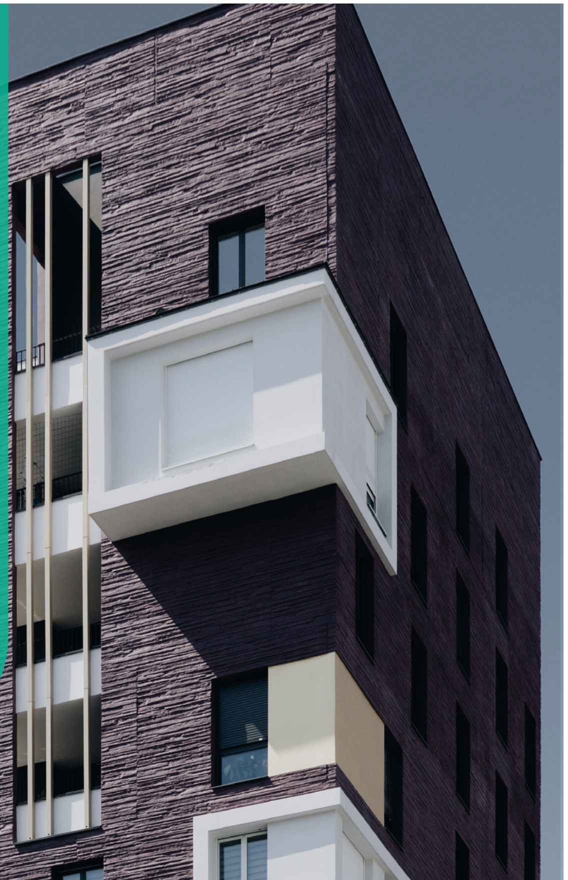
TPN VacancySurveyReport

2023 Q2

Consumer confidence dips but residential rental **vacancies** remain stable



from MRI Software

Published by
TPN Credit Bureau

Bradenham Hall, 1st Floor
7 Mellis Road, Rivonia 2128
Gauteng, South Africa

0861 876 000

info@tpn.co.za

www.tpn.co.za

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Reduced stock entering the market likely to drive rental escalations higher

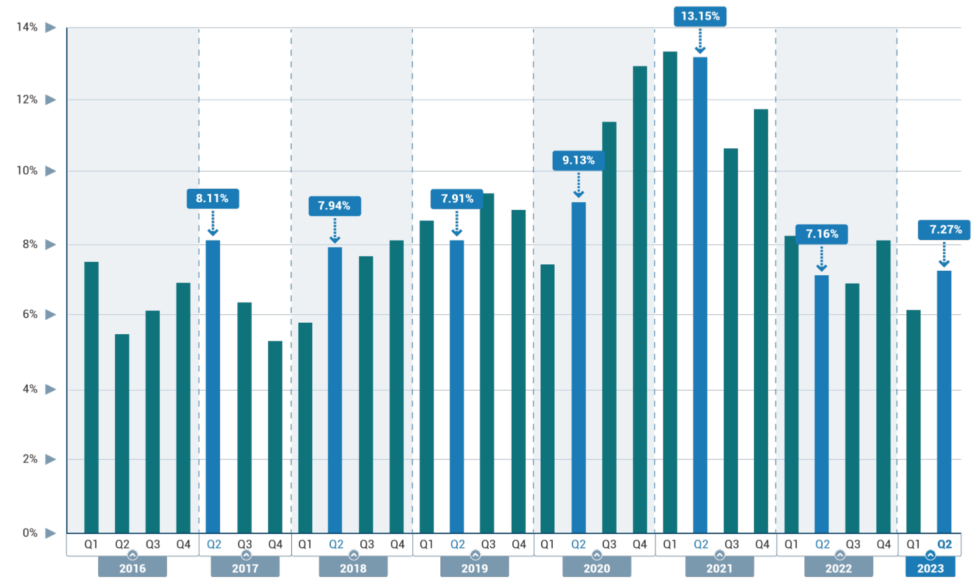
All indications are that the economy stabilised in the first half of 2023. According to Stats SA's Quarterly Labour Force Survey, employment improved slightly in the second quarter with 154 000 more people employed compared to the first quarter. As a result, unemployment saw a small decline from 32.9% in the first quarter to 32.6% in the second quarter. This slight increase in employment, however, needs to be balanced against the 42.1% of South Africans who remain unemployed according to the expanded definition of unemployment which includes discouraged job seekers.

