TPN Rental Monitor

"Greater discipline and vigilance are key in uncertain times"

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Property sector can be referenced as adopting a holding pattern

The property sector has not emerged from the past year unscathed by what economists frequently refer to as 'the distressed South African economy.' As we entered 2019, we were reminded of the upheaval that preceded the election year, and how much has centred on response to the election result, both politically and economically.

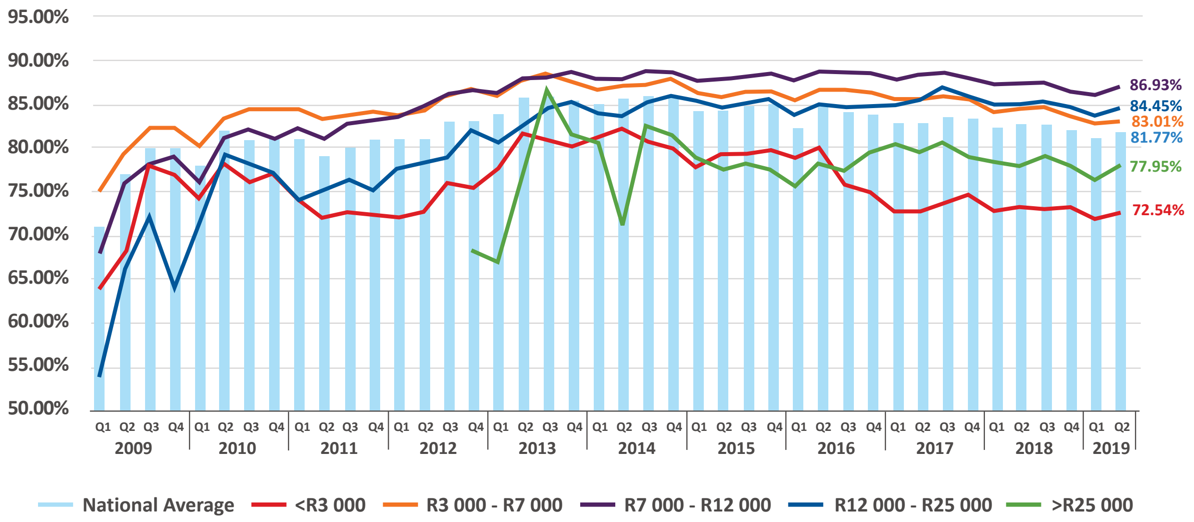
Given the pressure that has been placed on President Ramaphosa to gain traction on the reformation of our sluggish economy, to actively manage Eskom bail-out plans, and reduce the impact of a deteriorating currency, more than just the property sector has been left in a quandary.

Investors on all fronts have been questioning what steps should be taken next, and what levels of recovery might prevail. As such, we see the property sector reacting no differently to other sectors – a reaction we can reference as a holding pattern.

Residential tenants in good standing peaked at 85.95% in the third quarter of 2013, coinciding with the start of the downward business cycle that commenced in December 2013. Historically, the longest since World War 2.

Coming off this 2013 peak, TPN's tenant good standing performance has seen a slow and steady deterioration to 81.77% in the second quarter 2019, a combination of 66.15% of tenants who pay on time and in full, 4.72% who pay during the grace period and 10.90% of tenants who pay late. Delinquencies comprised 11.30% of tenants who made a partial payment and 6.94% of tenants who were recorded in the did-not-pay category.

