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PROPERTY BAROMETER

Western Cape Residential Property Review

FNB Western Cape house price growth outpaces the rest, creating an apparent affordability challenge for 1st time buyers

4TH QUARTER 2014 WESTERN CAPE HOUSE PRICE INDEX FINDINGS

According to the FNB Western Cape House Price Index, the average house price for the 4th Quarter of 2014 rose 13.8% year-on-year. This is slower than the previous quarter's 15.2% rate, but still represents very strong growth well above the national average of 6.6% in the same quarter.

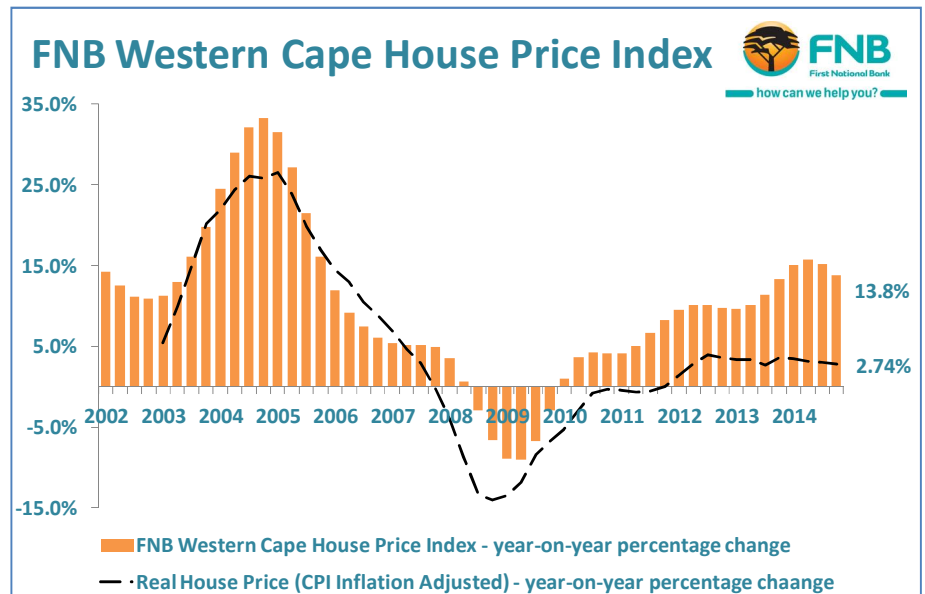
Real house price growth (i.e. when house prices are adjusted for Western Cape consumer price inflation), came in at a revised 2.74% year-on-year in the 4th Quarter. This also represents a minor de-celeration from a 3% rate in the previous quarter.

Although we do not yet have 2014 estimates for provincial household income, we believe that the average 14.9% house price inflation rate for the Western Cape, the fastest rate of the major provinces, is likely to have caused a noticeable affordability deterioration in housing in the province. 2014 was a weak economic year, and it thus unlikely that disposable income growth would have even nearly kept up with price growth in the province.

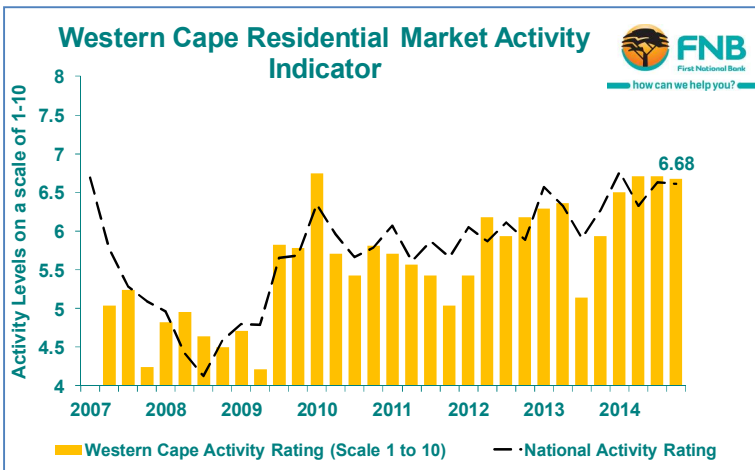
The average price of homes transacted (those financed by FNB) in the Western Cape was R1,272,303 in the 4th Quarter.

