PayProp

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THE LONG HAUL

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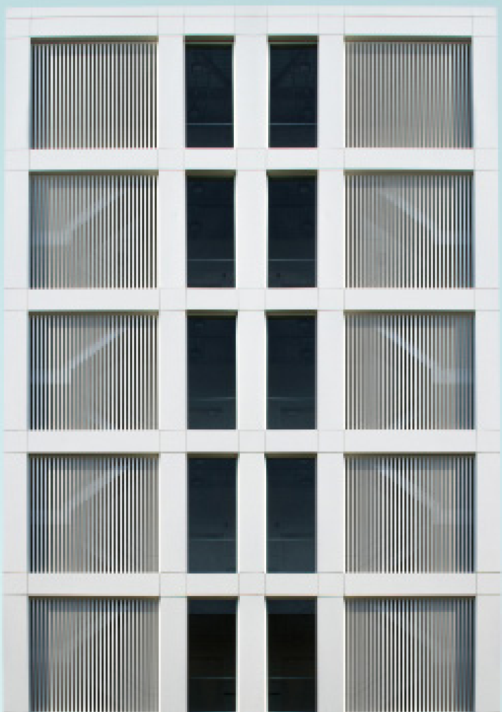
INTRODUCTION

We’re over the hump!

We’re officially halfway into the year – can you believe it? From here on in the days will only get longer and more pleasant, and psychologically at least, it looks like an easy downhill ride until the end of the year.

Not that things have been too hectic. Compared to the first three months of 2018, the second quarter has been positively uneventful. However, the two events that did cross our radar have been momentous – they were the VAT rate increase on 1 April and rampant petrol prices, which have been rising faster than the Middle East can pump oil, it seems. And then there is the matter of land expropriation, without any clear signs of where it is going. ▶▶



All around us we've been hearing (and feeling) that the market is tough, living costs keep rising, and I'm sure estate agents and business owners are worried about what the future holds. So in this issue, we look at exactly that uncertainty. We unpack rental growth history as far back as 2012 to contextualise current trends in the market, and we discuss the possible outcomes and underlying reasons – read more on p14.

Even though everything isn't exactly rosy in the property market at the moment, it's important to remember that things always change for the better again. Until then (and forevermore), remember to lower your risk by placing (and keeping) the best tenants you can!

Enjoy this issue of the PayProp Rental Index. ■

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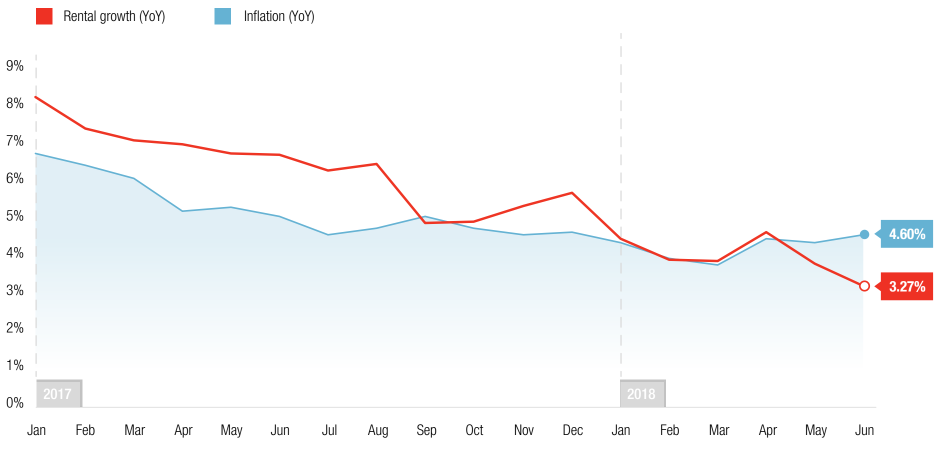
NATIONAL RENT STATISTICS

Still trending downwards

We're a long way from the 8.3% growth rate logged in January 2017. In fact, the weighted average national rental growth rate has trended even further downward over the last quarter, with the year-on-year (YoY) increase coming in at just 3.27% for June.

The weighted average national rental growth rate has trended even further downward over the last quarter, with the year-on-year increase coming in at just 3.27% for June.