Another positive was slowing inflation which dropped from 5.4% in June to 4.7% in July 2023. Food and non-alcoholic beverages have been the primary contributors to high inflation, increasing 9.9% year-on-year, followed by housing and utilities, which increased by 5.1% year-on-year. Housing and utilities contributed 1.2% to headline inflation in July 2023, up 0.2% from June 2023, fuelled by various factors, including escalating rental costs.

Consumer demand drives vacancies in the residential rental market and is influenced by whether consumers choose to purchase a property or rent it. The rental market consists of the formal rental market and the informal rental market. The latter is extremely difficult to track and record. Encouragingly, smaller landlords are starting to include previously 'informal' rental activity into a formal structure as it offers better protection and access to growing portfolio opportunities. These smaller investors make up an important portion of TPN's data inputs, allowing for a more accurate representation of the property market and its performance. TPN's data is balanced with medium and large residential portfolios from private investors and institutional funds to provide a clear and true reflection of the sector's performance.

In recent quarters vacancies have primarily been fueled by higher interest rates as consumers balance income with expenses and economic and political uncertainty. House prices saw healthier capital growth during the pandemic due to low interest rates and changes in consumer behavior around how property is used as an asset.The South African Reserve Bank's (SARB) aggressive interest rate hike cycle – aimed at taming inflation – has slowed this capital growth. The mounting economic challenges facing consumers have helped the rental market to regain the losses it incurred during the pandemic, by accelerating rental growth and improving collections and occupancy rates.

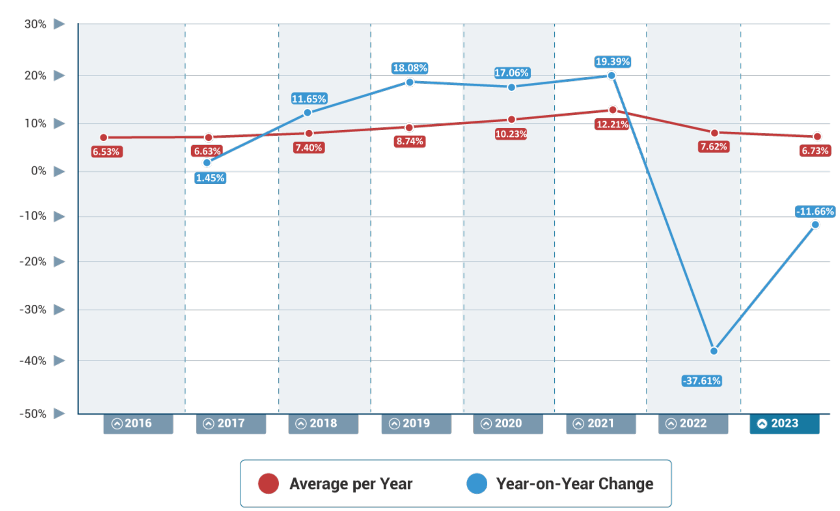
TPN National Residential Vacancy Rate



National vacancies increased slightly between the first and second quarters of 2023, from **6.19%** in the first quarter to **7.27%** in the second quarter.

Interestingly, the number of vacant residential rental properties in the second quarter of 2022 was similar at 7.16%, reflecting the strong recovery from the highs in 2021 when the vacancy rate was almost double at 13.15%. In the pre-pandemic period, vacancies were closer to 8% in 2018 and 8.11% in 2017. Steady inflow of supply offered tenants choice while demand softened which drove vacancies up during this time. Investors had to slow rental escalations to mitigate the uptick in vacancies. This negatively impacted on escalations during these years in real terms. Interest rates during this period was remarkably similar to what we currently experience in South Africa but came from the extreme highs we saw in 2008 (15.5%) and 2009 (13%).

Average Residential Vacancy Rate Change per Year



Vacancies are impacted by the number of units available for rent. They are also impacted by times of high uncertainty when capital costs are high. By January 2023, building costs had increased 9.4% compared to January 2022 but then slowed considerably in the second quarter of 2023 to 4.4% (June 2023) as demand for construction slowed.

