TPN from MRI Software

VacancySurvey

The struggle for balance amidst economic uncertainty

Vacancies drop but new influences mean the rental market is less predictable than ever

IN THIS EDITION

Published by
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The struggle for balance amidst economic uncertainty

National OVERVIEW

Vacancies drop as more consumers sign rental leases but new influences mean the rental market is less predictable than ever

The South African Reserve Bank embarked on an interest rate hiking cycle in November 2021. Since then, interest rates have increased by a cumulative 275 basis points. The Reserve Bank is expected to announce a further hike later this week.

Interest rate hikes have traditionally served the residential rental market very well, resulting in improved demand for rental property as consumers put off purchasing property. However, key consumer behavioural changes are making consumption predictions, including the property market, increasingly difficult.

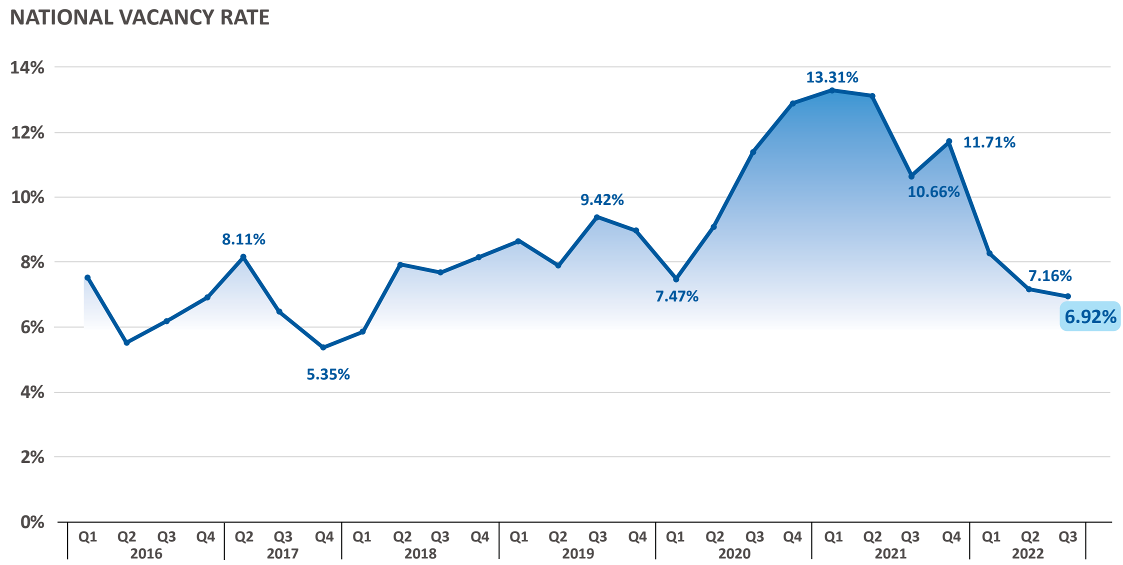
In the past, basic market influences such as interest rates and demand and supply have provided property owners with adequate direction. While these drivers are still applicable, new nuances are becoming more prominent drivers. Young professionals, for example, have become less attached to property ownership for long-term wealth creation and have shifted to shared living and working spaces.

Another trend that has become more prominent is that career and life balance mobility has become a bigger consideration than before.

Rather than being constrained by property ownership, a growing number of people are opting instead for rental accommodation, allowing them to move more easily. This is driving migration and shaping the demand for assets that are more challenging to pivot.