A year ago, this figure was 6.76% – more than double the current rate. We also see inflation trending upward again, but to be fair, that was to be expected after the increase in the VAT rate in April. Rental growth is included in the inflation rate, which means that the actual price of goods rose even more than the inflation rate of 4.6%.



Weighted average national rental growth rate (YoY) vs. inflation – 2017 to June 2018
Source: PayProp SA

PROVINCIAL RENT STATISTICS

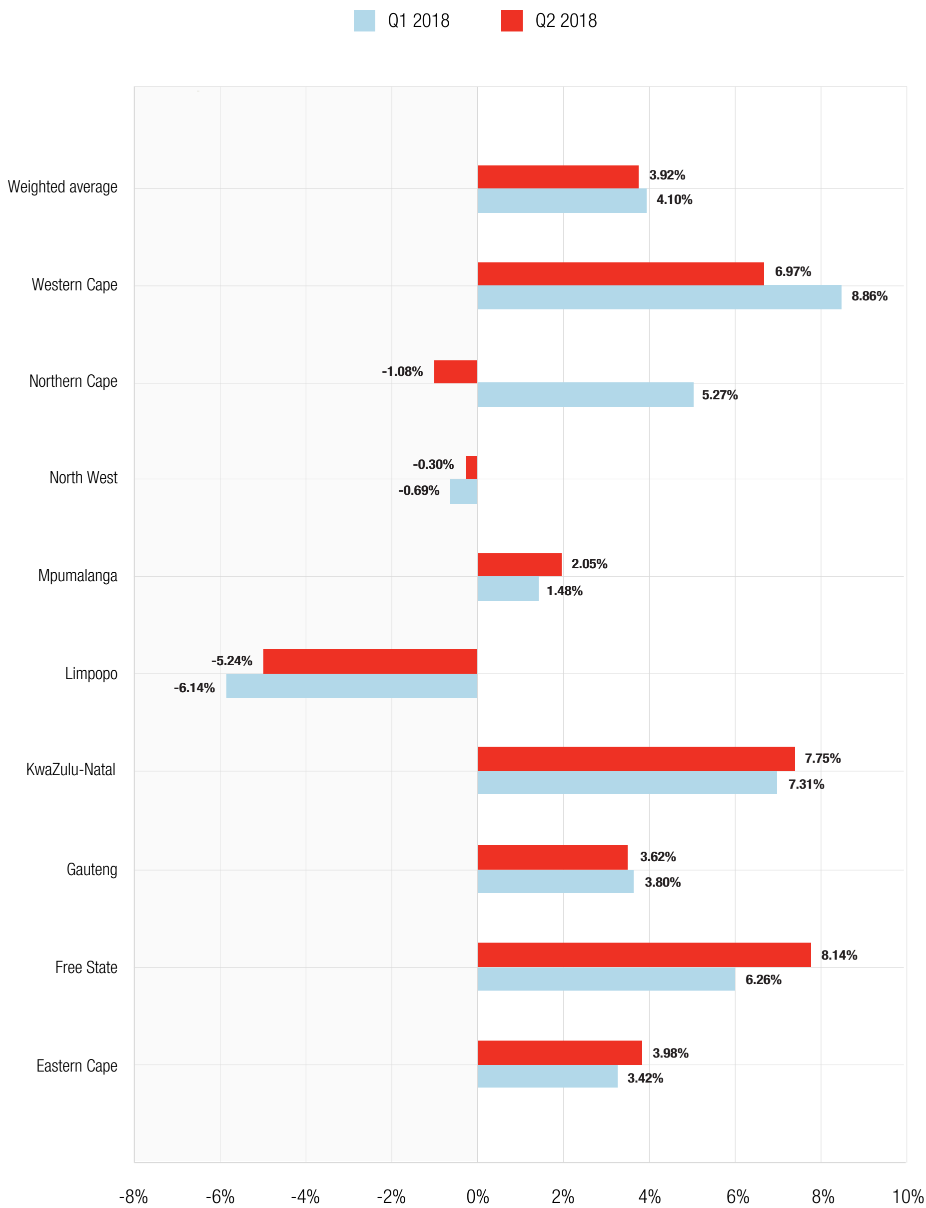
Free State growth spurt

For the first time in over a year, the Western Cape has lost its spot at the top of the provincial growth rate rankings. That place is now occupied by the Free State, with a year-on-year (YoY) growth rate of over 8% (compared to 4% a year ago).