In real terms (adjusted for CPI inflation), the FNB Western Cape House Price Index remains above levels of a decade ago, up a revised 12% from the 4th Quarter of 2004. However, compared with last decade's real average price peak, reached in the 2nd Quarter of 2007, the 4th Quarter 2014 real price was still a revised -13.4% lower.

In nominal terms, the 4th Quarter 2014 average price was 87.8% higher than the 10 years ago, and 47.7% above the 2nd Quarter 2007 level.



The FNB Estate Agent Survey still points to Western Cape Activity Rating being above the national average

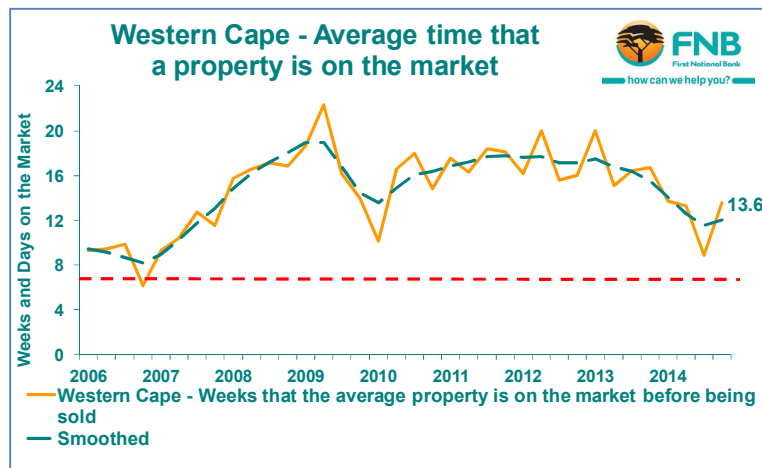


Our Western Cape FNB Estate Agent Surveys in recent quarters confirmed a strong regional market. At levels of 6.7 (scale of 1 to 10), the Agents' Residential Market Activity Rating has mildly exceeded the National Average Rating over the past 3 quarters, after a major increase back late in 2013.

The survey is of a sample of estate agents predominantly in The City of Cape Town metro. The 1st question asked to agents is with regard to their perceptions of residential market activity in their areas, a subjective question on a scale of 1 to 10, with 10 being the strongest level of activity.

And the province's demand relative to supply is significantly strengthened

One indicator of where the market is in terms of seller pricing realism relative to demand, or otherwise put the balance between demand and supply at prevailing price levels, is the estimated average time that properties remain on the market prior to sale.



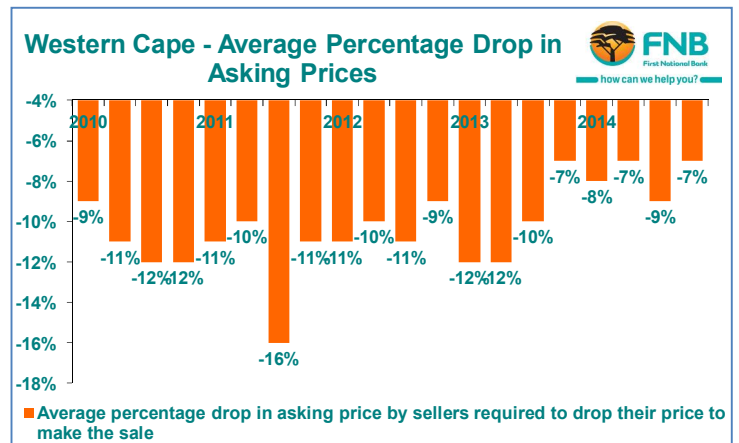
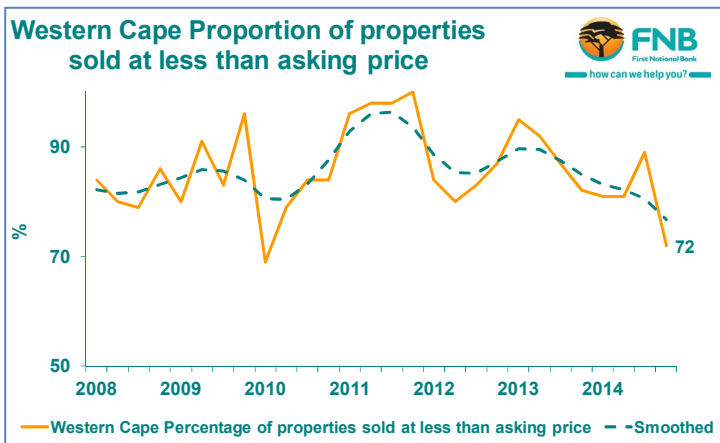
From a 3rd quarter 2014 low of 8.9 weeks, the 4th quarter saw a rise in the estimated average time on the market to 13.6 weeks.