TPN RENTAL GOOD STANDING: BY VALUE

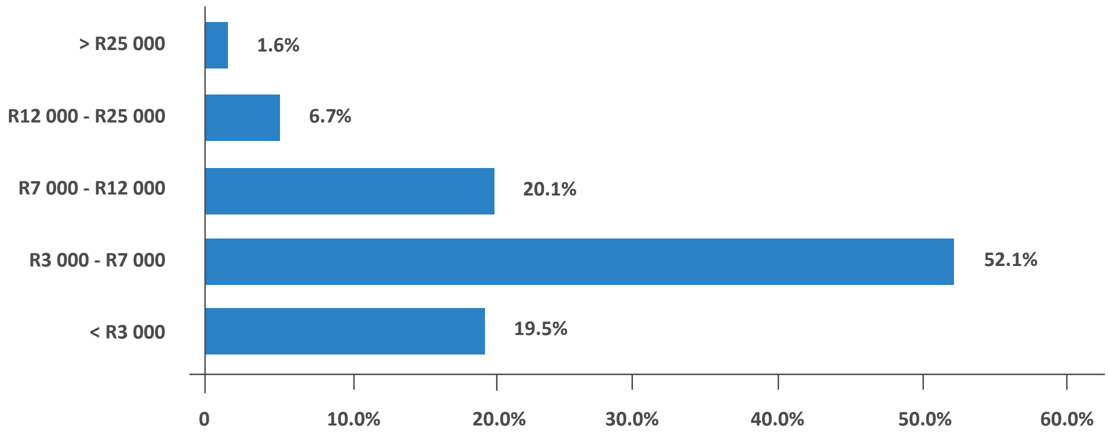


TPN Credex indicates weakening quality in tenant ratings

Property investors have always taken comfort in the truism that paying for the "roof over your head" is a priority payment for most consumers. Noticeably, during this current 6 year downward business cycle, mortgage repayments have maintained an average above 90% of accounts paid in the "current term" (source Consumer Credit Market Report).

TPN has also noted that the quality of tenants applying for rent has weakened from 80% to 75.24% on the Credex default scorecard. With a similar deterioration in tenants placed, it is clear landlords are experiencing pressure caused by a shrinking pool of quality tenants.

TPN RENTAL DISTRIBUTION BY VALUE (2019 Q2)



Percentage of residential tenants categorised by value of rent

While residential rental payments hold onto second place, the deterioration in tenant behaviour means the gap between mortgage and rental repayments has widened from only 5.15% in 2013 to 9.90% at present.

Undoubtedly there has been a period of stricter mortgage lending policies, the upside of which means mortgage repayments have not deteriorated. On the flip side, the number of mortgage accounts has dropped from 1.8 million in 2013 to 1.7 million in 2019.

Secured credit, credit facilities and unsecured credit achieved 73.78%, 73.76% and 73% respectively, of accounts paid in the "current term". Short term credit took the hardest knock with only 66% of accounts paid in the "current term". Furthermore, according to TransUnion's Consumer Credit Index, accounts in early default (3 months in arrears) have continued to increase.

Low end of the market plagued by shrinking disposable income

TPN SUMMARY BY RENTAL VALUE (2019 Q2)

Value	Vacancy Rate	Market Strength	Good Standing	Escalation	Lease Length	Market Share
< R3 000	8.02%	56.80%	72.54%	5.00%	23.8 months	19.50%
R3 000 - R7 000	6.69%	50.80%	83.01%	3.80%	20.5 months	52.10%
R7 000 - R12 000	6.99%	47.70%	86.93%	3.10%	19.5 months	20.10%
R12 000 - R25 000	13.92%	47.50%	84.45%	2.90%	19.4 months	6.70%
> R25 000			77.95%			1.60%
National	7.91%	49.60%	81.77%	3.80%	21 months	100.00%

Risky business:

In the low end of the market, tenants who pay less than R3,000 per month on rental remain the most risk-troubled category where 72.54% of tenants are in good standing. With one in five tenants falling into this category, the 14.82% of tenants who are listed as non-payers, plus a further 12.64% making only partial payment. This segment represents a significant number of the delinquencies in the property market.

Shrinking disposable income is impacting tenant affordability, compounded by limited new rental stock in this sector, which is reflected in the TPN Market Strength Index of 56.80. (Where 50 indicates a market in equilibrium and an amount above 50 indicates more demand than supply.)

Mass market:

One in two tenants rent for between R3,000 and R7,000 per month. This portion of the market attracts investors due to its large market share and high demand, which is reflected in the low vacancy rate of 6.69%. The good standing percentage of 83.01% also remains above the national average.

However, data is beginning to reflect a distinction between tenants paying R3,000 - R4,500 compared to the R4,500 - R7,000 range. A lower good standing percentage of 81% for the R3,000 - R4,500 tenants occurs, while the R4,500 - R7,000 tenants payment performance is slightly better with 84% in good standing.