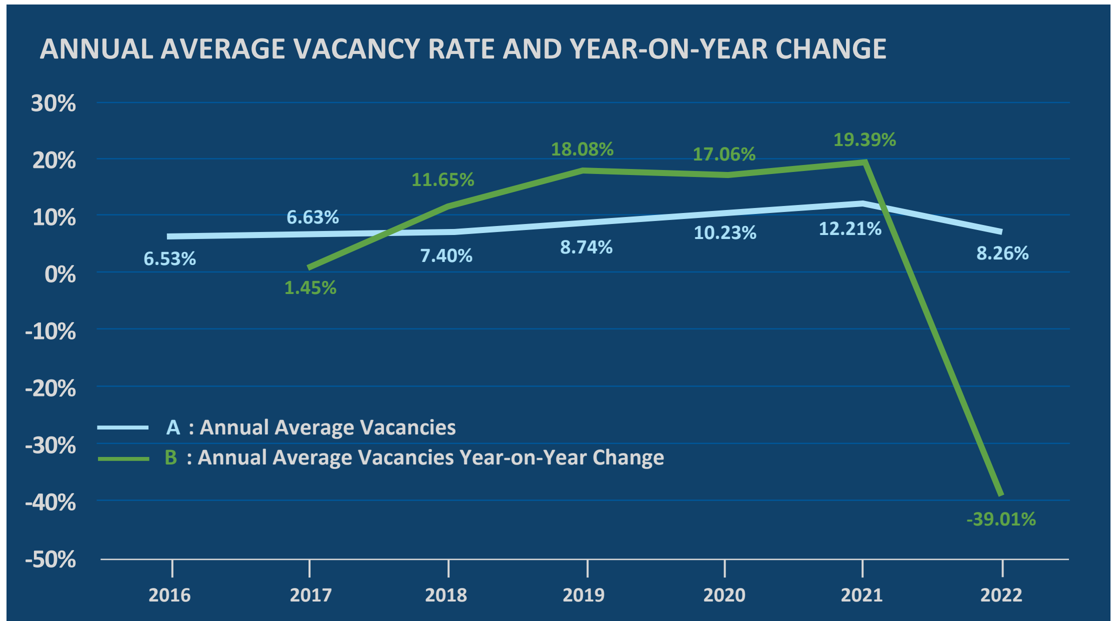
That being said, consumers will always need a place to live and work, albeit that both are now consumed in different forms fit for function. Increasingly, consumers looking for rental accommodation also require space to work from home. Although the residential rental market in South Africa is showing that it is able to cater to these shifts, it remains challenged by various macro and micro factors including rising interest rates, increased rates, municipal mismanagement, policy and regulations, a lack of cashflow and the cost of capital, amongst others. The rental market will only be able to overcome these challenges if it is able to be a little more creative with its financial models including deposit structures, rental payments and rent to own models.

Residential rental accommodation needs to be designed taking into account the need for living and working in the same space. At the same time, property owners will need to push for better rates and provide tenants with uninterrupted utility supply if they hope to attract good quality tenants.