However, quarter-to-quarter fluctuations can be a little volatile, so one quarter's improvement should be interpreted with caution. More significant is that the smoothed trend line continues to point to an average time on the market hovering at close to 3 months, far lower than a high of 20 weeks back in early-2013.

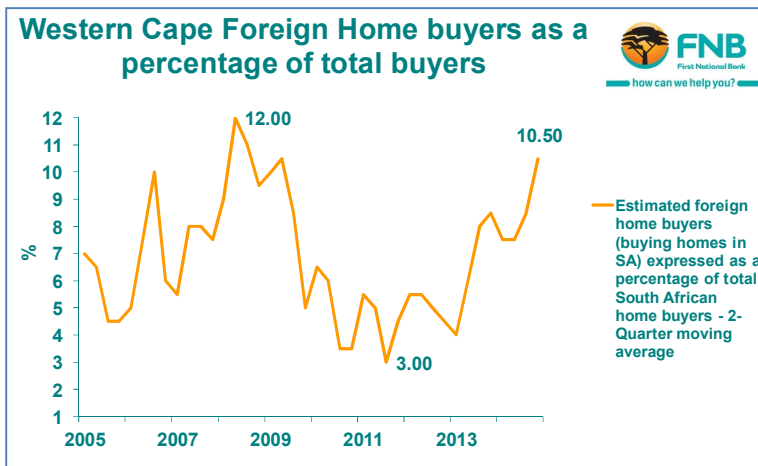
The sample of survey respondents also point to a significantly lower percentage of sellers being required to drop their asking price to make a sale, another important indicator of pricing realism.

They reported an estimated 72% of sellers having to drop their asking price in the 4th quarter of 2014, which is well down on the 95% high back at the beginning of 2013.

We also ask agents to estimate the average percentage asking price drop on those properties where a price drop is required to make the sale. This average estimated drop of -7% in the 4th quarter was less than the -9% estimate of the previous quarter, and significantly smaller than the estimated -12% early in 2013.

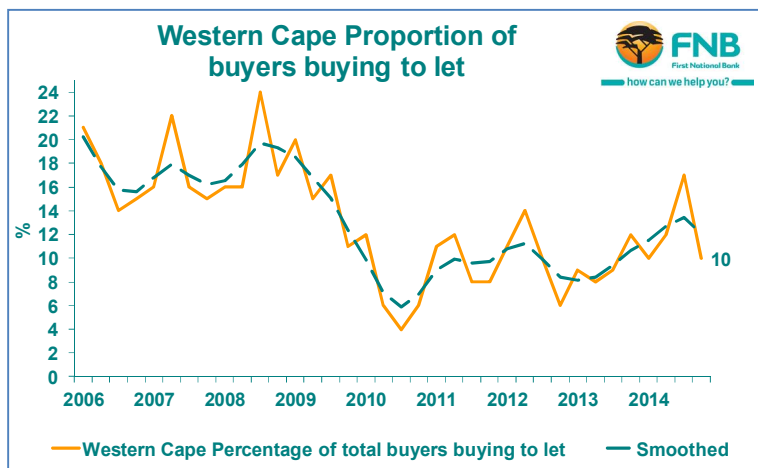


Improved foreign buying of Western Cape property may be a minor partner in supporting demand of late



The FNB Estate Agent Survey also suggests that the Western Cape has regained its popularity amongst foreign buyers. Whereas the percentage of home buyers estimated to be foreigners dropped to as low as 3% by late-2011, a recovery in the popularity of residential property as a global asset class since 2012 has seen this percentage rise considerably. For the 2nd half of 2014 foreigners were estimated 10.5% of total buying in the areas in which our estate agent sample operated in, significant higher than the 5.5% national average.

