PayProp

# RENTAL INDEX

Q2 2019

## Silver linings

### – subdued rental market offers hope

Stabilised rental growth

Tenants get relief

# CONTENTS

Introduction

# HALFWAY THERE!

In less than five months it will be 2020. Let that sink in for a moment.

While not much has changed in the South African rental market so far this year, even a sluggish economy can have silver linings! Other than the recent repo rate reduction, we've also had a few other glimmers of good news.

Sometimes it's a matter of perspective. In this issue, we unpack rental growth from multiple angles to put lower growth into its proper context.

In other sections, we look at long-term trends in tenants' financial metrics and identify the red flags that can help agencies avoid bad tenants.

A highlight of our annual calendar is the PayProp Academy, held across the country in May. Now that it is over, it's on to planning the next one! Read more about the cybercrime theme of this year's event on p24.

As always, there's a lot to sink your teeth into in this issue of the PayProp Rental Index. Enjoy! We'll be back next quarter to bring you the last quarterly edition for 2019. ■

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> In this issue, we unpack rental growth from multiple angles to put lower growth into its proper context.

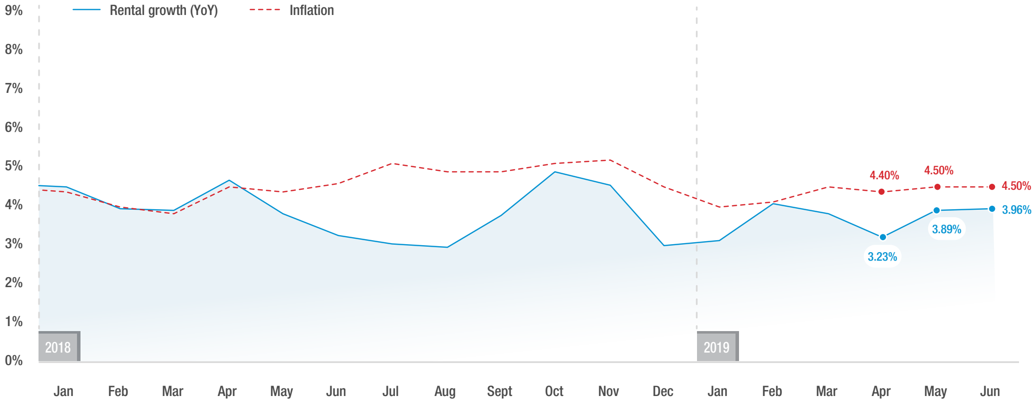
National rent statistics

# FLAT GROWTH THROUGHOUT

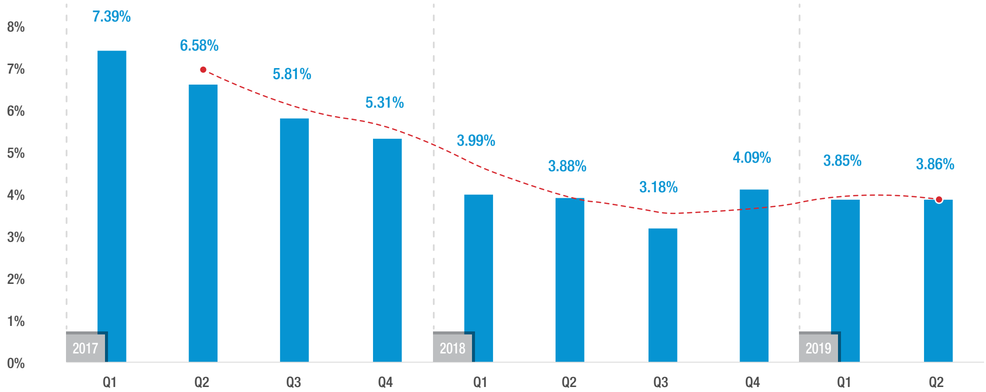
We have now seen 18 months – or six quarters – of subdued, mostly sub-inflationary rental growth.

But while that is not the best news for landlords, at least it is not trending downward.

The same can be said for the inflation rate. While a low inflation rate may indicate weak economic growth, long-suffering consumers will welcome slower growth in the cost of living.




Weighted average national rental growth rate (YoY) vs. inflation – Jan 2018 to Jun 2019
**Source: PayProp**




Quarterly YoY rental growth rates with a moving average trendline
**Source: PayProp**

Moving averages are often used to forecast trends because they look at the average movement over longer, overlapping periods of time.