Building Plans Passed By Larger Municipalities At Current Prices 'R000 - South Africa

Residential Buildings Reported As Completed At Current Prices By Larger Municipalities 'R000 - South Africa

The slowdown in the supply of residential rental stock is reinforced by the value of residential buildings completed as reported by the larger municipalities.

There were **R1.45 billion** fewer new completed residential buildings in the first half of 2023 compared to the same period in 2022. The overall trend indicates a slowdown in the value of completed new residential buildings.

Building plans approved at current value appear to follow a similar trend. None of this bodes well for new residential stock entering the market. Reduced stock entering the market will impact consumers in two direct ways: firstly, it will ensure less supply to choose from which will drive escalations higher, and secondly, an increase in house prices will make it even more difficult for new buyers to enter the market given that it is already plagued by high interest rates.

For residential property investors, this indicates a market environment characterised by higher demand and less competing supply in the short and medium term. Although vacancies remain relatively low, limited inventory coming online in the near future means more competition to find and place good quality tenants to ensure a decent return on investment.

Properties at the lower end of the rental value band continued to have the highest number of vacant units - 13.9% - in the second quarter of 2023. This figure has almost doubled since the first quarter of the year and is leading the vacancy growth trend.

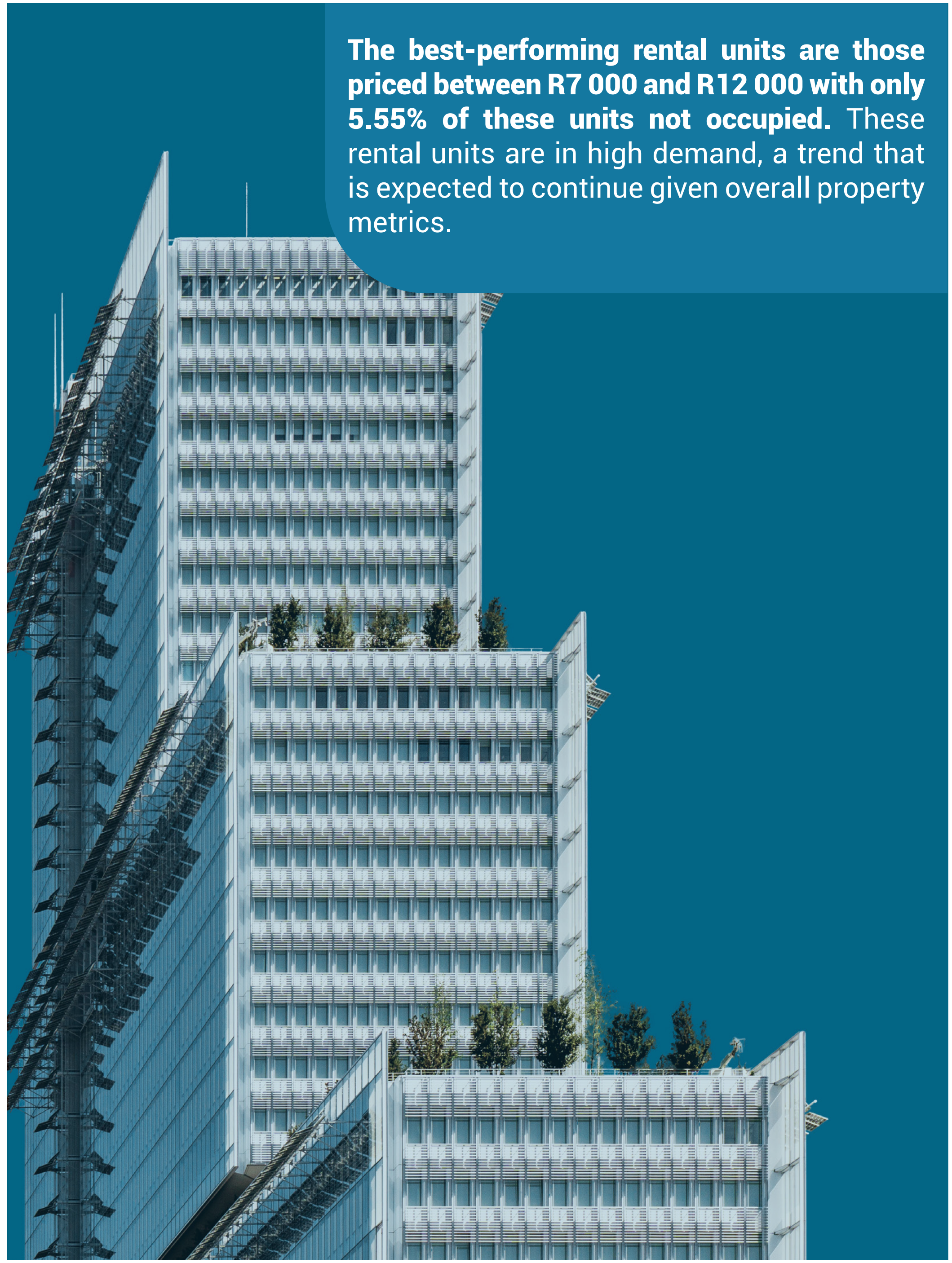
All value bands except those units achieving a rental income of R12 000 to R25 000 are moving up in terms of vacancy rates.