And buy-to-let buying up off its lows has assisted too



The focus still seems firmly on primary residential demand. However, non-essential forms of home buying such as buy-to-let buying have shown some gradual improvement.

The estimated level of buy-to-let buying in the Western Cape, expressed as a percentage of total home buying was 10% in the 4th quarter 2014 Estate Agent Survey, also slightly higher than the 9% national average, and significantly higher than the 6% recorded at the end of 2012.

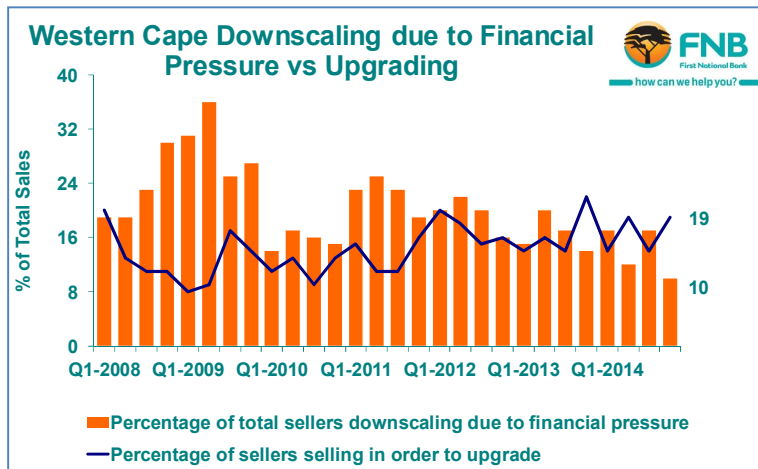
The province also usually has a strong net inflow of repeat buyers from other regions

Although we have not yet updated our inter-provincial repeat buyer migration stats, the Western Cape normally has the strongest net inflow of repeat home buyers from other regions off all of the 9 provinces, a function of its strong reputation that it has built up as a well-run province with the combination of a strong economy and good lifestyle.

It is likely that 2014 brought more of the same, and that repeat buyer arrivals in the Western Cape once again supported residential demand, and thus price inflation, a little more than in other provinces.

But supply constraints also appear to be more of an issue in the Western Cape than in other regions

The Western Cape has a greater “natural supply constraint “ of residential property than, for instance, land-locked Gauteng, due to a greater land scarcity, and it is possible that relative to demand levels the provinces is not able to respond as rapidly in terms of increasing new residential development levels.



However, there are other constraints on supply constraints, notably a big improvement in the financial positions of many households, resulting in a drop in supply emanating from financial pressure-related home selling.

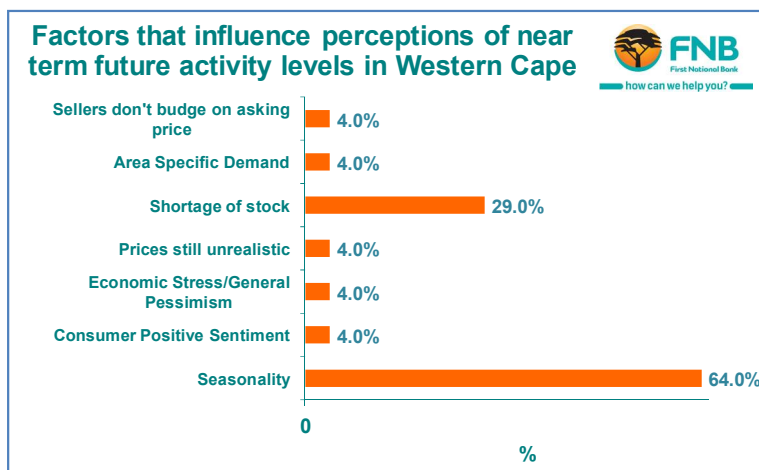
The Estimated percentage of home sellers selling in order to downscale due to financial pressure recorded a low of 10% by the 4th quarter of 2013, now sharply lower than the 36% back in mid-2009. As many of these financial stress-related sellers exit home ownership for the rental market, their decline in significance impacts negatively on residential supply on the market.