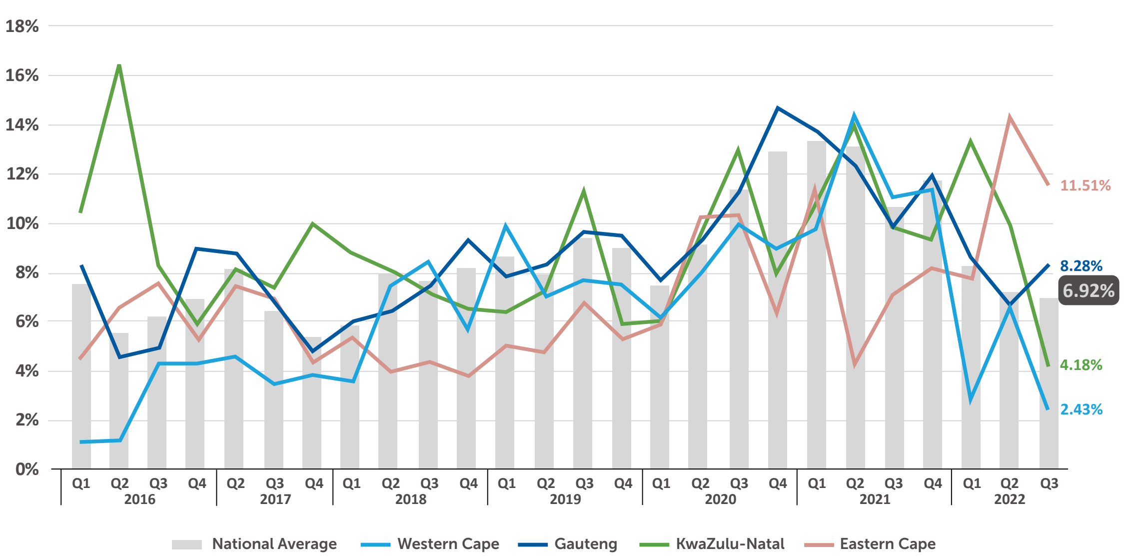
National Overview | Continued

The national vacancy rate has dropped to 6.92% during the third quarter



A	6.53%	6.63%	7.40%	8.74%	10.23%	12.21%	7.45%
B		1.45%	11.65%	18.08%	17.06%	19.39%	-39.01

VACANCY RATE BY PROVINCE



There has been an encouraging uptick in the number of tenants signing rental leases with the result that national vacancies have dropped from 7.12% in the second quarter of 2022, to 6.92% in the third quarter, the lowest rate in four years. While this is good news for property owners, what has become very apparent in recent years is that the property type, location and rental cost are all major factors when tenants consider taking up a rental property.

TPN's Vacancy Survey for the third quarter of 2022 reveals that vacancies by rental band are moving in sync and that all segments are relatively similar. The rental bracket R7 000 to R12 000 remains the overall 'sweet spot' within the residential rental market with the lowest vacancy rate at 5.94%.

There has been a major decline in the average vacancy rate after year-on-year growth since 2017. When comparing the year-on-year vacancy change in average vacancies, 2022 was a sharp turning point. Since 2021, the average vacancy rate has reduced by almost 40%. This however, needs to be balanced against a high base due to the pandemic. When comparing the average vacancy rate change between 2016 to the third quarter of 2022, vacancies have increased by 7.5%.

Escalation drops in Eastern Cape, while Gauteng supply still exceeds demand

Regional PERSPECTIVES

8.28%

Gauteng vacancies increased from 6,7% to 8,28%

Eastern Cape vacancies decreased from 14,3% to 11,5%

11.51%

Provincial vacancies are reflective of the TPN Rental Market Strength Index findings. The index is a measure of market supply and demand for residential rental property. Market equilibrium is achieved at 50 points at which point demand and supply are on an equal footing, indicating the potential for escalation and reduced vacancy rates.

GAUTENG

Gauteng's rental market is still not in equilibrium. Although rentals are increasing at a much lower rate than the national average, tenant demand remains subdued with availability slowing – albeit not as quickly as required to fill the empty spaces. Vacancies in Gauteng saw an uptick in the third quarter of 2022 to over 8%, compared to 6,7% in the second quarter. Interestingly, vacancies are driven by city centres such as Tshwane and Johannesburg CBD.

EASTERN CAPE

The Eastern Cape had a vacancy rate of 11.5% in the third quarter of 2022, a sharp decline from the previous quarter's 14.3%. This decline is primarily due to a reduction in supply but also to reduced demand. Property owners are under pressure to reduce rentals in order to fill empty spaces. This has impacted rental escalations. The Eastern Cape is the only province where escalations slowed and dropped marginally from the second quarter to the third quarter. Although the province remains above the national average as far as escalations are concerned, this trend might need to continue to reduce the high vacancies in the province. Early indicators reveal this price shift is working.

Regional PERSPECTIVES Continued

Not only is the cost of living rising, but so are rental costs, as escalations also increase

KZN market difficult to predict due to unique circumstances

WESTERN CAPE

Good news for property owners in the Western Cape is that the province is in the enviable position of having high demand and a lack of supply. This has accelerated the rate at which rental prices are increasing - and are expected to continue increasing. However, although property owners will be able to demand higher rental prices, they will have to ensure that tenants are able to afford these higher prices. The risk is that tenants desperate for accommodation might start falling behind on their rental payment commitments as the pressure of higher living costs starts to bite.

KWAZULU-NATAL

KwaZulu-Natal experienced its second consecutive quarter of reduced empty residential properties. Property analysts attribute this lower vacancy rate to a major slowdown in supply. In fact, supply perception has been reducing since the start of 2022. There have been fluctuating perceptions about demand as well since 2020. Another possibility is that rental stock is being removed from the market when owners are not satisfied with the proposed rental returns and 'mark' the property as no longer vacant. This reduces the amount of available rental property on the market while at the same time driving up rental prices as quality inventory becomes less readily available. A shortage of quality inventory is reflected in the high escalations of 5% achieved in the province. This is the highest of all provinces. The unique circumstances and behaviour in KwaZulu-Natal are challenging the market's ability to predict the way forward.