Properties with a rental value of R3000 to R7000 had a marginal increase in the number of vacant units from 6.54% in the first quarter to 7.56% in the second quarter. Dissecting this value band in more detail reveals that the lower rental value bands are experiencing higher vacancies.

There has also been a sharp increase in the number of vacant units reported for the rental value band R3 000 to R4 500. At the end of the second quarter, the vacancy rate for this rental band entered the double digits with 11% of units vacant.

Vacancies in the rental value band

R4500 to R7000 were 6.52%.



The best-performing rental units are those priced between R7 000 and R12 000 with only 5.55% of these units not occupied. These rental units are in high demand, a trend that is expected to continue given overall property metrics.

The luxury residential rental market - units achieving a rental of R12 000 to R25 000 - has the second lowest vacancy rate at 6.49%.

This rental value band is the only segment that has seen a slight decline in the number of vacancies, down from 7.16% in the first quarter to 6.49% in the second quarter.

In the second quarter, it recorded the lowest vacancies since 2016. This indicates that even those who can afford to purchase property are instead opting to remain in the rental market to avoid a long-term commitment and mitigate against the current uncertainty.

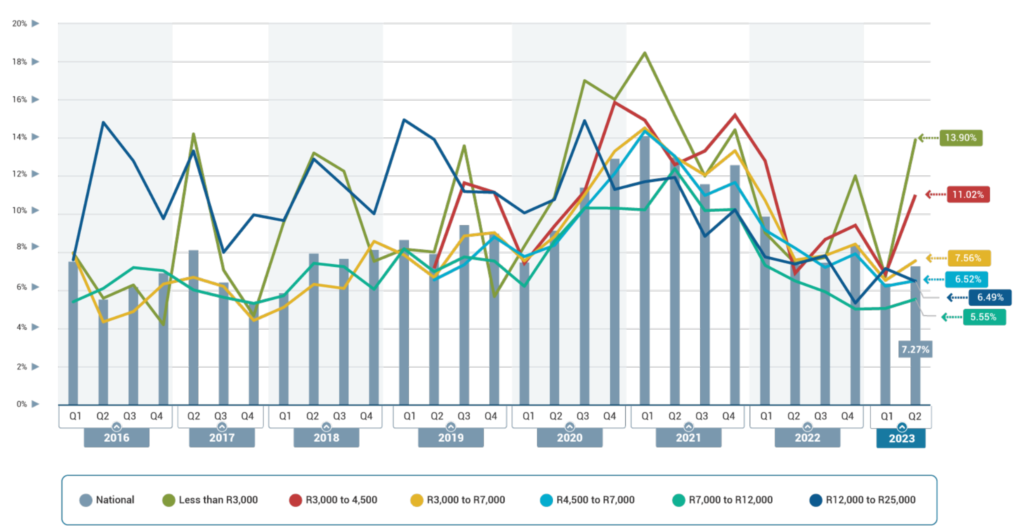
TPN Residential Vacancy Rate By Value Band - Heatmap

This rental value band has the lowest number of vacant units.

