November 2020

Property Barometer.

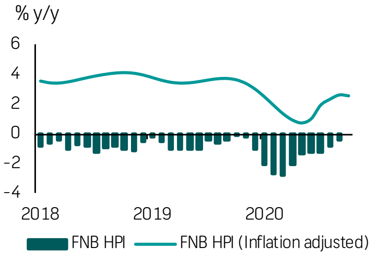
2.6%
y/y FNB HPI

10.6
weeks on market

48.47
FNB Valuers' Market Strength Index

Price growth resilient; outlook uncertain

Figure 1: FNB HPI – Mild reflation; still below CPI



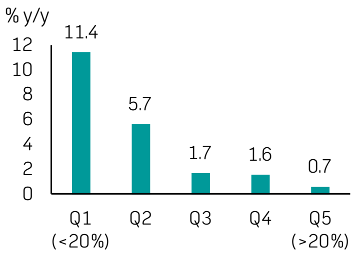
Source: FNB Economics, Stats SA

Key themes: 3Q20

- The pandemic has not had as chilling an effect as initially expected: prices growth has held up and volumes reached multi-year highs, particularly in middle-priced segments, in contrast to initial expectations.
- The aggressive reduction in interest rates (and mortgage rates), good pricing and lower transfer duties have momentarily improved mortgage affordability and incentivised renters to buy property. In part, this has contributed to rising flat vacancies and, subsequently, low rental inflation.
- The impact of the pandemic on labour markets has been disproportionate: low-paying occupations have been more severely affected, and professionals relatively insulated. In part, this explains an uptick in property sales due to financial pressure in lower-priced segments. In wealthy segments, however, income losses are exacerbated by their exposure to financial markets (mainly via dividends), corporate income (self-employment) and rental income.
- Overall, the impact of the pandemic is more visible in the rental market, relative to the home buying market.

FNB HPI shows resilience in price growth

Figure 2: Price growth by price quintile – Stronger growth in the lower end, despite labour market pressures



Source: FNB Economics

The FNB House Price Index (HPI) shows annual house price growth flatlined in October, reaching 2.6% y/y (last month downwardly revised from 3.1%). Despite the mild reflation in recent months, the overall residential property price growth remains below inflation, as has been the case for most of the last decade. Lower-priced properties are performing better, with the bottom 20% of price distribution (values below R500k, using FNB transaction data) averaging 11.4% y/y in 3Q20. On the opposite end the spectrum, the top 20% (>R1.9m) averaged 0.7% y/y in the same period.

Despite the pandemic, industry-wide data shows bourgeoning home buying activity, with the volume of mortgage applications reaching multi-year highs. Year-to-date, applications volumes are approximately 9% above the same period in 2019. However, approvals lag as lenders apply caution amid an uncertain economic outlook, only outpacing 2019 levels by approximately 1.5% year-to date. In our view, activity is shored up by lower interest rates, attractive market pricing, lower transfer duties and the changing housing needs due to the pandemic. Furthermore, liquidity in the market has remained relatively intact. Approval rates are slowly recovering from their recent lows in May/June during the height of lockdown (and subsequently, risk cuts from lenders) and have now cleared the long-term average (Figure 4). Loan-to-value ratios (estimated from Deeds data) also continue to tick up, mainly driven by market forces: first-time buyers generally require higher LTVs, but there is also stiff market competition among lenders.

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The improved affordability (lower acquisition and repayment costs) and increased demand has, inadvertently, offered sellers a bit more room to negotiate: the FNB Estate Agents Survey shows that the average discount from the listing price has pulled back somewhat, from 13% in 1Q20 to 11% in 3Q20. As a result, price reductions have not been as large as initially feared, underpinning resistance in house prices.

Notwithstanding, income pressures pose a significant downside risk in the coming quarters. For instance, if job losses spread to more white-collar occupations, we should expect further weaknesses in house price growth into 2021.