Different rental value categories face their own unique challenges

Sweet spot:

When it comes to rental payment, the best performing tenants are in the R7,000 - R12,000 category where 86.93% of tenants are in good standing and only 4.19% of tenants did not pay. The challenge for this segment of the market is its deteriorating market strength. Tenant affordability constraints, coupled with an increase of rental stock development has resulted in a TPN market strength index of 47.7 indicating increasing oversupply compared to demand.

Mixed bag:

Although the 12,000 - R25,000 bracket performs well in terms of rental payment with 84.45% of tenants in good standing, escalations remain severely low at 2.9%, while vacancies remain desperately high at 13.92%.

Luxury living:

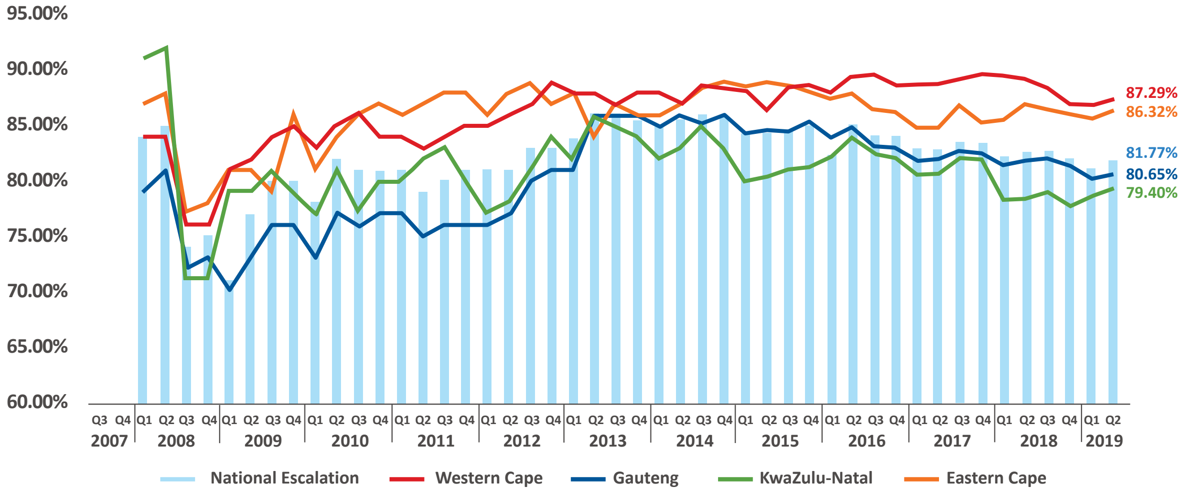
Without detracting from the poor payment performance of the low-end of the market, the weakest area of the market is the above R25,000 per month segment. Albeit that only 1.2% of tenants can afford to live in such luxury, the good standing percentage is only 77.95%. It is important to note that the biggest challenge is represented by partial payments from 15.38% of tenants, while non-payments are only 6.66%. This, together with a vacancy rate of 13.92%, typifies significant leakage in this segment.

TPN RENTAL GOOD STANDING: BY RENT VALUE

2019 Q2	Paid on Time	Grace Period	Paid Late	Partial Payment	Did not Pay	Good Standing	National Average	Market Share
< R3 000	56.65%	5.43%	10.46%	12.64%	14.82%	72.54%	81.77%	19.5%
R3 000 - R7 000	66.64%	4.79%	11.58%	11.72%	5.27%	83.01%	81.77%	52.1%
R7 000 - R12 000	73.78%	3.76%	9.39%	8.88%	4.19%	86.93%	81.77%	20.1%
R12 000 - R25 000	69.27%	4.46%	10.72%	10.37%	5.17%	84.45%	81.77%	6.7%
> R25 000	57.46%	6.69%	13.80%	15.38%	6.66%	77.95%	81.77%	1.6%

Despite pressure, Western Cape still the best performing region

RENTAL GOOD STANDING: BY PROVINCE



The Western Cape has been showing signs of stress, although its good standing percentage of 87.29% remains best in the country. In addition, investors can take enviable relief in only having to deal with 3.9% of non-paying tenants. Provincially the Western Cape also enjoys the highest escalation rate of 4.5%, as well as the second-lowest vacancy rate of 7.08%.