Period		National	Less than R3,000	R3,000 to R4,500	R4,500 to R7,000	R7,000 to R12,000	R12,000 to R25,000
2020	Q1	7.47%	8.33%	7.43%	7.78%	6.23%	10.07%
	Q2	9.13%	10.89%	9.38%	8.37%	8.59%	10.77%
	Q3	11.39%	17.01%	11.20%	10.31%	10.34%	14.91%
	Q4	12.91%	16.02%	15.86%	12.14%	10.32%	11.30%
2021	Q1	14.08%	18.45%	14.93%	14.35%	10.23%	11.71%
	Q2	12.97%	15.19%	12.60%	13.04%	12.39%	11.93%
	Q3	11.57%	12.00%	13.32%	10.98%	10.19%	8.84%
	Q4	12.57%	14.42%	15.19%	11.67%	10.26%	10.23%
2022	Q1	9.88%	9.04%	12.80%	9.17%	7.32%	7.77%
	Q2	7.35%	7.44%	6.91%	8.23%	6.51%	7.39%
	Q3	7.46%	7.74%	8.68%	7.21%	5.94%	7.83%
	Q4	8.13%	12.02%	9.43%	7.93%	5.03%	5.35%
2023	Q1	6.19%	6.73%	6.87%	6.23%	5.07%	7.16%
	Q2	7.27%	13.90%	11.02%	6.52%	5.55%	6.49%

The lowest rental band has the highest number of vacant units.

TPN Residential Vacancy Rate by Rental Value Band



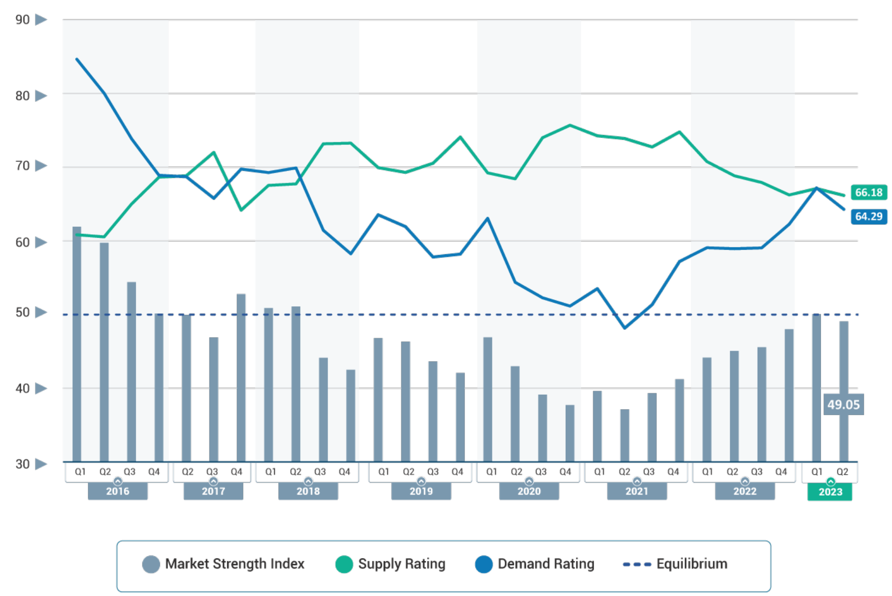
Vacancy rates by Province

Eastern Cape:

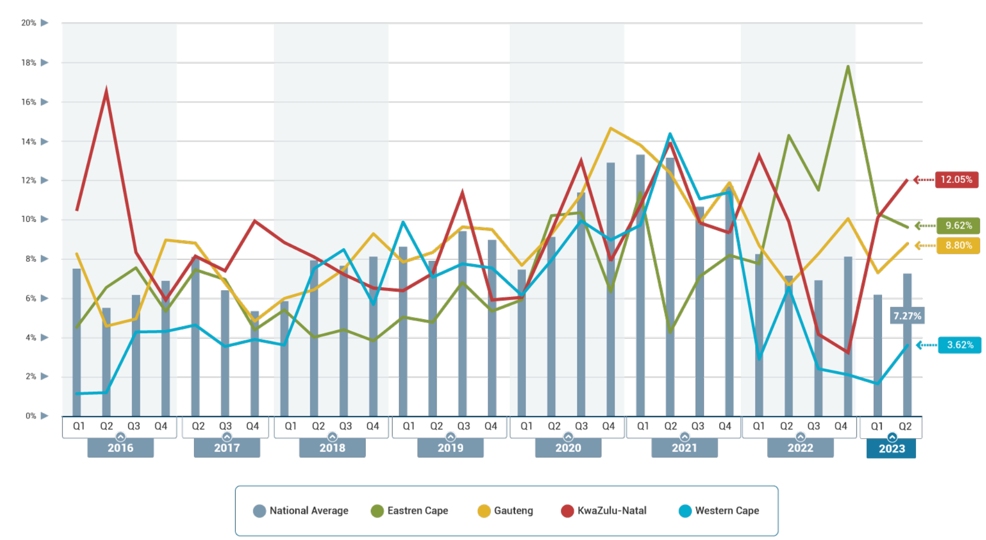
This is the only province that has seen an improvement in occupancies. At the end of the second quarter of 2023, 9.62% of residential rental properties were vacant, compared to 10.32% in the first quarter. Interestingly, the Eastern Cape has seen a gradual increase in the value of completed residential properties as reported by large municipalities since 2021.

This is reflected in a perceived increase in supply rating as reported by property professionals. The province's overall vacancy rate, however, remains above the national average. The demand rating deteriorated during the same period, resulting in a market equilibrium of 58.33 points. Market equilibrium above 50 means there is a higher demand than supply, providing investors with an opportunity to escalate rentals.