Lower rental bands were the most affected during the pandemic while properties priced between R7 000 and R12 000 maintained the best occupancies. Properties in higher rental bands – R12 000 and upwards – reduced their vacancies the fastest after the pandemic. Although the national vacancy rate has declined, the recovery is not yet at the same levels as those seen in 2016 and 2017.

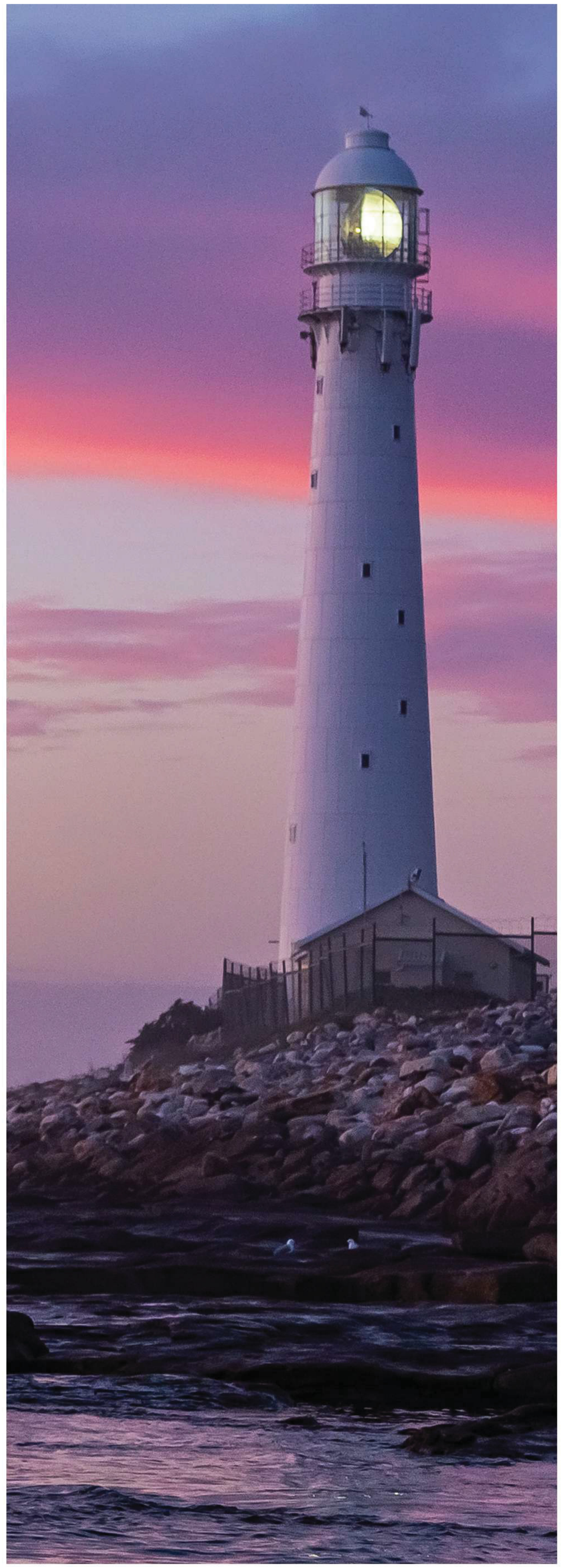
The recovery in the vacancy rate is expected to slow down as consumers come under pressure with increased demand on households. Not only is the cost of living rising, but so are rental costs with rental escalations entering their fifth quarter of continued national growth, at more than 3% in the third quarter of 2022.