By comparison, those financially strong sellers, who sell in order to upgrade, were estimated at a significantly higher 19%, and their desire to increase their spend on housing drives demand higher.

| WESTERN CAPE - REASONS FOR SELLING (AS % OF TOTAL SALES) | Q1-2013 | Q2-2013 | Q3-2013 | Q4-2013 | Q1-2014 | Q2-2014 | Q3-2014 | Q4-2014 |
|--|---------|---------|---------|---------|---------|---------|---------|---------|
| Downscaling due to financial pressure | 15 | 20 | 17 | 14 | 17 | 12 | 17 | 10 |
| Upgrading | 14 | 16 | 14 | 22 | 14 | 19 | 14 | 19 |
| Downscaling with life stage | 19 | 21 | 24 | 19 | 23 | 27 | 23 | 25 |
| Moving for safety and security reasons | 12 | 10 | 12 | 12 | 11 | 10 | 7 | 9 |
| Emigrating | 2 | 3 | 4 | 1 | 4 | 2 | 2 | 3 |
| Relocating within SA | 7 | 5 | 8 | 9 | 5 | 6 | 9 | 8 |
| Change in family structure | 16 | 14 | 16 | 14 | 16 | 16 | 17 | 20 |
| Moving to be closer to work or amenities | 15 | 11 | 7 | 9 | 9 | 7 | 9 | 5 |

HOW WESTERN CAPE AGENTS SEE THE NEAR TERM OUTLOOK

We ask agents for their expectations of residential demand strength in the near term, i.e. the three months subsequent to when the survey takes place, requesting them to choose between 3 options, namely the market will “strengthen”, “weaken”, or “remain the same”.



In the 4th quarter survey, 43% of Western Cape agents expected activity to increase in the next 3 months, while only 7% expected it to stay the same and 50% expected a decrease in activity.

When asking agents for the factors influencing their near term expectations, “seasonal factors” unsurprisingly came out as the most common factor, given that we were moving into the Summer vacation period.

But the level of, “agent stock constraints” was the interesting factor, arguably explaining the high rate of Western Cape House Price Inflation. 29% of respondents cited stock constraints as an issue in their lives.

THE BIG IMPLICATION OF STRONG HOUSE PRICE INFLATION? A POSSIBLE 1ST TIME BUYER AFFORDABILITY CHALLENGE

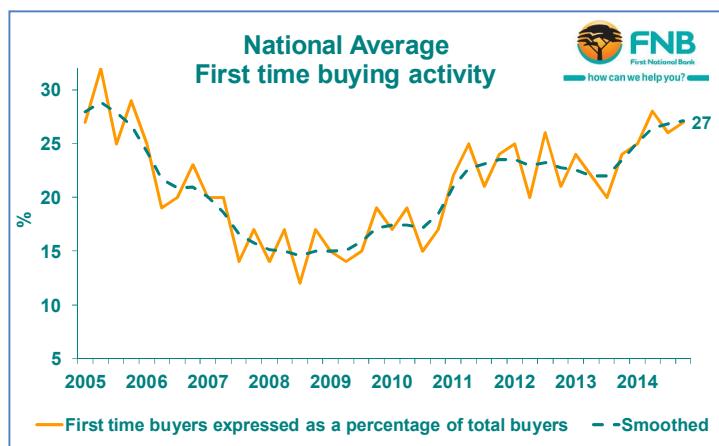
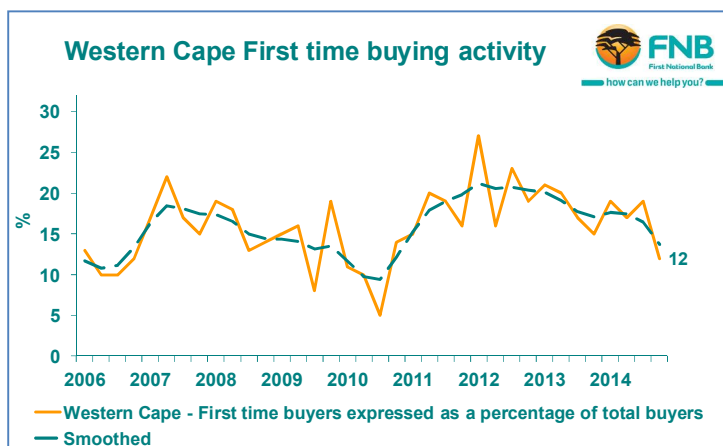
The Western Cape's big residential stock constraints and strong house price growth may be taking their toll on aspirant 1st time buyers with their affordability constraints.