## No signs of up or down

Average quarterly rental growth compared to the same quarter last year was 3.86%. This is very much in line with the quarterly year-on-year (YoY) growth rate of 3.85% in Q1 of 2019. Adding a moving average trendline to highlight longer-term trends adds further confirmation of the happy news for landlords – rental growth is at least not trending downward anymore, although there are no signs it will increase soon either.

In this section, we look at the average YoY growth rate in rent, inflation and income in 2016, 2017 and 2018. The average for 2019 was calculated over the first six months of the year.

## Long-term changes

As the data from 2018 and 2019 very much reflected the current flat growth, it is easy to forget that higher-than-inflation rental growth prevailed for much of 2017. In that year, the average growth rate over 12 months was 6.45%, compared to an average inflation rate of 5.3%.

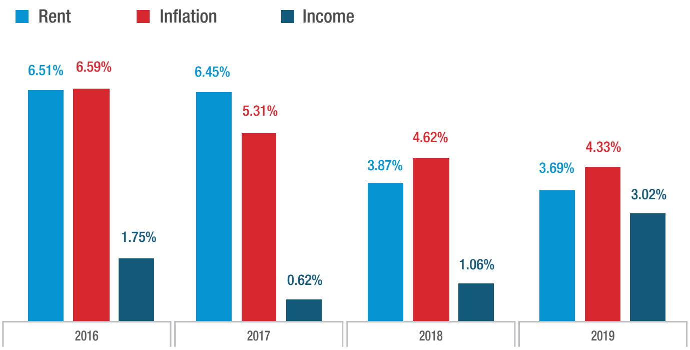
Before that, in 2016, rental growth was much more in line with inflation.

For the last two years, however, we have seen inflation outpacing rental growth rates, even though the rate of growth in consumer prices has dipped over previous years.

In all discussions about rental growth, we are mindful that there are two sides to the coin – while landlords and agents prefer higher growth, as it directly impacts their bottom line, tenants prefer the opposite.

While we have seen a rebound in income growth figures so far in 2019, they have not kept up with the average rise in inflation, meaning that consumers have increasingly less purchasing power.

Rent and income data are generated by the PayProp system. Both metrics are weighted according to each province's contribution to GDP. For inflation, official CPI rates are used.




Rental growth, inflation and income growth by year
**Source: PayProp**

South African economy

# HOW DO INTEREST RATES AFFECT THE ECONOMY?

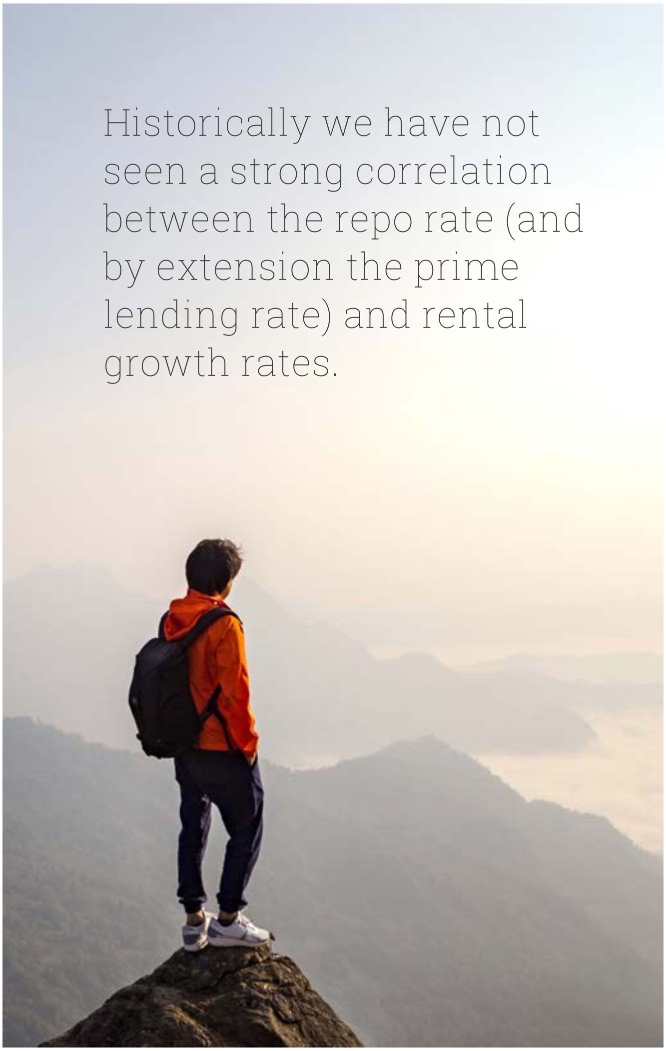
On 18 July, the South African Reserve Bank (SARB) announced that the repo rate had been cut by 25 basis points from 6.75% to 6.5%. The prime interest rate is directly linked to the repo rate and was reduced from 10.25% to 10%.