Period		National Vacancy Rate
2016	Q1	7,52%
	Q2	5,52%
	Q3	6,19%
	Q4	6,90%
2017	Q2	8,11%
	Q3	6,42%
	Q4	5,35%
2018	Q1	5,86%
	Q2	7,94%
	Q3	7,66%
	Q4	8,13%
2019	Q1	8,64%
	Q2	7,91%
	Q3	9,42%
	Q4	8,97%
2020	Q1	7,47%
	Q2	9,13%
	Q3	11,39%
	Q4	12,91%
2021	Q1	14,08%
	Q2	12,97%
	Q3	11,57%
	Q4	12,57%
2022	Q1	9,88%
	Q2	7,35%
	Q3	7,46%

Best
Worst

Period		National	Less than R3.000	R3.000 to R4.500	R3.000 to R7.000	R4.500 to R7.000	R7.000 to R12.000	R12.000 to R25.000	More than R12.000
2020	Q1	7.47%	8.33%	7.43%	7.55%	7.78%	6.23%	10.07%	10.65%
	Q2	9.13%	10.89%	9.38%	8.83%	8.37%	8.59%	10.77%	11.32%
	Q3	11.39%	17.01%	11.20%	11.02%	10.31%	10.34%	14.91%	16.30%
	Q4	12.91%	16.02%	15.86%	13.30%	12.14%	10.32%	11.30%	12.55%
2021	Q1	14.08%	18.45%	14.93%	14.52%	14.35%	10.23%	11.71%	12.42%
	Q2	12.97%	15.19%	12.60%	13.00%	13.04%	12.39%	11.93%	12.20%
	Q3	11.57%	12.00%	13.32%	12.06%	10.98%	10.19%	8.84%	9.02%
	Q4	12.57%	14.42%	15.19%	13.34%	11.67%	10.26%	10.23%	9.86%
2022	Q1	9.88%	9.04%	12.80%	10.73%	9.17%	7.32%	7.77%	9.12%
	Q2	7.35%	7.44%	6.91%	7.61%	8.23%	6.51%	7.39%	7.96%
	Q3	7.46%	7.74%	8.68%	7.84%	7.21%	5.94%	7.83%	8.17%

Best
Worst



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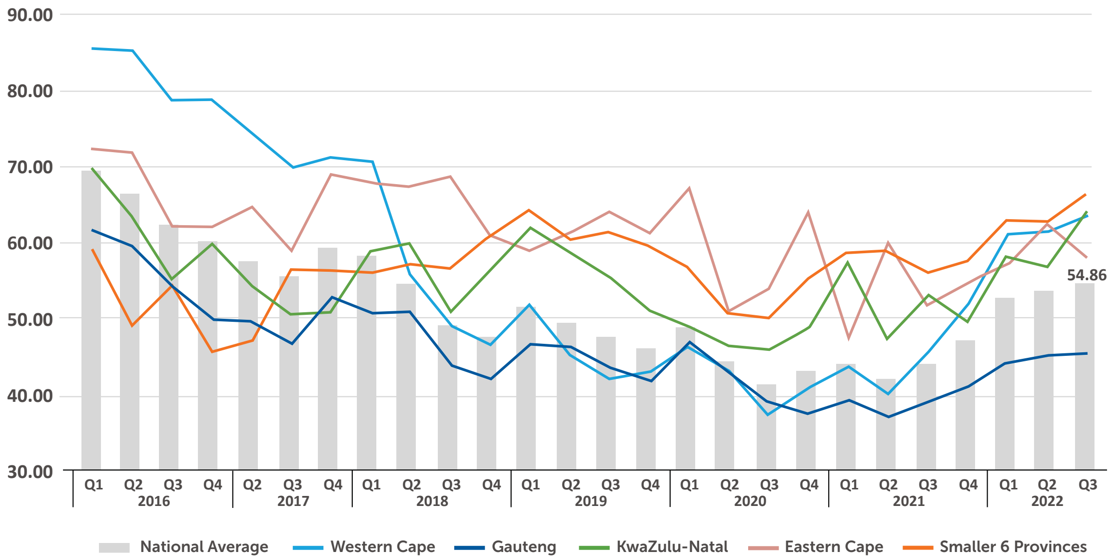
RENTAL MARKET STRENGTH INDEX: PROVINCE



NATIONAL MARKET NEAR EQUILIBRIUM

TPN's Rental Market Strength Index is indicating a market in balance as a whole - nationally, demand and supply is at 54.86 which indicates a higher perceived demand than supply in the residential rental market.