KwaZulu-Natal, too, has overtaken the Fairest Cape with YoY growth of 7.75%. This is slightly higher than the 7.31% recorded in Q1 2018. ▶▶

We often talk about quarterly YoY growth – but how is it calculated and how does it differ from quarterly growth?

Quarterly YoY growth looks at the value of a quarter and compares it to the same quarter in the previous year (e.g. Q2 2017 vs. Q2 2018). Simple quarterly growth (which we seldom use) compares the value of a quarter to the one before it (e.g. Q1 2018 vs. Q2 2018).



Provincial rental growth rates: Q1 2017 vs Q1 2018

Source: PayProp SA

Interestingly (and perhaps unexpectedly), the YoY growth rate increased slightly for most of the provinces when compared to the same figure in Q1 2018, even though Limpopo and the North West are still showing negative growth.

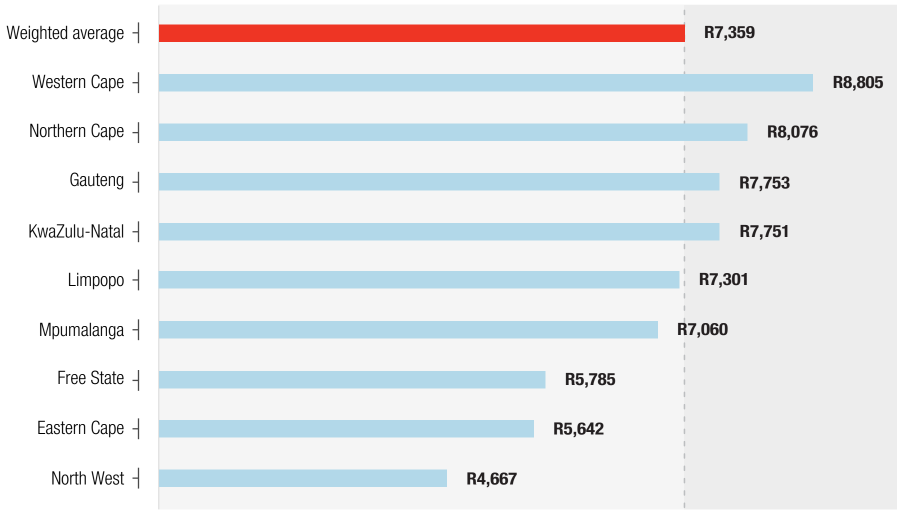
Western Cape growth slowed to just 6.97% in the quarter. This is the lowest rental growth we've seen for that province since Q4 2012, when the year-on-year figure was 6.44%. That being said, average rent levels are still highest in the Western Cape at R8,805, compared to the weighted national average of R7,359.

Lastly, if we consider that the top three provinces by weight (contribution to GDP) are Gauteng, KwaZulu-Natal and the Western Cape, it explains much about the lower national growth rate – it's thanks to the disproportionate influence of lower growth rates in those provinces.

Western Cape growth slowed to just 6.97% in the quarter. This is the lowest rental growth we've seen for that province since Q4 2012.

Provincial rent levels

If the weighted national average rent is R7,359, how do the rest of the provinces measure up?



Average rent levels per province for Q2 2018
Source: PayProp SA

As we can see, the Western Cape still has the highest rent levels at R8,805. The Northern Cape, with the second-highest rents, is the only other province where the average rent level is above R8,000.

Gauteng and KwaZulu-Natal are the other two provinces with rent levels above the average. The three provinces with the lowest rent all have average rent levels of below R6,000, with the bottom province, the North West, coming in at R4,667.