TPN Rental Market Strength Index- Gauteng



TPN Residential Vacancy Rate by Province



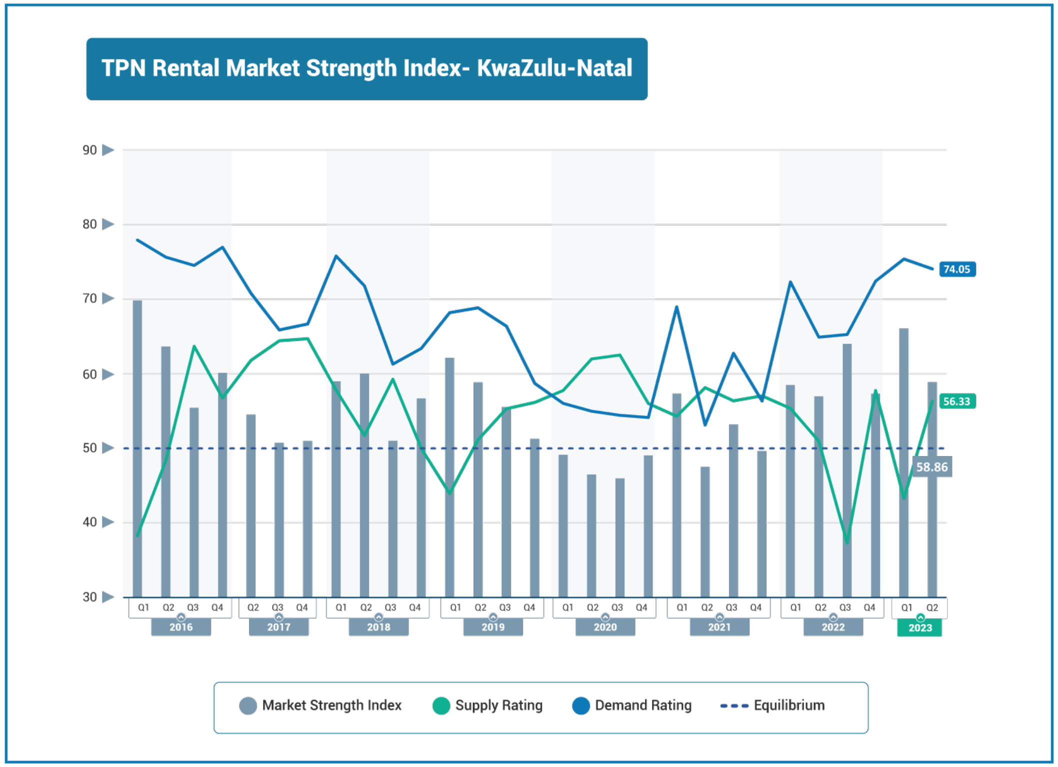
Gauteng

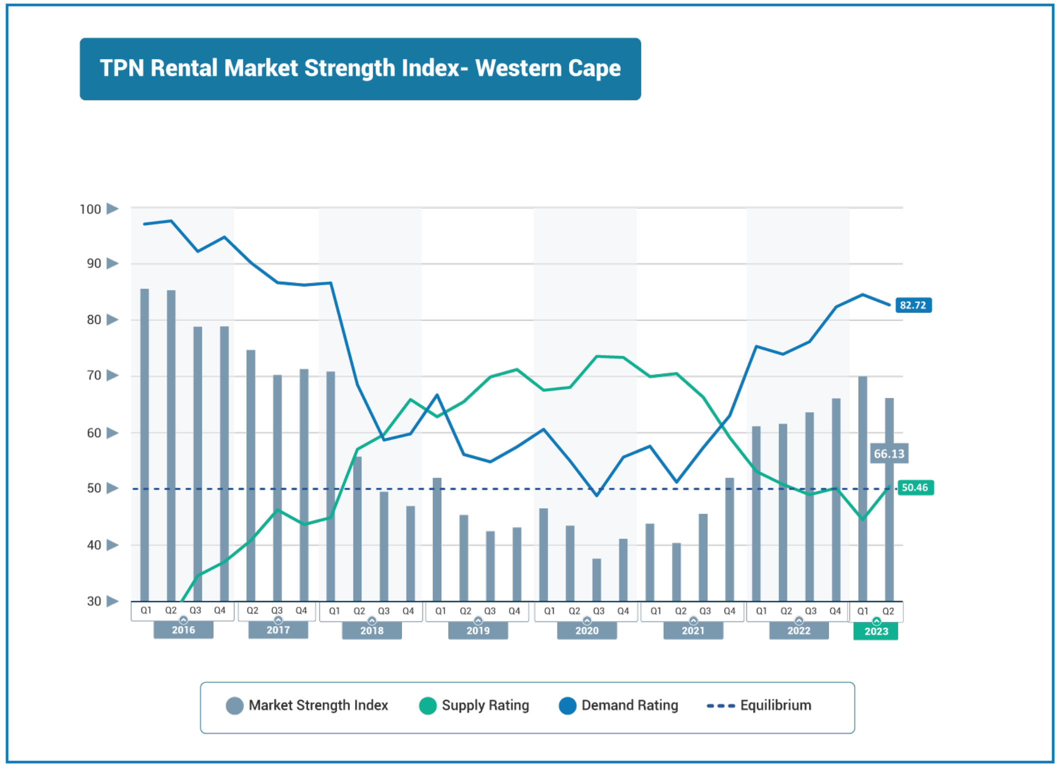
Residential property investors and owners in Gauteng can expect an 82.2% occupancy. This is down from the previous quarter but remains below the national average of 92.73%.

The TPN Residential Market Strength Index in Gauteng also dropped to below 50 points in the second quarter of 2023, meaning that the perceived supply is higher than demand in this province. Escalations in Gauteng have been slower compared to other provinces and the weak market strength will tame rental growth.

Gauteng had the highest value of completed residential properties in the second quarter. However, a notable slowdown in the value of building plans passed in the province reflects slowing demand. Gauteng has been struggling to reach a market equilibrium with supply outstripping demand since 2018.

Gauteng has fallen short of the equilibrium mark with demand and supply being relatively equal. Perceived demand is slightly below the number of units available for rent.





KwaZulu-Natal

KwaZulu-Natal continues to experience an increase in the number of vacancies. In the fourth quarter of 2022, vacancies in the province were at the lowest levels since 2016, at 3.26%. Early 2023 saw an increase in the number of vacant units to 10.13% in Q1 which increased further to 12.06% in the second quarter. The province currently has the lowest occupancy rate in South Africa. The demand rating for the province remains extremely strong at 74 points while the supply rating is at 56.33 points.

This is resulting in a Market Strength Index of 58.86 points which is above the national average of 57.3 points, but a decrease from the previous quarters' optimistic strength index position of 66 points. Although the value of completed residential buildings remains stable, an increase in the value of new building plans submitted shows a potential increase in the number of new residential properties.