### What does this mean and why does it matter?

A lower interest rate means it is cheaper to borrow money and consumers pay less interest on their current debt. When consumers borrow and spend more, more money enters the economy, which, in theory, should boost economic activity and increase economic growth.

### How does this affect the rental market?

Historically we have not seen a strong correlation between the repo rate (and by extension the prime lending rate) and rental growth rates. Rather, rental growth is stimulated by other economic factors like supply and demand and affordability. Different economic activity in the various provinces (e.g. mining) also affects provincial growth rates. ■


Historically we have not seen a strong correlation between the repo rate (and by extension the prime lending rate) and rental growth rates.

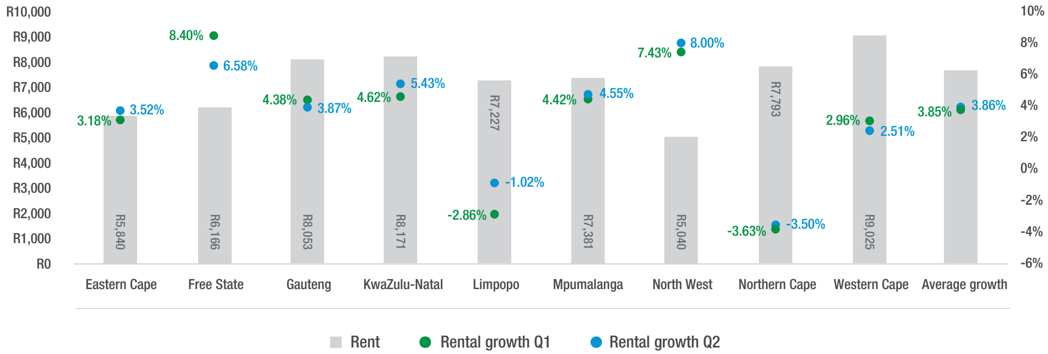
Provincial rent statistics

# QUARTERLY CANVAS

Nationally, year-on-year (YoY) rental growth for the second quarter equalled that in the first quarter, further corroborating the sideways trend we have been speaking about.

Of course, rent levels and growth across individual provinces can differ substantially from the national average, which is a good reason to delve deeper into current rental statistics.

Six out of the nine provinces saw higher rental growth levels in Q2 compared to Q1.




Provincial rent levels in Q2 2019, plotted with Q1 and Q2 rental growth rates
**Source: PayProp**

Highlights from the graph include:

- While the North West is still the cheapest province in which to rent, it had the highest growth rate (YoY) in the second quarter. The province also showed rapid rental growth in the first quarter of the year.
- Rental growth in the Western Cape continued to slow, but the province remains the most expensive for renters.
- Limpopo and the Northern Cape both saw negative rental growth in quarter one, and the trend continued in quarter two. Negative growth means rents are now lower than a year ago.
- Free State rentals are still increasing at a much faster rate than most provinces. The same is true of rentals in KwaZulu-Natal.
- Six out of the nine provinces saw higher rental growth levels in Q2 compared to Q1. ■

Tenants' financial health

# LONG-TERM TRENDS

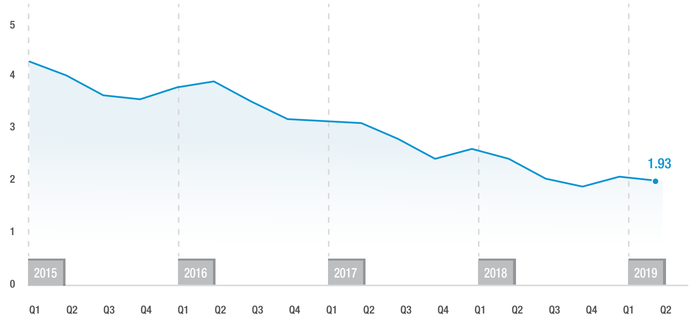
In the previous PayProp Rental Index we lifted the lid on ways to spot a bad tenant. Several factors can harm a credit score, and here we take a closer look at some of them over the longer term.

## Types of accounts

The data reveals that riskier tenants have more 'bad debt' accounts (National Loans Register or NLR debt, including payday loans), and fewer 'good debt' accounts (Credit Providers Association or CPA debt, such as retail store accounts). The opposite is true for lower-risk tenants.