This is not the case for all provinces, however. Gauteng remains below the 50-mark point while Western Cape, Eastern Cape and KwaZulu-Natal are trending above the equilibrium mark. The five smaller provinces - Northern Cape, Free State, North West, Limpopo and Mpumalanga - have a high demand rating and low supply rating with supply a consistent challenge in these provinces.

Escalations in Gauteng remain below the national average

In Gauteng, the supply rating remains high compared to other provinces. Excess supply is one of the reasons that there has not been a lot of positive growth in terms of rental escalations. The province has been struggling to strike a balance between demand and supply since 2017 and as South Africa's economic hub continues to struggle with a lack of business and work travel, this positon is expected to remain unchanged for the foreseeable future. For these reasons, escalations in Gauteng remain under the national average as excess supply competes with a lack of demand.

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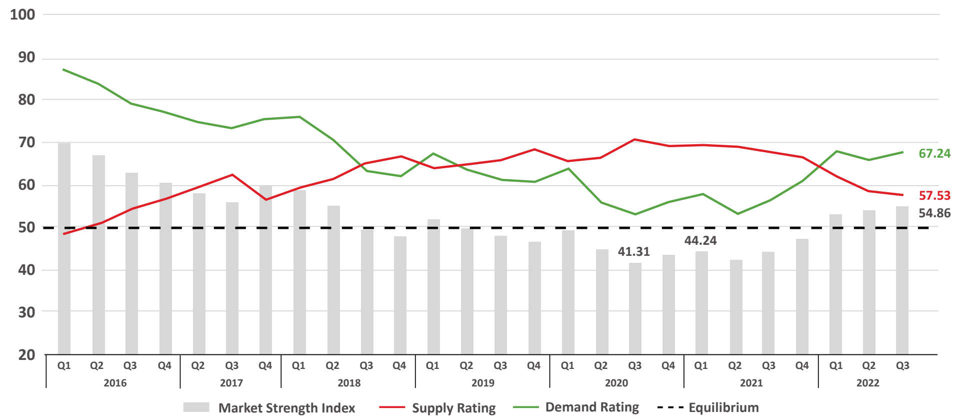
RENTAL MARKET STRENGTH INDEX - NATIONAL



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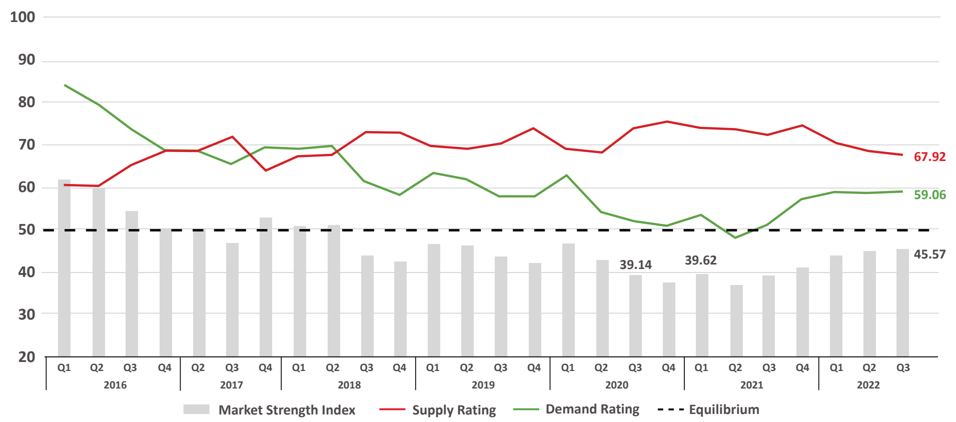
RENTAL MARKET STRENGTH INDEX - GAUTENG



Western Cape applications and approvals for new building plans overtake Gauteng

The Western Cape's demand rating is the highest of all individual provinces. Its supply rating dropped further to below the 50 point mark in the third quarter of 2022, pushing rental prices up. Escalations are expected to continue to grow.

