

The decline in the number of bonds being granted by retail banks indicates a changing economic landscape. Financial institutions may therefore need to explore alternative revenue opportunities and smaller property investors could potentially be a viable avenue. Just like larger property funds, smaller investors can also focus on providing well-structured leases with low-risk tenants who are willing and able to make timely rental payments. This approach will not only help property practitioners and investors expand their portfolios, but also enable them to invest in additional amenities such as alternative power and water supply, making their properties more attractive to potential tenants and meeting their evolving needs.

In this changing landscape, understanding tenant risk becomes crucial and proactive property management becomes even more important. Investors and property managers alike need to be diligent in assessing and managing the risk associated with potential tenants and avoid cutting corners, as it could prove to be costly in the long run. Given that consumers are facing extreme financial challenges, ensuring that tenants are reliable in meeting their rental obligations can safeguard the financial viability of the property investment and protect the interests of both investors and property managers.

Staying abreast of market trends and consumer needs can provide property practitioners with an opportunity to offer value-added services that cater to the changing demands of tenants. For example, investing in alternative power and water supply solutions will not only make properties more attractive to environmentally conscious tenants, but also help mitigate utility supply disruptions and enhance the overall tenant experience.