Number of CPA accounts held by the average applicant
**Source: PayProp**

The trends discussed here are observed from credit checks done via the PayProp system.



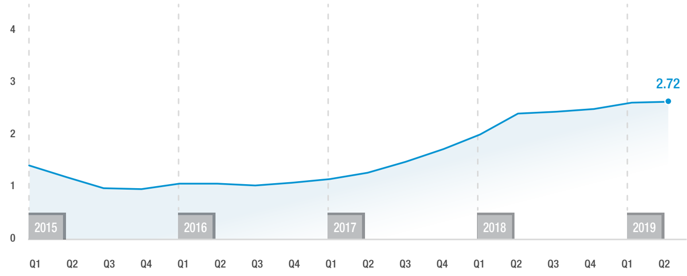

Number of NLR accounts held by the average applicant
**Source: PayProp**

Over the long term, there is some good news: while the average number of CPA accounts has stayed relatively stable at just over eight, there was a reduction in the average number of NLR accounts, from four to around two.

### Credit enquiries

While there is such a thing as the right type of credit, the very fact of applying for credit too often is an indication that the need for it is too great, or that the credit applied for was refused. Both are red flags.

Over the long term, our analysis shows an increase in the number of credit enquiries for the average tenant, to almost three over 12 months.



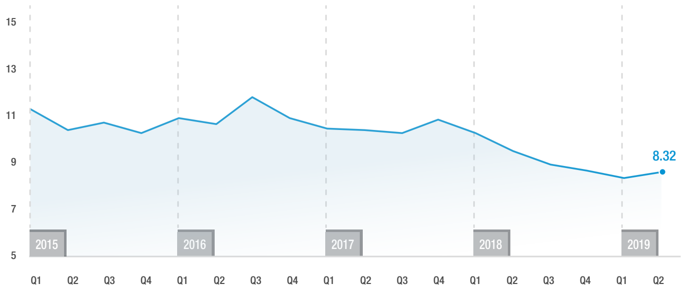

Average number of credit enquiries done on an applicant

**Source: PayProp**

### Payment behaviour

Generally, three indicators come into play:

- The number of months since an applicant has been in arrears for three months or more
- The highest number of months in arrears on any account
- The number of accounts in arrears during the preceding year




Months since an applicant has been in arrears three months or more

**Source: PayProp**

Over the long term, the second and third measures have been very stable in our sample base. The highest number of months in arrears on any account has been between three and four. And the average number of accounts in arrears during the previous year has stayed around 1.5 for the last three years. (Any account in arrears will be counted here, regardless of how many months the account was in arrears for.)

We have, however, seen a reduction in the number of months since the average applicant has been in arrears for three months, meaning tenants are three months or more in arrears more often now than in previous years – not a good sign at all.

## Affordability

While affordability measures do not necessarily affect a credit score very much, affordability is a very important consideration when assessing a potential tenant's risk of defaulting.

Here, we look at three variables:

- Debt-to-income ratio, which expresses an applicant's monthly debt repayments as a percentage of his or her net (after-tax) income.
- Rent-to-income ratio, which expresses an applicant's monthly rent as a percentage of net income.
- Affordability ratio, which expresses the sum of debt repayments and rent as a percentage of net income. The higher this number, the lower the percentage of their net income that is available to save or spend on things like groceries, school fees, levies, etc.

Looking at these categories over time, we can see that all three have been increasing slowly for the average tenant. This is to be expected, given our earlier discovery that both inflation and rental growth have been outperforming increases in income.

This has brought about a steady erosion in tenants' disposable income, putting them under increasing financial pressure.

## Summary

In summary, most credit metrics have weakened slightly over time, while average credit scores have stayed around the same level. In a weak economy, this is to be expected, but good financial health is vital when placing a tenant.

We also recommend that you always recheck a tenant before renewing a lease – it is the best way to spot potential red flags.