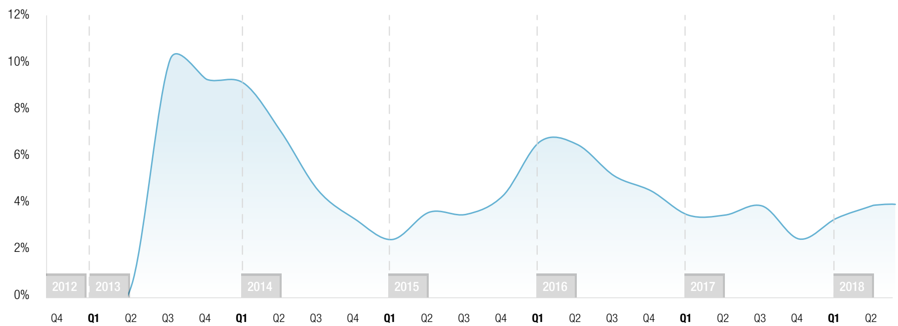
Provincial rental growth cycles

We know most things are cyclical – it's true for everything from economic growth, inflation rates, interest rates and even petrol prices (we live in hope). But different cycles don't necessarily coincide, and they are not always predictable, as we see below when we analyse rental growth cycles for a few provinces.

> *Research note*
> To delve into provincial rental pricing trends, we use the Western Cape, Eastern Cape, KwaZulu-Natal and Gauteng because together, their collective contribution to national GDP is over 70% and we weight provincial data according to this. We also have the most data on them.

Three of the four provinces we analysed (with the exception of the Western Cape) present cyclical rental growth over time (since our first rental pricing dataset, dating back to 2012). Cycles last anything from 6 to 11 quarters. In provinces where we identify two cycles, we see that they are more or less the same length within the same province – in Gauteng, there were two – 7 quarters and 6 quarters in duration respectively, and in KZN, they lasted 9 and 11 quarters, measured from peak-to-peak (with the latest possibly ongoing).

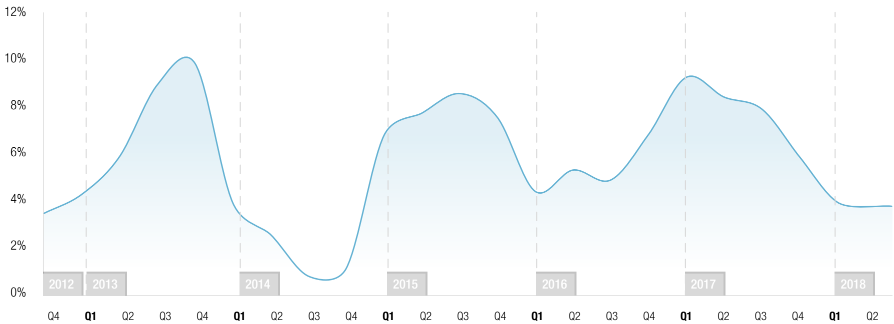
EASTERN CAPE



Eastern Cape quarterly provincial growth rate (YoY) since Q4 2012
Source: PayProp SA

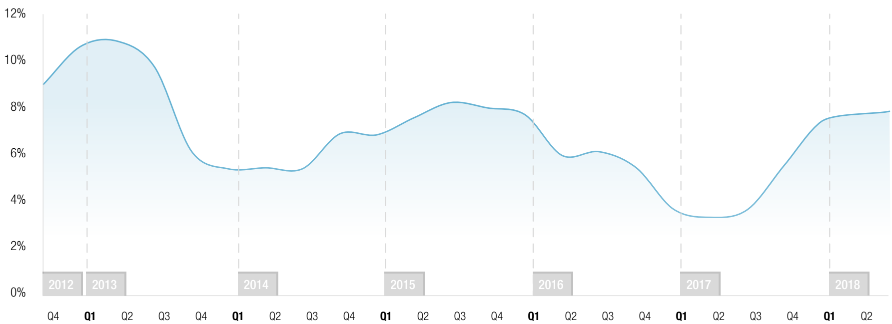
Three of the four provinces we analysed present cyclical rental growth over time.

GAUTENG



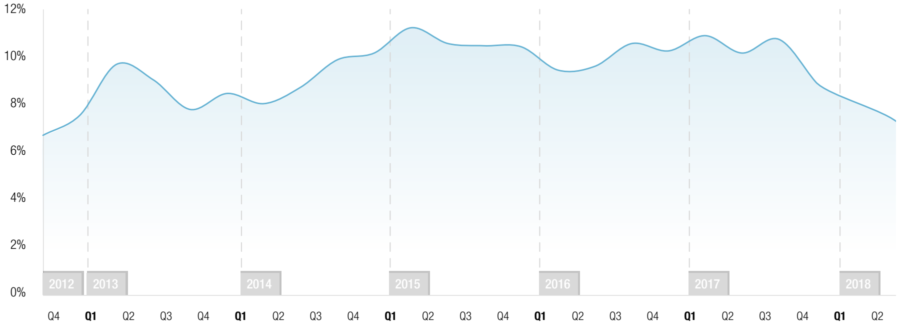
Gauteng quarterly provincial growth rate (YoY) since Q4 2012
Source: PayProp SA