For the first time, new building plan applications and approvals are higher than in Gauteng. This is expected to improve supply to feed the increased demand. All in all, higher property prices combined with the cost of debt is proving positive for the Western Cape.

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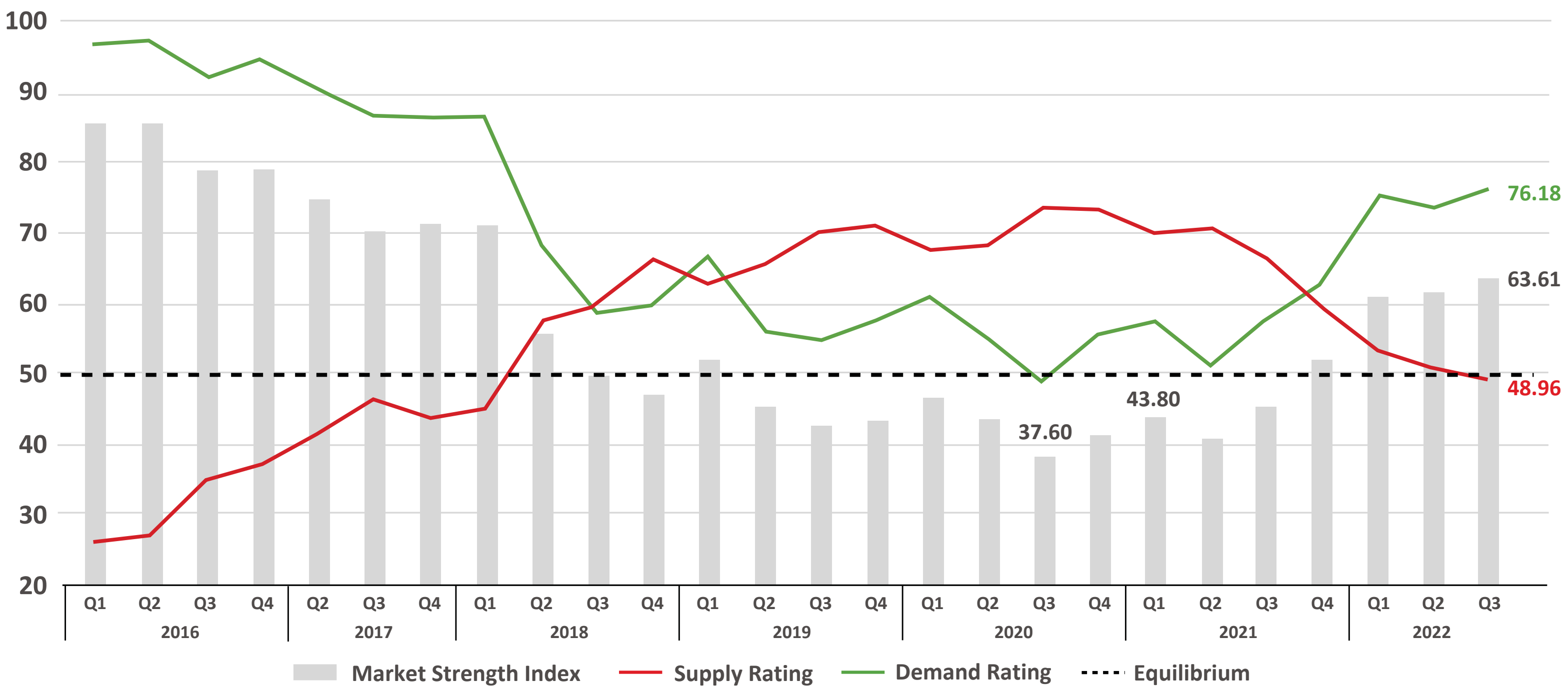
RENTAL MARKET STRENGTH INDEX - WESTERN CAPE



CONCLUSION

Innovation and creativity will be required to improve future returns on investment

Rising interest rates coupled with higher costs of living are impacting the disposable income of consumers.

While this has traditionally been positive for rental accommodation demand, shifting consumer priorities is making it harder to predict property market trends.

What is not in question, however, is a need for property owners to be more creative in terms of how they design rental accommodation and to come up with more innovative financial models for tenants.