Insights from the FNB Estate Agents Survey

Affordable market (<R750k): Income squeeze evident

Labour market data shows that, so far, the low-income earners have had to bear the brunt of the labour market pressure. Job losses have been more severe in low-paying occupations, those with limited ability to work remotely, and those whose jobs are either on a fixed-term contract or of unspecified duration. Commensurately, the FNB Estate Agents Survey data shows rising incidents of property sales due to financial pressure, predominantly in the lower end of the market. Importantly, however, data shows that majority still look for a cheaper property (68%), reflecting sentimental value property holds in the affordable segment.

While income squeeze is a valid concern, so far there have been enough buyers in the segment, which, combined with structural supply deficit and lower rates, has helped keep prices afloat. Slightly positively, agents in this segment expected activity to pick up over the next three months (survey conducted in August), presumably as lockdown restrictions are lifted and income squeeze eases.

Middle market (R750k-R2.6m): Most improvement in activity

Data shows that the impulse in activity and market sentiment has been stronger in the middle price segments. This, in our view, is mainly driven by low interest rates and lower transfer duties.

In our estimation, recovery is mainly driven by younger (<35 years old), first-time buyers. These buyers typically require higher gearing (higher loan-to-value), and preliminary data shows that market LTVs on new loans are rising.

Further, the aggressive reduction of low interest rates (and mortgage rates); good pricing and lower transfer duties have momentarily improved mortgage affordability, and incentivised renters to buy property. In part, this has contributed to rising flat vacancies and, subsequently, low rental inflation.

Affluent market (R2.6m-R3.6m; >R3.6m): Financial pressure building up

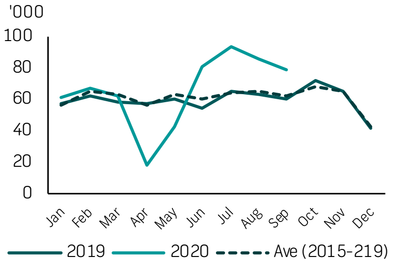
Recent data show that emigration has slowed, in part due to the pandemic (and impact on global labour markets). Further, anecdotal evidence suggests that homeowners are withdrawing properties on market for-sale, in favour of home improvement (using savings from interest rates and travel costs). This may be due to the changing living requirements, requiring a more conducive environment for working from home, but also a tough selling environment (weak demand growth).

So far, this has somewhat helped prevent a major deterioration in the supply gap. Notwithstanding, income pressures are building up, exacerbated by their exposure to financial markets (mainly via dividends), corporate income (self-employment) and rental income.

Outlook

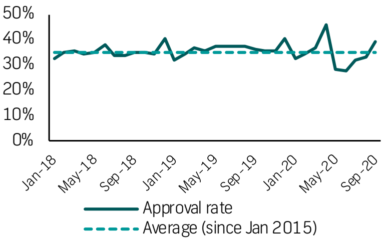
In our view the 2Q20 data reflects the initial impact of lockdown restrictions on employment (the “first wave”). There is a risk of a “second wave” of job losses: faced with low demand levels, corporates will likely seek to reduce operational costs and achieve efficiencies. This could come in the form of labour shedding and may even extend to higher-skilled workers, who, during the “first wave”, were relatively insulated. Our expectation of more pressure in labour market conditions implies greater downward pressure on activity, and consequently price growth in the medium term.

Figure 3: Robust demand for mortgages



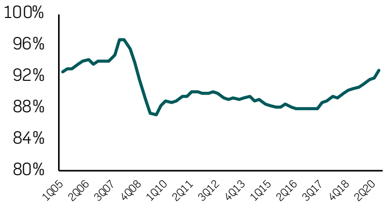
Source: SARB, FNB Economics

Figure 4: Gradual recovery in approvals



Source: SARB, FNB Economics

Figure 5: LTVs tracking higher



Source: Deeds, FNB Economics

Note: data are preliminary

Risk factors:

- Labour market tailwinds (delayed impact), spreading to white-collar professionals, in turn knocking confidence (demand factors)
- Shrinking demand and rising vacancy rates in the rental market present a threat to housing stock for sale: more landlords may elect to sell their properties (supply impulse)
- If emigration in the upper end resumes, it will push supply up and prices down
- Pressure on other income streams, e.g. dividend or rental income intensifies (affects mainly affluent households)