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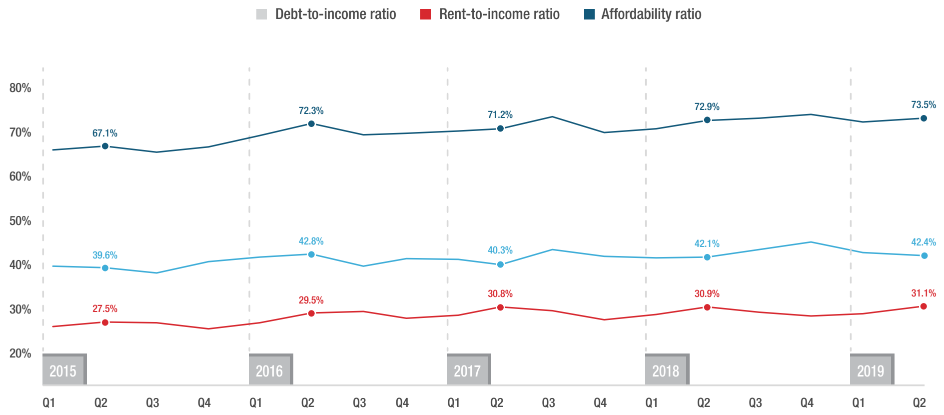



Affordability measures over time

**Source: PayProp**

Tenants' financial health

# PROVINCIAL SNAPSHOT

After looking at long-term national trends in credit metrics, you might be wondering how tenants in your province are doing. Look no further! Below we look at a province-by-province breakdown of the credit metrics for Q2. We also indicate whether tenants in your area are doing better or worse than the national average.

- **CPA accounts:** The average number of 'good debt' accounts that an applicant has. Lower-risk applicants tend to have a higher number of CPA accounts.
- **NLR accounts:** The average number of 'bad debt' accounts. Lower-risk applicants have fewer of this type of account.
- **Previous enquiries:** The number of credit checks done on an applicant in the last 12 months. A lower number is linked to lower applicant risk.
- **Months since an account was three months in arrears:** The number of months since an applicant was three months or more in arrears on any account. The higher the number, the better.
- **Highest number of months in arrears:** Indicates the highest number of months that an applicant was in arrears on any account in the last 12 months. The lower the number, the better.
- **Accounts in arrears:** Indicates the number of accounts that were in arrears at any point in the last 12 months. The lower the number, the better.
- **Debt-to-income ratio:** Expresses an applicant's monthly debt obligations as a percentage of their net income (after tax). The lower the percentage, the better.
- **Rent-to-income ratio:** Expresses an applicant's monthly rental applied for as a percentage of their net income (after tax). The lower the percentage, the better.
- **Affordability risk:** Expresses the sum of an applicant's monthly debt and rent payments as a percentage of their net income (after tax). A higher number indicates less disposable income.

Tenants’ financial health

# AVERAGE NATIONAL METRICS

### Types of debt

CPA accounts
8.2

NLR accounts
1.9

### Enquiries

Previous enquiries
2.7

### Payment behaviour

Time since an account was three months in arrears
8.3 months

Number of months in arrears
3.8 months

Accounts in arrears
1.6 accounts

### Affordability

Debt-to-income ratio
42.4%

Rent-to-income ratio
31.1%

Affordability risk
73.5%

Tenants' financial health

# EASTERN CAPE

● Worse than national average ● Better than national average ● Same as national average