The FNB Estate Agent Survey estimated that, in the 4th quarter of 2014 only 12% of buyers were 1st time buyers. This represents a noticeable decline from a high of 27% back in early-2012.

In addition, the declining trend of the past few years stands in stark contrast to the national average trend in the 1st time buyer percentage, which measured 27% by the end of last year, and had been rising.

The western Cape percentage being far lower than the national average may hint at a now more noticeably less affordable market than is the case in Gauteng, whose 1st time buyer percentage reached a massive 34.5% by the end of 2014, after having out-inflated the Gauteng property market recently.

This apparently mounting 1st time buyer affordability challenge can affect the Western Cape's ability to retain young skills in the province in future, although the province does seem to compensate for this by attracting older more established repeat buyers from other regions.



ADDENDUM - NOTES:

Note on The FNB Western Cape Average House Price Index: Although also working on the average price principle (as opposed to median or repeat sales), the FNB Western Cape House Price Index differs from a simple average house price index in that it could probably be termed a “fixed weight” average house price index.

One of the practical problems we have found with house price indices is that relative short term activity shifts up and down the price ladder can lead to an average or median price index rising or declining where there was not necessarily “genuine” capital growth on homes. For example, if “high end” volumes remain unchanged from one month to the next, but low priced areas’ transaction volumes hypothetically double, the overall national average price could conceivably decline due to this relative activity shift.

This challenge of activity shifts between segments is faced by all constructors of house price indices. In an attempt to reduce this effect, we decided to fix the weightings of the FNB Western Cape House Price Index’s sub-segments in the overall national index. This, at best, can only be a partial solution, as activity shifts can still take place between smaller segments within the sub-segments. However, it does improve the situation.

We segment not only according to room number, but also to segment according to building size within the normal segments by room number, in order to reduce the impact of activity shifts on average price estimates.

The FNB Western Cape House Price Index’s main segments are now as follows:

- The weightings of the sub-segments are determined by their relative transaction volumes over the past 5 years, and will now change very slowly over time by applying a 5-year moving average to each new price data point. The sub-segments are:

- Sectional Title:

- Less than 2 bedroom – Large
- Less than 2 bedroom – Medium
- Less than 2 bedroom – Small

- 2 Bedroom – Large
- 2 bedroom – Medium
- 2 bedroom – Small

- 3 Bedroom and More - Large
- 3 Bedroom and More - Medium
- 3 Bedroom and More - Small

- Full Title:

- 2 Bedrooms and Less - Large
- 2 Bedrooms and Less - Medium
- 2 Bedrooms and Less - Small

- 3 Bedroom - Large
- 3 Bedroom - Medium
- 3 Bedroom - Small

- 4 Bedrooms and More - Large
- 4 Bedrooms and More - Medium
- 4 Bedrooms and More – Small

The size cut-offs for “small”, “medium” and “large” differ per room number sub-segment. “Large” would refer to the largest one-third of homes within a particular room number segment over the past 5 year period, “Medium” to the middle one-third, and “Small” to the smallest one-third of homes within that segment.

- The Index is constructed using transaction price data from homes financed by FNB.

- The minimum size cut-off for full title stands is 200 square metres, and the maximum size is 4000 square metres
- The maximum price cut-off is R10m, and the lower price cut-off is R20,000 (largely to eliminate major outliers and glaring inputting errors).
- The index is very lightly smoothed using a Hodrick-Prescott smoothing function with a Lambda of 5.

Note on the FNB Western Cape Valuers' Market Strength Index: *When an FNB valuer values a property, he/she is required to provide a rating of demand as well as supply for property in the specific area. The demand and supply rating categories are a simple "good (100)", "average (50)", and "weak (0)". From all of these ratings we compile an aggregate demand and an aggregate supply rating, which are expressed on a scale of 0 to 100. After aggregating the individual demand and supply ratings, we subtract the aggregate supply rating from the demand rating, add 100 to the difference, and divide by 2, so that the FNB Valuers' Residential Market Strength Index is also depicted on a scale of 0 to 100 with 50 being the point where supply and demand are equal.