KwaZulu-Natal has high perceived demand for rental property, but excess supply is keeping rental escalations mostly in check.

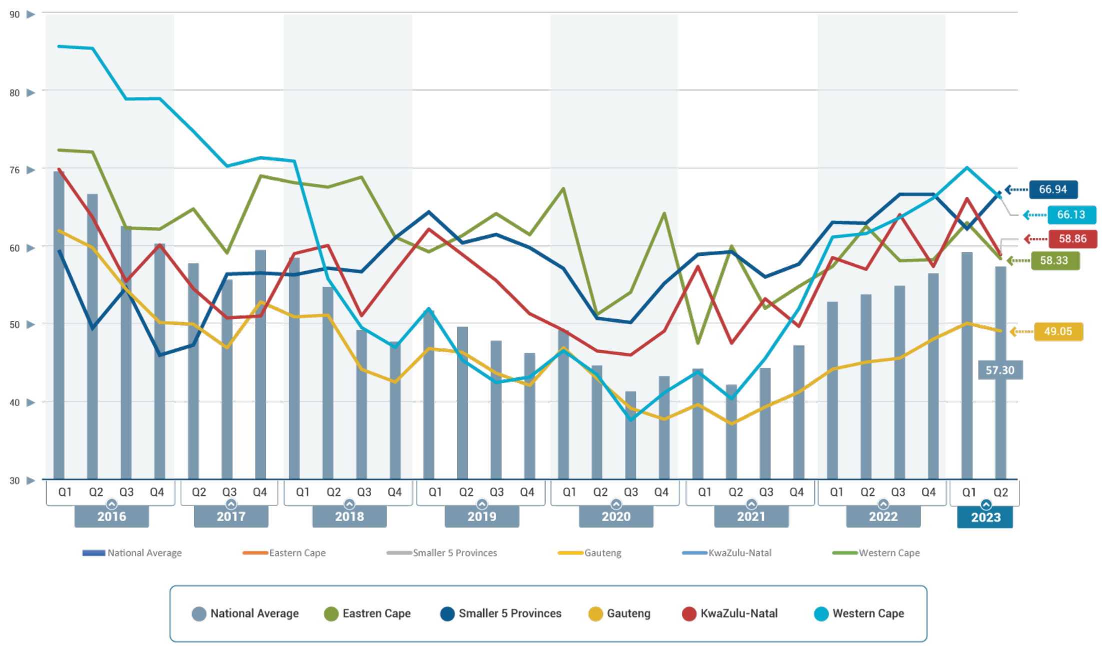
Western Cape

The Western Cape retains its position as the province with the lowest number of vacant units. Just 3.62% of residential units are vacant. The province also boasts the highest rental Market Strength Index at 66.13 points. The Western Cape has seen healthy rental escalations as a result of a strong perception of demand and a low supply rating. Investors can expect escalations to remain healthy as demand remains elevated with the supply rating 32.26 points below the perceived demand rating.

The market is, however, reacting to the shortage in supply as both completed and planned building values increased in the second quarter of 2023. The value of building plans passed in the Western Cape exceed those in the economic hub of Gauteng.

A perceived lack of residential rental stock combined with an extremely high demand rating is driving rental escalations in the **Western Cape**.

TPN Residential Rental Market Strength Index by Province



Conclusion

All things considered, the residential rental market has remained strong, particularly considering the economic pressures facing consumers.

Consumers are acclimating to higher interest rates and adjusting their lifestyles to allow for higher food, fuel, and housing costs. Confidence levels, however, have dropped from -23 in the first quarter to -25 points in the second quarter, according to the latest study from the Bureau of Economic Research. Poor confidence levels do not bode well for potential house buyers or investors.

Investors have seen a healthy recovery since 2020 with improved escalations, lower vacancies and a relative slowdown in new supply coming online. During uncertain times it is imperative that landlords balance rental growth with vacancies. Although early indications are that inflation is under control locally, global economies continue to exhibit strain which has the potential to impact the volatile rand which could result in imported inflation. It is also unlikely that there will be an easing of interest rates in the short-term given the SARB's commitment to inflation targets.

Ultimately, while demand for rental property is likely to remain high, without the economic means to fulfill these demands, returns for investors may remain muted.