KWAZULU-NATAL



KwaZulu-Natal quarterly provincial growth rate (YoY) since Q4 2012
Source: PayProp SA

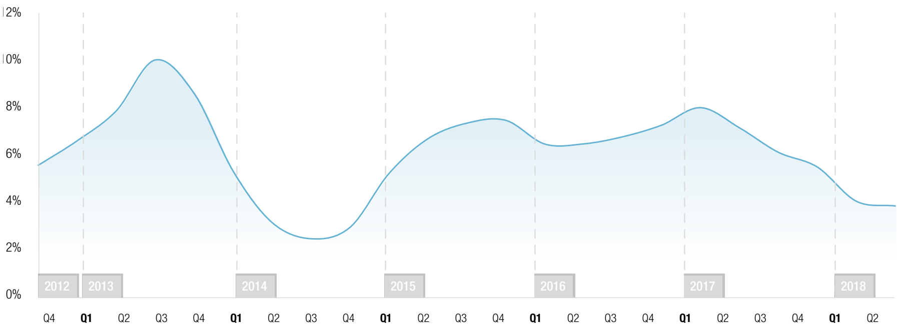
WESTERN CAPE



Quarterly provincial growth rate (YoY) since Q4 2012
Source: PayProp SA

- By contrast, the Western Cape doesn't show any clear peaks and troughs. The two lowest points over the period are the first and last quarters, so one could view the entire period as one long cycle. As noted with the other provinces in this section, it's completely normal for rental growth to go through cycles, and we expect the Western Cape to normalise (have clearer cycles) over quarters to come.

WEIGHTED AVERAGE



Weighted average quarterly national growth rate (YoY) since Q4 2012
Source: PayProp SA

There might be some good news for Gauteng – judging by the previous cycles, it is very possible that we'll see signs of recovery within the next two quarters.

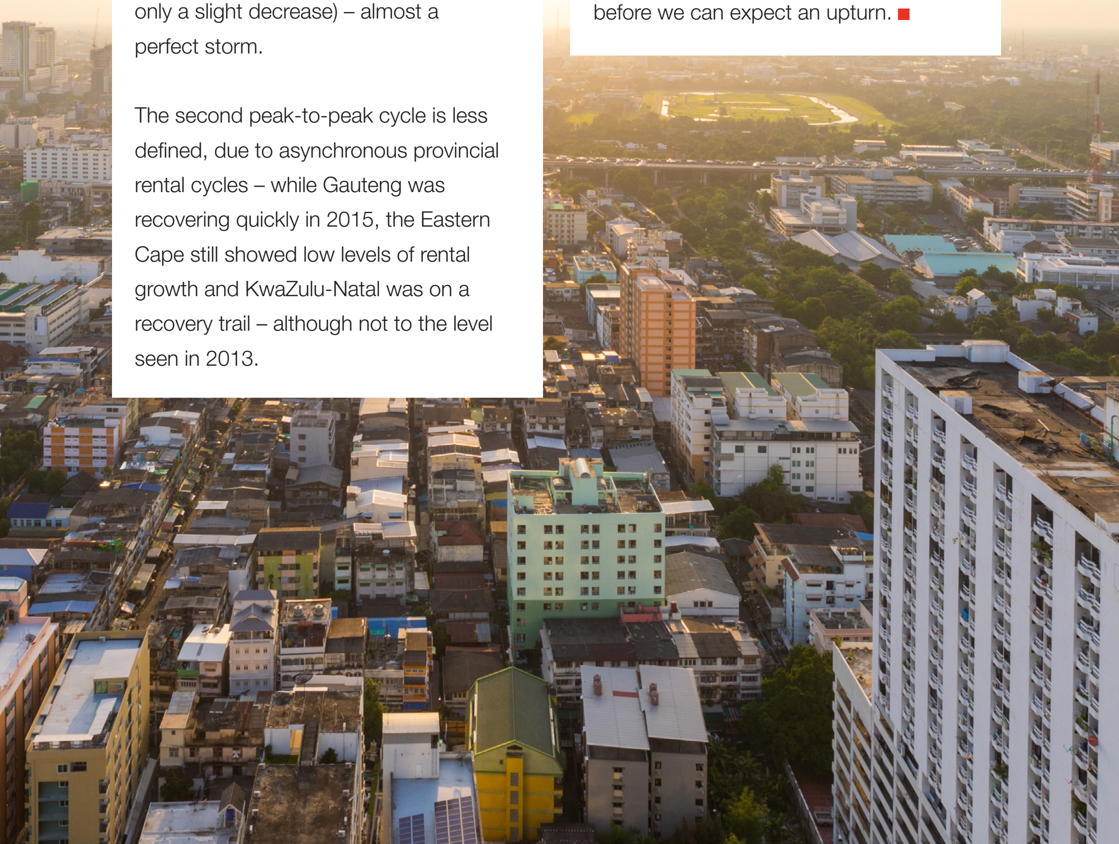
If we keep in mind that these four provinces contribute over 70% of the country's GDP, we can fully appreciate their influence on the national trendline.

