how can we help you?

PROPERTY BAROMETER – RESIDENTIAL PROPERTY AFFORDABILITY

2013 was a year in which residential and residential affordability improvement all but came to an end. 2014 looks increasingly like the year in which certain key measures of affordability deteriorate.

3 April 2014

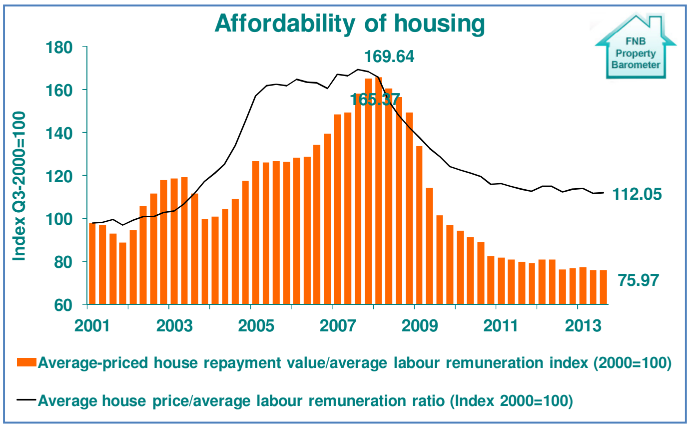
It appears increasingly likely that the "residential affordability cycle" is gradually turning the corner in the direction of deteriorating affordability, following a number of years of improvement, with house price growth solid, interest rates in a rising phase of the cycle, and average employee remuneration growth struggling.

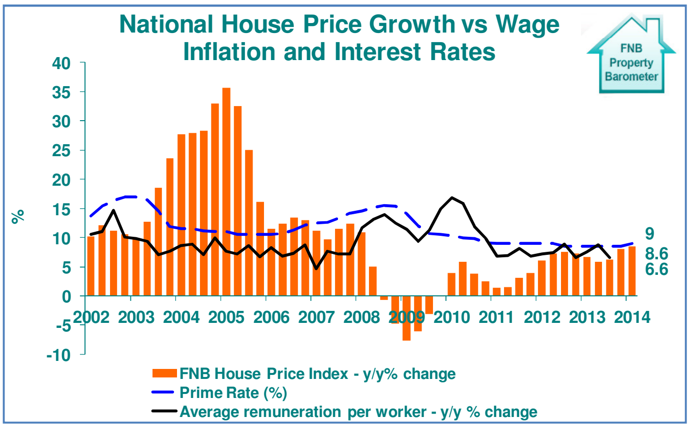
ESTIMATES OF HOME BUYING AFFORDABILITY

The March SARB Quarterly Bulletin enabled us to update our own 2 housing affordability indices for the 3rd quarter of 2013, using the SARB Average Employee Remuneration Index, the FNB House Price Index, and a Prime Rate time series. As at the 3rd quarter of last year, the improving trend in affordability that had started in 2008 appeared to have all but ended.

Of our 2 affordability measures, the 1st measure, namely the Average House Price/Average Employee Remuneration Index rose (deteriorated) slightly by +0.2% in the 3rd quarter of 2013 compared to the level for the previous quarter. The 2nd measure, namely the "Installment Payment Value on a new 100% Bond on the Average Priced House/Average Employee Remuneration Ratio" Index, also rose by +0.2% in the 3rd quarter, with both indices being driven slightly higher by the combination of accelerating house price growth and slower growth in average employee remuneration.

At this stage, however, the quarterly rise is very small, and the affordability levels still far improved on the highs of "in-affordability" experienced back around 2007/8. The cumulative decline (improvement) in the 2 affordability indices since their 2007/8 peak levels are -to -33.9% and -54.2% respectively.





Looking forward, however, certain key factors look set to work increasingly against further home affordability improvements for the time being, and possibly even bring about some mild deterioration in affordability in 2014.

Interest rates are now one of these factors. The SARB (South African Reserve Bank) has begun with its interest rate hiking cycle late in January, and has intimated at further moderate interest rate rises to come. It projects consumer price inflation to rise to a level above the 6% upper target limit in the near term, and we expect prime rate to be nearer to 10% by the end of this year, and 11% by the end of 2015.

Therefore, in 2014 we expect interest rates to be negative for home affordability.

The other 2 factors that also threaten to be negatives for home affordability are mildly faster house price growth of late, and the possibility that labour remuneration growth continues to struggle if 4th quarter StatsSA labour data is anything to go by.