Support factors:

- Low interest rates for longer
- Efforts to reignite economic activity may boost sentiment and employment

Monthly FNB House Price Index (% y/y)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2001		-1.7	-0.7	-0.4	-0.5	0.7	3.0	5.9	8.6	10.6	11.6	11.8
2002	11.6	12.0	12.8	13.8	14.2	14.0	13.6	13.1	13.2	13.5	13.8	13.8
2003	14.0	14.5	15.3	16.2	17.1	18.2	19.3	20.3	21.4	22.9	24.7	27.0
2004	29.4	31.3	32.4	33.2	33.7	33.9	34.5	35.1	35.3	35.2	35.3	35.4
2005	34.8	33.8	32.9	31.8	30.7	29.7	28.8	27.9	26.9	25.7	23.9	21.7
2006	19.9	18.5	17.6	17.3	17.3	17.2	16.9	16.5	15.8	15.1	14.4	14.0
2007	14.0	14.3	14.9	15.7	16.3	16.6	16.3	15.5	14.5	13.2	12.0	11.0
2008	9.7	8.0	5.5	2.5	-0.4	-2.9	-4.7	-5.6	-5.8	-5.6	-5.1	-5.1
2009	-5.0	-5.0	-4.5	-3.8	-2.8	-1.8	-0.7	0.0	0.5	0.9	1.2	2.0
2010	3.0	3.9	4.6	5.2	5.6	5.5	5.0	4.7	4.5	4.1	3.7	3.1
2011	2.4	2.1	2.0	2.2	2.5	2.8	3.3	3.6	3.8	3.9	4.1	4.4
2012	4.7	4.8	4.8	4.7	4.6	4.7	4.9	5.2	5.6	5.7	5.8	5.8
2013	5.9	6.0	6.1	6.1	6.1	6.3	6.5	6.4	6.3	6.5	7.0	7.7
2014	8.2	8.3	8.2	8.3	8.4	8.3	8.0	7.8	7.6	7.2	6.8	6.2
2015	5.8	5.9	6.3	6.5	6.6	6.4	6.3	6.2	6.1	6.2	6.3	6.3
2016	6.3	6.2	6.1	6.0	5.9	5.8	5.7	5.6	5.4	5.1	4.8	4.8
2017	4.7	4.6	4.5	4.3	4.2	4.1	4.1	4.2	4.2	4.2	4.0	3.8
2018	3.5	3.3	3.4	3.5	3.7	3.8	3.9	4.0	4.1	4.2	4.1	4.0
2019	3.8	3.6	3.4	3.4	3.4	3.5	3.6	3.7	3.8	3.7	3.5	3.1
2020	2.5	1.9	1.3	0.9	0.7	1.0	1.9	2.3	2.6	2.6		

ADDENDUM - NOTES:

Note on The FNB House Price Index:

The FNB Repeat Sales House Price Index has been one of our repertoire of national house price indices for some years, and is based on the well-known Case-Shiller methodology which is used to compile the Standard & Poor's Case-Shiller Home Price Indices in the United States.

This "repeat sales approach" is based on measuring the rate of change in the prices of individual houses between 2 points in time, based on when the individual homes are transacted. This means that each house price in any month's sample is compared with its own previous transaction value. The various price inflation rates of individual homes are then utilized to compile the average price inflation rate of the index over time.

The index is compiled from FNB's own valuations database, thus based on the residential properties financed by FNB over the past 18 years.

We apply certain "filters" and cut-offs to eliminate "outliers" in the data. They main ones are as follows:

- The maximum price cut-off is R15m, and the lower price cut-off is R20 000.
- The top 5% of repeat sales price growth rates, and the bottom 5% of growth rates are excluded fromthe data set.
- Repeat transactions that took place longer than 10 years after the previous transaction on the same home are excluded, as are repeat transactions that took place less than 6 months after the previoustransaction on the same home.
- The index is very lightly smoothed using a Hodrick-Prescott smoothing function with a Lambda of 5.

Note on the FNB 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.