During the peak growth period in the weighted average national rent at the end of 2013, all four provinces also experienced high growth rates. And during the following dip in the market, Gauteng, KwaZulu-Natal and the Eastern Cape all saw declining levels of rental growth (while the Western Cape showed only a slight decrease) – almost a perfect storm.

The second peak-to-peak cycle is less defined, due to asynchronous provincial rental cycles – while Gauteng was recovering quickly in 2015, the Eastern Cape still showed low levels of rental growth and KwaZulu-Natal was on a recovery trail – although not to the level seen in 2013.

The Western Cape showed no real signs of a second cycle and rent levels continued to grow at around 10%. If we take the long-term trend into account, there might be some good news for Gauteng – judging by the previous cycles, it is very possible that we'll see signs of recovery within the next two quarters.

And if provincial cycles are anything to go by, the Western Cape is at the start of a declining cycle. It is likely that there will be at least two more declining quarters before we can expect an upturn.



SUPPLY AND DEMAND 101

Downturns and their causes

What affects rental price growth? Aside from a correlation with inflation, it all comes down to Economics 101: Price is determined by supply and demand. Let's discuss three things that could affect rental supply and demand – and in turn, rental growth:

Supply and demand in a nutshell

When demand is high and rental stock is limited, suppliers have pricing power and can price items higher, putting upward pressure on price levels. When supply is high, consumers have pricing power – because they have more choices and they can shop around for cheaper options, putting downward pressure on prices.

"Semigration" and the property bubble

When the valuation of an asset rises sharply and consistently to values above a value justified by fundamentals, a bubble occurs. Often, the sudden rise in value causes speculative, risk-seeking investors to buy these assets, pushing up prices even further.

Source: Financial Times

One can see signs of a bubble in the Western Cape, particularly Cape Town. Capital growth on property in the city has, according to property research company Lightstone, exceeded 10% for the past three years and counting (compared to growth in Johannesburg of around 3% per annum). This has further increased demand for these high-yielding properties.

- Another factor that increased demand over the past few years is "semigration" – the phenomenon of families moving to the Western Cape from elsewhere in the country, for various reasons.

  How can suppliers maximise their return when demand is that high? Supply more units and sell them at high prices! The effect is that there is an increase in properties to satisfy demand.

  That said, investors who buy properties as an investment need to fill them with tenants – and it's here where you, the real estate agent, comes in.

  But whereas Western Cape tenants were once queueing to get into a decent property when supply was low, this changed somewhat in recent months – it seems that there are more rental properties available and fewer tenants are queueing to live in them. That means agents have less pricing power and have to accept lower rentals – one possible reason for lower rental growth rates.

While all provinces have unique factors that affect the supply and demand of properties, we focus on three factors affecting the Western Cape that could explain the recent drop in rental growth in other provinces too.

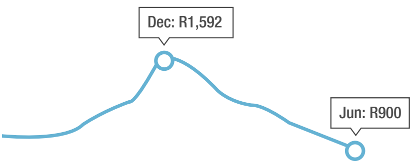
As more landlords advertise on Airbnb, the number of holiday rentals on that platform increases, occupation rates decrease, and investors' revenues drop.