Be that as it may, the Western Cape story is characterised by a dramatic three year decline, during which the market strength plummeted from 85.57 to 45.32, driving down escalations and pushing vacancies from 1.2% to current 7.08% (marginally better than the 9.9% reported in the last quarter).

GOOD STANDING: RENT BY PROVINCE

2019 Q2	Paid on Time	Grace Period	Paid Late	Partial Payment	Did not Pay	Good Standing	National Average
Eastern Cape	72.74%	3.33%	10.25%	9.45%	4.22%	86.32%	81.77%
Free State	60.57%	3.40%	12.26%	11.86%	11.92%	76.23%	81.77%
Gauteng	63.81%	5.27%	11.57%	12.10%	7.24%	80.65%	81.77%
KwaZulu-Natal	64.36%	4.09%	10.95%	12.75%	7.84%	79.40%	81.77%
Limpopo	64.41%	6.49%	15.78%	8.39%	4.94%	86.68%	81.77%
Mpumalanga	67.43%	4.34%	11.60%	11.73%	4.89%	83.37%	81.77%
Northern Cape	71.85%	5.15%	9.45%	8.39%	5.15%	86.45%	81.77%
North West	67.42%	3.26%	11.06%	11.71%	6.55%	81.74%	81.77%
Western Cape	76.23%	3.26%	7.80%	8.82%	3.90%	87.29%	81.77%

Eastern Cape outperforms KZN and Gauteng regions

TPN SUMMARY BY PROVINCE (2019 Q2)

Province	Vacancy Rate	Market Strength	Good Standing	Escalation	Lease Length
Eastern Cape	4.79%	61.31%	86.32%	3.9%	21.8 months
Gauteng	8.35%	46.32%	80.65%	3.6%	21.3 months
KwaZulu-Natal	7.28%	58.85%	79.40%	4.3%	21.1 months
Western Cape	7.08%	45.32%	87.29%	4.5%	21.6 months
Smaller 5	9.87%	60.36%	81.05%	3.2%	19.4 months
National	7.91%	49.60%	81.77%	3.8%	21.0 months

Although Gauteng commands the largest market share, a recent surge in new rental property stock has resulted in supply now exceeding demand with a market share index of 46.32. The consequent oversupply has driven vacancies higher to 8.3%. Nevertheless, escalations seem to have bottomed out and have subsequently risen to 3.6% in Q2 2019.

Gauteng tenants have a worse payment profile than the national average with 80.65% of tenants in good standing and the most severe challenge caused by 7.24% of non-paying tenants.

KwaZulu-Natal still attracts good tenant demand with a market strength of 58.85, meaning that relative to the national market this province enjoys higher escalations of 4.5% and lower vacancies of 7.28%. Conversely, the province continues to struggle with rent collection at just 79.4% of tenants in good standing.

Eastern Cape enjoys the best market strength index at 61.31, combining excellent rent collection with 86.32% of tenants in good standing, the lowest vacancy rate of 4.79% and comparably speaking, a reasonable rental escalation of 3.9%.

Greater discipline and vigilance are key in uncertain times

The property market remains flat. Property investment buying peaked in quarter three of 2007 with 25% of properties being purchased for investment. Subsequently, the market bottomed out to 18% during the 2008/09 financial crisis and then recovered to flatten out again at current levels of 20.35%. For context, property investment buying was in single digits in 2000.

For those property investors who are committed to rental property investment, it would make sense to become more vigilant in monitoring returns coupled with being more disciplined in mitigating their portfolio risks.

From a rental portfolio perspective – the monitoring of payments and a quick response to delinquent tenant conduct should be reinforced by proactive behaviour, which remains within direct control of all of us in this sector.

The concept of maintaining a holding pattern while we observe how matters that are out of our control unfold, merely means that discipline and vigilance will remain the way forward for both owners, and investors, in the foreseeable future.

TPN AVERAGE LEASE LENGTH BY RENTAL VALUE BAND