## Types of debt

CPA accounts ●
7.6

NLR accounts ●
2.2

## Enquiries

Previous enquiries ●
2.6

## Payment behaviour

Time since an account was three months in arrears ●
8.1 months

Number of months in arrears ●
4.3 months

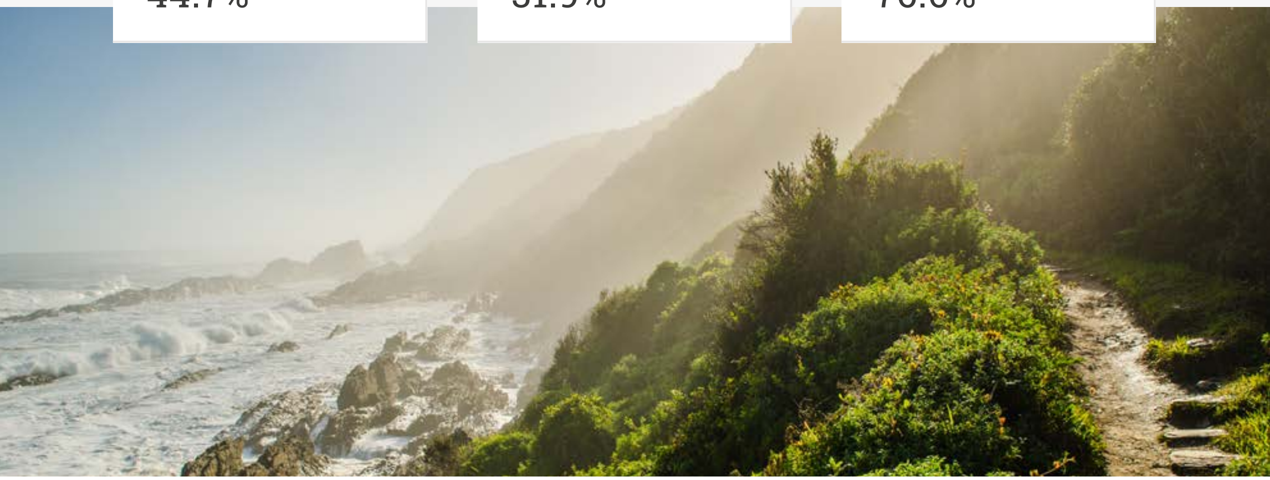
Accounts in arrears ●
1.7 accounts

## Affordability

Debt-to-income ratio ●
44.7%

Rent-to-income ratio ●
31.9%

Affordability risk ●
76.6%



Tenants' financial health

# FREE STATE

- Worse than national average
- Better than national average
- Same as national average

## Types of debt

CPA accounts
8.3

NLR accounts
1.6

## Enquiries

Previous enquiries
2.7

## Payment behaviour

Time since an account was three months in arrears
9.8 months

Number of months in arrears
3.6 months

Accounts in arrears
1.6 accounts

## Affordability

Debt-to-income ratio
39.5%

Rent-to-income ratio
27.7%

Affordability risk
67.2%

Tenants' financial health

# GAUTENG

● Worse than national average ● Better than national average ● Same as national average

### Types of debt

CPA accounts (better than national average)
8.6

NLR accounts (worse than national average)
2.2

### Enquiries

Previous enquiries (worse than national average)
3.0

### Payment behaviour

Time since an account was three months in arrears (same as national average)
8.3 months

Number of months in arrears (worse than national average)
3.9 months

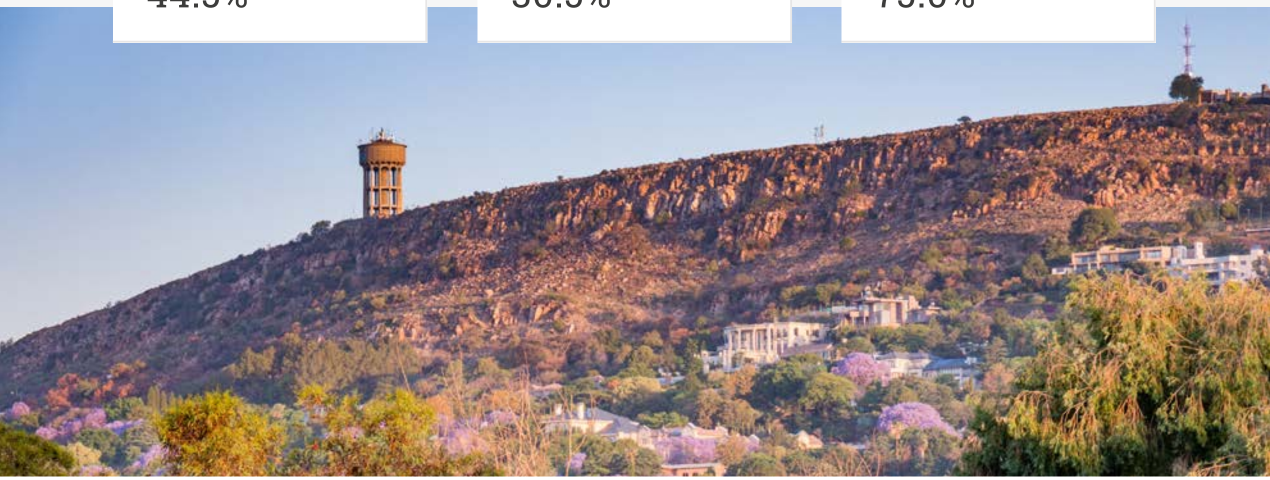
Accounts in arrears (worse than national average)
1.7 accounts

### Affordability

Debt-to-income ratio (worse than national average)
44.5%

Rent-to-income ratio (better than national average)
30.5%

Affordability risk (worse than national average)
75.0%



Tenants' financial health

# KWAZULU-NATAL

● Worse than national average ● Better than national average ● Same as national average

## Types of debt

| CPA accounts (worse than national average) | NLR accounts (better than national average) |
| --- | --- |
| 8.1 | 1.7 |