Airbnb and short-term gains

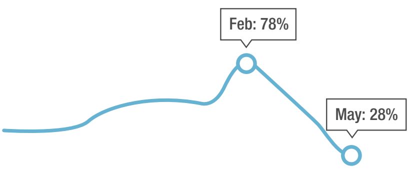
The rapid rise of Airbnb in Cape Town poses a nice dilemma for investors when letting their properties – should they stick with long-term rentals for a steady monthly income at a lower rate, or should they advertise on Airbnb (where the average daily rate for Cape Town is R900) at a lower occupancy rate? For a lot of investors wanting to make a quick buck, it's a no-brainer.

Letting on Airbnb takes stock out of the long-term rental market, which ostensibly puts pricing power back into the hands of suppliers and rental agents due to lower levels of long-term rentals available. But as more and more landlords advertise on Airbnb, the number of holiday rentals on that platform increases, occupation rates decrease, and investors' revenues drop. At this point in the supply cycle, the longer-term option starts to seem like a better investment deal again, and more properties become available for long-term rentals. Tenants have more choice once more, and voilà – pricing power is back in their hands, with the effect of lowering rental growth. ▸▸

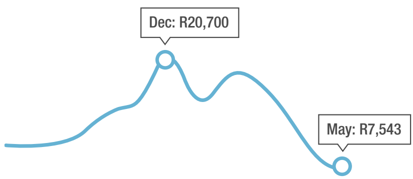
AVERAGE DAILY RATE



OCCUPANCY RATE



REVENUE



Cape Town Airbnb statistics

Source: www.airdna.co

Developers want in on the action

We've seen it happen in Gauteng as well as Cape Town – a new development is built, but rather than selling the units to investors who engage real estate agents, developers hold on to them to benefit from the capital gains and let units out themselves.

Economies of scale and little to no commission cost are the business drivers of this letting permutation. Developers can make the same profit margin as an agency, with lower rental income levels. Rental properties enter the market at lower rents, leaving agents in competition with developers for tenants.

With the resulting increase in supply of rental properties in the market, tenants have more pricing power and rental price growth drops.

It's important to bear in mind that the supply of new-built property is quite sticky (i.e. it takes a long time to change due to the time it takes to develop property sites). By contrast, demand is more elastic. Supply and demand will therefor always be in a state of imbalance, and as a result, we'll see cycles in growth.

LOOK BEYOND CREDIT CHECKS

Choosing good tenants in a tough market

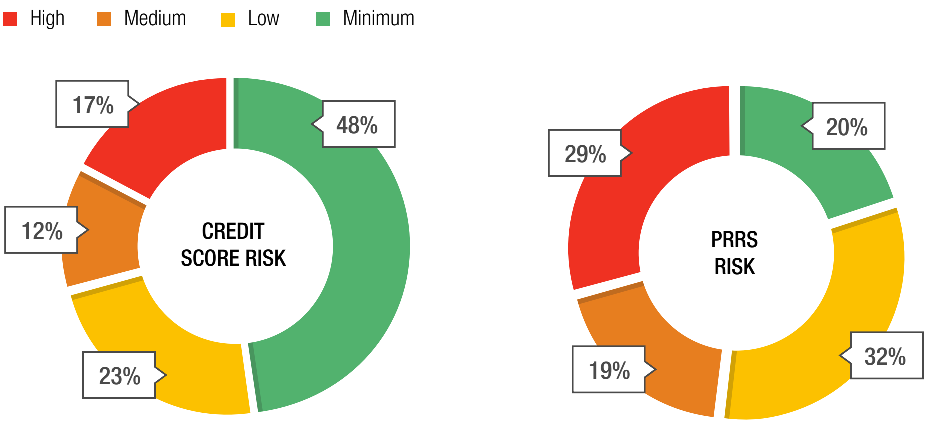
On 29 May this year, PayProp launched the revamped Tenant Assessment Report. The Tenant Assessment Report complements our credit checks by adding another spectrum of calculations such as affordability, rent-to-income ratios, a rental risk matrix and a summary of the most important data from a standard credit check, for one clean, clutter-free, higher-value document.