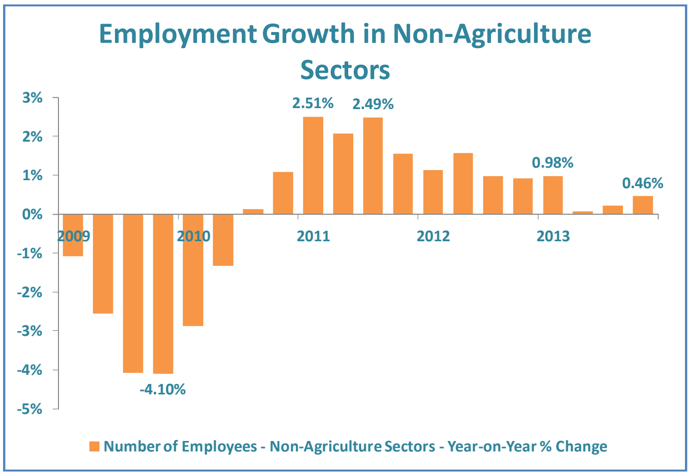
While economic growth still looks set to be pedestrian in the near term, with the SARB Leading Business Cycle indicator in year-on-year decline and both consumer and business confidence indicators weak, sentiment in the residential market remains upbeat, and house price growth early in 2014 above 8% year-on-year.

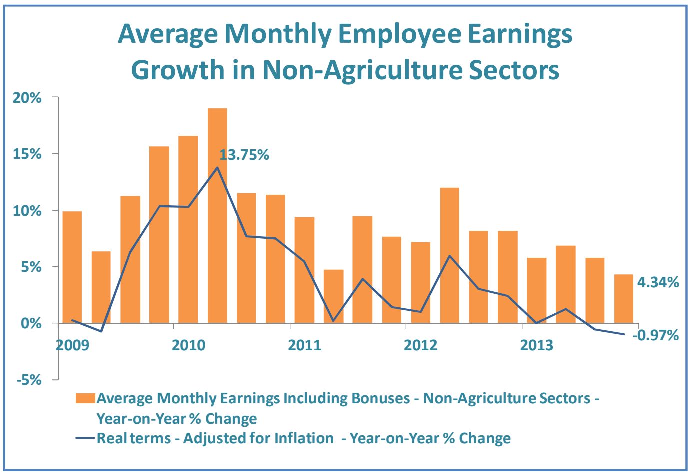
Building activity has remained slow for the past 5 years, and our FNB Estate Agent survey reports significant agent stock constraints, while FNB's valuers too continue to report increasingly constrained supply along with steadily rising residential demand.

On the other hand, the release of StatsSA labour data recently showed a further slowing in estimated Average Monthly Employee earnings growth, from 5.8% year-on-year in the 3rd quarter to 4.3% in the 4th quarter. While this series is not exactly the same as the SARB labour remuneration index, it would suggest that we probably saw a deterioration in the affordability indices in the final quarter of 2013, with that 4.3% average earnings growth faring poorly against a 4th quarter 8% year-on-year house price inflation rate.

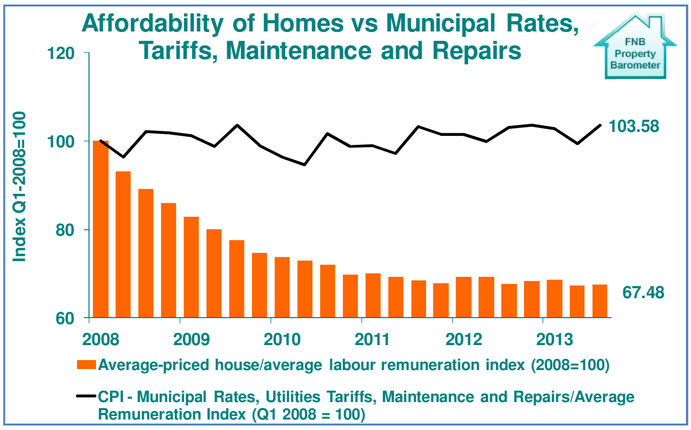
While wage settlements are indeed higher than the recent estimates of average employee earnings, it would appear that the discretionary component of employee remuneration is declining steadily.

According to the SARB Quarterly Bulletin, the Andrew Levy estimate for average wage settlements for the entire 2013 was 7.9%. This is slightly higher than the 7.6% estimate for 2012, but can it continue to accelerate under conditions of almost zero employment growth? We suspect not. If it did, this would exert even more pressure on already-weak employment numbers (with employment growth still not far above zero), as well as on the discretionary component of remuneration.





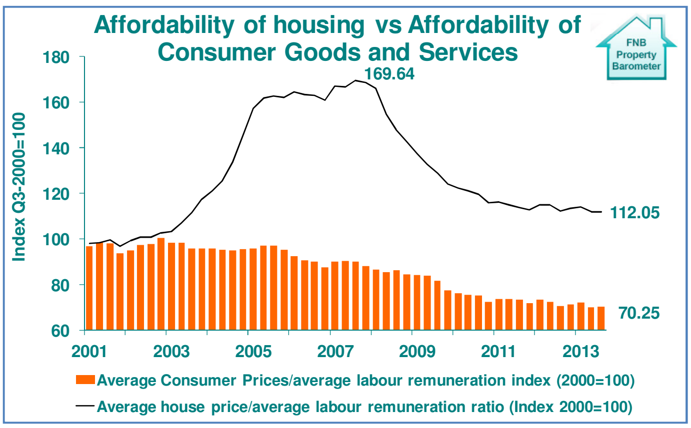
ESTIMATE OF HOME RUNNING COST-RELATED AFFORDABILITY



It is also important to consider measures of affordability that are related to the home, i.e. those that are running cost related, and to this effect we use components of the CPI (Consumer Price Index) to construct a CPI for Municipal Rates and Tariffs, along with the index for maintenance and repairs costs. Unlike the home buying-related affordability measures which saw improvement from 2008-2012, the 3rd quarter2013 Municipal Rates, Tariffs, Maintenance and Repairs/Average Employee Remuneration Index merely continued on its broad rising trend which it has sustained throughout the 2008-13 period.