## Enquiries

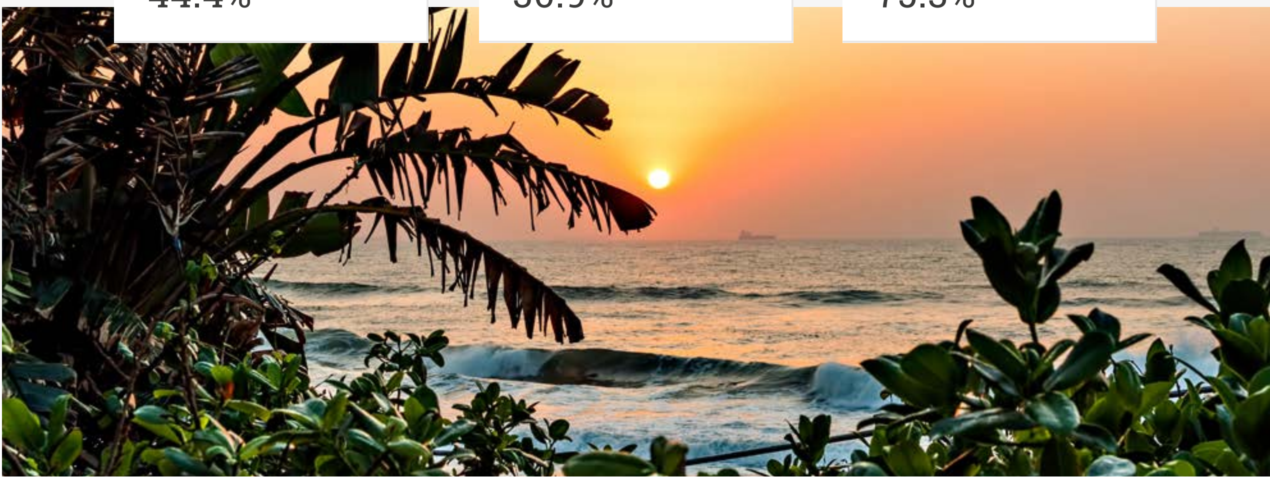
| Previous enquiries (better than national average) |
| --- |
| 2.6 |

## Payment behaviour

| Time since an account was three months in arrears (worse than national average) | Number of months in arrears (worse than national average) | Accounts in arrears (same as national average) |
| --- | --- | --- |
| 7.7 months | 3.9 months | 1.6 accounts |

## Affordability

| Debt-to-income ratio (worse than national average) | Rent-to-income ratio (better than national average) | Affordability risk (worse than national average) |
| --- | --- | --- |
| 44.4% | 30.9% | 75.3% |



Tenants' financial health

# LIMPOPO

● Worse than national average ● Better than national average ● Same as national average

### Types of debt

CPA accounts
8.1

NLR accounts
0.7

### Enquiries

Previous enquiries
2.4

### Payment behaviour

Time since an account was three months in arrears
12.3 months

Number of months in arrears
2.9 months

Accounts in arrears
1.4 accounts

### Affordability

Debt-to-income ratio
30.6%

Rent-to-income ratio
29.0%

Affordability risk
59.6%

Tenants' financial health

# MPUMALANGA

- Worse than national average
- Better than national average
- Same as national average

## Types of debt

CPA accounts
8.2

NLR accounts
3.1

## Enquiries

Previous enquiries
3.0

## Payment behaviour

Time since an account was three months in arrears
7.5 months

Number of months in arrears
4.7 months

Accounts in arrears
2.0 accounts

## Affordability

Debt-to-income ratio
56.9%

Rent-to-income ratio
31.7%

Affordability risk
88.6%

Tenants' financial health

# NORTH WEST

- Worse than national average
- Better than national average
- Same as national average

## Types of debt

CPA accounts
8.1

NLR accounts
2.7

## Enquiries

Previous enquiries
3.1

## Payment behaviour

Time since an account was three months in arrears
7.6 months

Number of months in arrears
4.7 months

Accounts in arrears
1.9 accounts

## Affordability

Debt-to-income ratio
44.1%

Rent-to-income ratio
28.1%

Affordability risk
72.2%

Tenants' financial health

# NORTHERN CAPE

Worse than national average | Better than national average | Same as national average

## Types of debt

CPA accounts
8.6

NLR accounts
2.7

## Enquiries

Previous enquiries
2.4

## Payment behaviour

Time since an account was three months in arrears
5.8 months

Number of months in arrears
4.8 months

Accounts in arrears
2.0 accounts

## Affordability

Debt-to-income ratio
36.7%

Rent-to-income ratio
27.5%

Affordability risk
64.2%

Tenants' financial health

# WESTERN CAPE

● Worse than national average ● Better than national average ● Same as national average