The most exciting feature in the new Tenant Assessment Report is without doubt the PayProp Rental Risk Score. Combining rental data with credit data, it provides a metric that is much better at predicting bad future tenant behaviour than a credit score alone.

How does it work?

If we compare a group of tenants classified by their credit scores to the same group classified by their PayProp Rental Risk Score, we see fewer tenants deemed to be high-risk in the classification on the left. This means there's a high chance of placing bad tenants when using the credit score alone, simply because that tenant may be better at paying their accounts than their rent.

If you were a landlord, wouldn't you like to have this information?



Risk classifications of a group of tenants according to credit scores (left) and according to the PayProp Rental Risk Score (right)

Source: PayProp SA

Recheck before you renew!

We know that consumers are continuously under more pressure – inflation, rent, petrol, VAT and other living costs are rising while incomes are slow to increase (and in some provinces even decrease over time).

In the previous Index, we saw an upward trend in both the number of tenants in arrears and the size of the arrears. Given that income levels increased by less than 2% in the past year, it should come as no surprise that the average debt-to-income level increased from 40.3% in Q2 2017 to 42.1% in Q2 2018.

Your tenants are probably worse off now than when you first placed them. And presuming that is the case, wouldn't you like to be sure they are still financially secure, and manage the risk of a non-paying tenant better?

Recheck before you renew – it doesn't really make sense not to.

Your tenants are probably worse off now than when you first placed them.

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MANAGE YOUR RENTAL PORTFOLIO
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PayProp is plugged directly into the banking system so you can unplug, relax and run your rental portfolio wherever you are.
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Advertorial

NEW FEATURE

PayProp in your landlord's pocket

Our first entry into mobile, the PayProp Landlord App, is in the final stages of live beta testing with a handful of our letting agent clients. There are clear benefits to both landlords and agents.

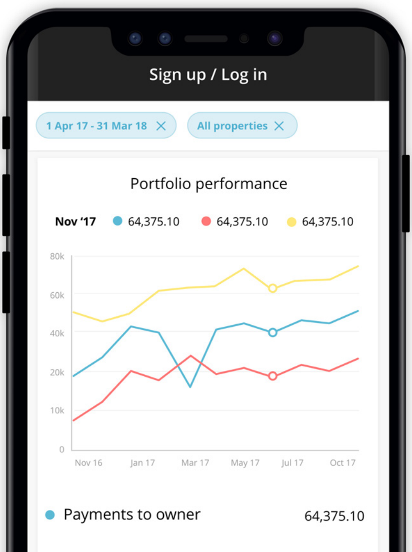
For a landlord, seeing your financial data as a transaction is processed is extremely valuable. To be able to request historic data since day one of the property being on PayProp is even better. And to have all of it on demand is spectacular. For landlords with more than one property, having to keep up with statements, maintenance and arrears for each property can be very time-consuming. The landlord app has everything in one place, meaning an owner can access these stats for his entire property portfolio in one place.

For you, the agent, putting real time transactional data and up-to-the-minute reporting on all balances in the palm of your landlords' hands means less time answering queries and more time growing your business.

GET IT ON Google Play

Download on the App Store

The app was developed for Android and iOS and can be downloaded from both app stores.



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The PayProp Landlord App is here

IN SUMMARY

No reason to panic

Yes, the market is tough. Sales are down, rental growth is declining and consumers have less cash to spend.

The reality is that rental prices are heavily affected by supply and demand (as are most prices), and high-impact market developments such as the rise of Airbnb and developer rentals are also influencing the equation.

We further see that property prices, and more importantly, growth, move in cycles. These differ in length and rarely coincide, as different provinces are affected by different factors that in turn, affect supply or demand.

Lower rental growth in the South African lettings stronghold, the Western Cape, is nothing to panic about – as we saw, consistently high rental growth is abnormal, and a correction is long overdue.

We see that property prices, and more importantly, growth, move in cycles.

In tough markets, mitigating risk becomes all the more important to protect your monthly income. A consistently effective way to do that is to make sure you place (and keep) good, financially secure tenants with a good rental track record. ■

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.

Contact details

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www.payprop.co.za

"If I had a manual management system I would have to double my costs to cater for all the work."

TARYN STEVEN
Rawson Northriding

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