This affordability measure is 3.6% above its level at the beginning of 2008, having been driven higher largely by high inflation in the area of municipal rates and tariffs, but moderated in part by lower maintenance and repairs cost inflation.

"COMPETITOR" AFFORDABILITY



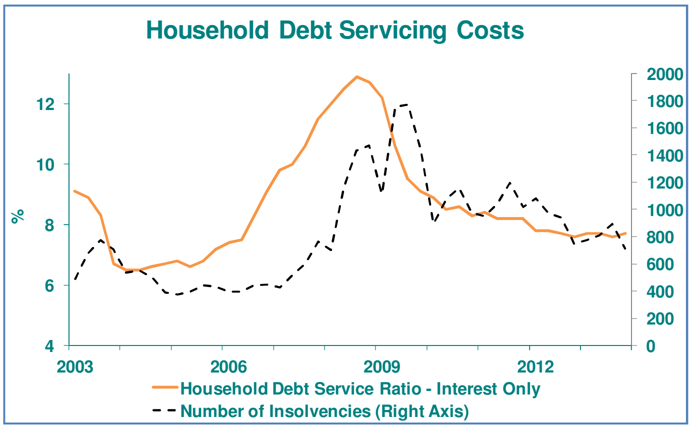
Then there is the matter of the "competitiveness" of housing versus consumer goods and services that in part compete with it for a share of household disposable income.

Relative to where we started back in 2000, at the start of the housing and consumer booms, housing is significantly worse off today. Limited housing supply back in those boom years, when demand surged, led to massive house price growth and resultant affordability deterioration. By comparison, affordability of consumer goods and services continued to improve throughout the boom years, with especially the importable consumer goods not experiencing major supply constraints and price inflation surges during demand booms.

Therefore, despite the Average House Price/Average Remuneration Index (with the year 2000=100) having improved (declined) quite dramatically to a 112 by the 3rd quarter of 2013, the Average Consumer Price/Average Remuneration (with the year 2000=100) had dropped as low as 70.25, having never really risen in the 1st place during the boom years of 2000-2007.

This trend of consumer goods and services increasingly out-competing housing on price is a long term one, with housing suffering from greater supply constraints as a result of long term increase in urban land scarcity. It partly explains why the trend is towards smaller average size of homes and stand, with less built in luxuries.

"CREDIT" AFFORDABILITY



Finally, there is the matter of credit affordability, which is a function of how much credit is outstanding, the level of disposable income, and of course the prevailing level of interest rates.

The best measure of the affordability of Household Sector credit is the Household Debt-Service Ratio (The cost of servicing the household sector debt burden, expressed as a percentage of Household Sector Disposable Income).

The SARB's "interest only" version of this ratio, like the 2 housing affordability indices, had more-or-less stabilized in 2013, and looks set to rise mildly in 2014 as interest rates rise.

IN CONCLUSION

To assess home affordability, the key factors to evaluate against incomes and interest rate levels are house price trends, rates and tariffs trends, maintenance and repair cost trends, affordability relative to "rival" consumer goods and services, and of course the cost of credit given that the residential market is so credit-dependent.

The 2008-2012 period saw major affordability improvements in certain key housing-related affordability measures, namely the Average House Price/Average Remuneration Ratio, the Average Installment Repayment Value on the Average Priced House/Average Remuneration Ratio, and the all-important Debt-Service Ratio. However, all 3 saw their improving trends all but end in 2013, due to the combination of mildly accelerated house price growth, slower average remuneration growth, and no further interest rate cuts.

Looking into 2014, it is likely that we will see all 3 of these affordability measures deteriorating mildly, with wage bill growth under pressure in a weak economy, house price growth having started the year higher, and interest rates now in a rising phase of the cycle.

It thus looks unlikely that housing affordability will meaningfully narrow the gap with consumer goods and services affordability in the near term though, as the latter continue to show a gradually improving affordability trend over the longer term.

At the other end of the affordability scale, the home-related Municipal Rates, Tariffs, Maintenance and Repairs Affordability measure remained on its long term trend of deterioration in 2013. This trend may, however, flatten out, as we have been witnessing slowing Rates and Tariff inflation rates in recent times, notably in the area of electricity tariffs.

But the overall affordability picture for 2014 looks set to be one of mild deterioration, and this informs our expectation that, later in the year, house price inflation may once again start to slow mildly, weighed down a little by such a general affordability deterioration.

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