## Types of debt

CPA accounts
7.8

NLR accounts
1.5

## Enquiries

Previous enquiries
2.4

## Payment behaviour

Time since an account was three months in arrears
8.7 months

Number of months in arrears
3.4 months

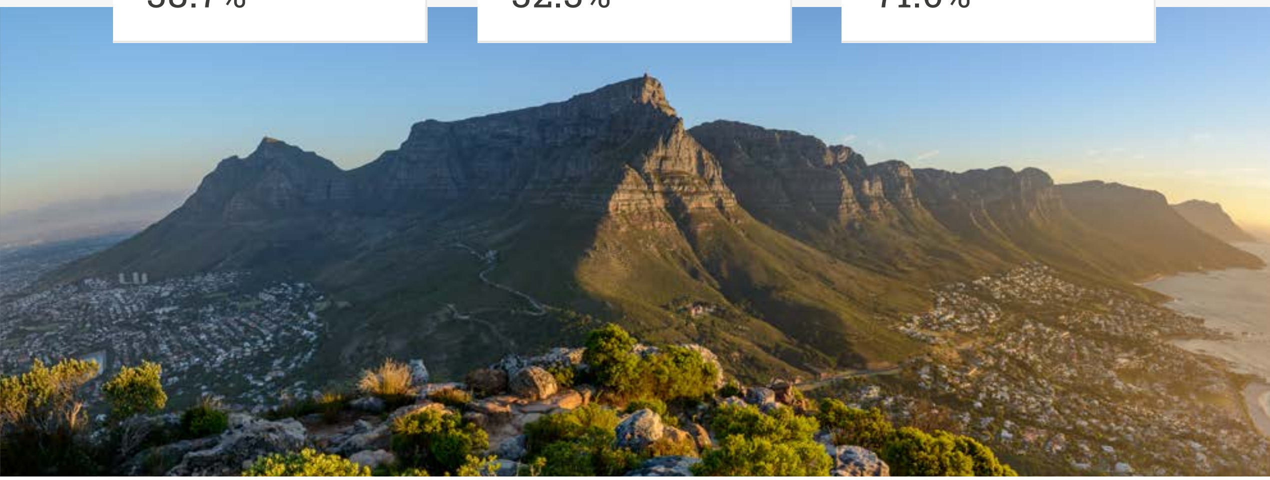
Accounts in arrears
1.3 accounts

## Affordability

Debt-to-income ratio
38.7%

Rent-to-income ratio
32.3%

Affordability risk
71.0%



PayProp Academy 2019

# CYBERSECURITY 101

Our annual PayProp Academy took place with great success in May this year. We tackled the topic of cybersecurity – which many of us have heard about but do not necessarily fully understand.

Our two guest speakers – Bernard Chadenga, Senior Manager of Cybersecurity at PwC, and Handré van der Merwe, a Certified Security and Marketing Consultant from BUI – provided a much-needed eye-opener to our guests, demonstrating how vulnerable they are to hacking and the potential consequences of not securing their data.

To provide balance, our own Laurent Peretti-Poix, the Chief Technology Officer at Humanstate, was able to calm everyone's nerves by illustrating the lengths to which PayProp goes to protect and secure our clients' data.

We had a great time and look forward to hosting another PayProp Academy next year. Hope to see you there! ■

We tackled the topic of cybersecurity – which many of us have heard about but do not necessarily fully understand.

In summary

# SILVER LININGS

While the rental market and economy as a whole are not in the best shape, there are a few silver linings:

- Rental growth may be subdued, but the trend is at least not downward anymore.
- Low levels of inflation and rental growth are good news for tenants, who are under continued financial pressure.
- We have seen an increase in income growth so far in 2019, even though it is still below inflation and rental growth levels.
- Six out of the nine provinces saw an increase in their rental growth rate compared to Q1.
- While most tenants' financial indicators have been declining slowly over time, this has not affected the average credit score much.

Rental growth may be subdued, but the trend is at least not downward anymore.

Rental growth is expected to stay muted for the time being, with a best-case scenario of a slow recovery towards the end of the year. ■

Quarter 2 2019

# PAYPROP RENTAL INDEX

The PayProp Rental Index is a quarterly guide outlining trends in the South African residential rental market, and is compiled from transactional data collected by PayProp, the largest processor of residential letting transactions in South Africa.

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