

4th QUARTER FNB BUY-TO-LET ESTATE AGENT SURVEY

- Unlike the home buying market, prospects for the rental market may be improving for 2011, although this is only expected to drive greater buy-to-let demand at a later stage.



FNB PROPERTY MARKET ANALYTICS

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JOHN LOOS:
FNB PROPERTY STRATEGIST
011-6490125
John.loos@fnb.co.za

EWALD KELLERMAN:
PROPERTY MARKET ANALYST
011-6320021
ekellerman@fnb.co.za

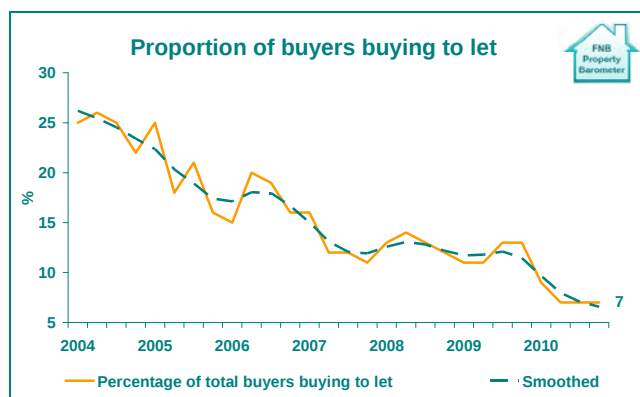
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FUNDAMENTALS DRIVING THE COUNTRY'S RENTAL MARKET MAY BE IMPROVING

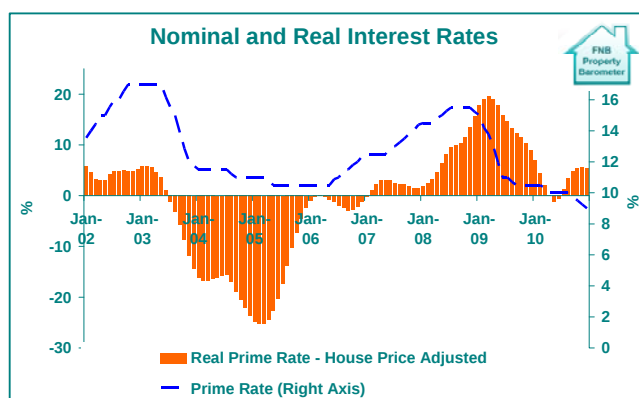
Data availability for the rental market is far less comprehensive than for the home buying market in South Africa. However, with what data we have it would appear that the fundamentals of the rental market may be improving, and this may lead to rental market strengthening in 2011.

During the property boom years, buy-to-let buying of residential property was taking place at a far greater pace, implying that the supply of rental stock coming onto the market was growing rapidly. This appears to no longer be the case. In the 4th quarter FNB Estate Agent Buy-to-Let survey, buy-to-let buying remained at a lowly estimated 7% of total buying, unchanged for the 2nd successive quarter, a far cry from the estimated 25% back early in 2004.



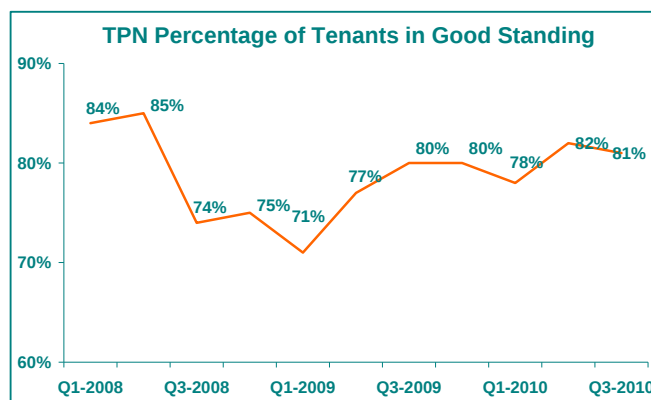
This buy-to-let weakness comes as little surprise, with the household sector still under very significant financial pressure, as well as being highly-indebted, while banks' credit criteria remain conservative by the standards of a few years ago. This not only constrains the supply growth in rental stock, but also keeps a greater number of would-be first time home buyers in the rental market for longer than would otherwise be the case, thereby supporting rental demand.

In addition, very low house price inflation means that our property-related real prime rate, i.e. adjusting prime rate for house price inflation, remains positive (+5.4% in December 2010). This curtails the short term speculative component of buy-to-let buying, where buy-to-let buyers are more focused on profiting through short term capital growth on property outstripping interest rates. This form of buying is believed to have been far more significant during the boom years, where at one stage of 2005 the property-related measure of real prime rate was negative to the tune of -25.3%, a speculator's paradise.



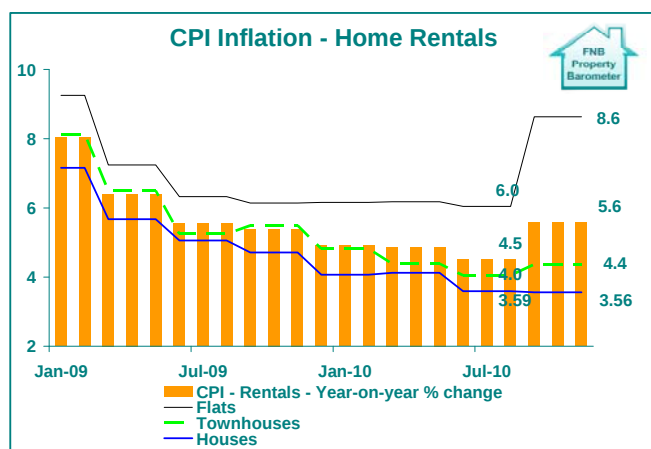
How can we help you?

Lower interest rates and a growing economy (albeit mildly) may have also brought about a better quality of tenant.



According to credit bureau, TPN, there has been a broad improvement in the quality of tenants since early-2009. As at the 1st quarter of 2009, only 71% of tenants on TPN's records were "in good standing". During the 2nd and 3rd quarters of 2010, this percentage has risen to 82% and 81% respectively, the highest percentages since back in the 1st half of 2008 prior to the national recession. Yes, many tenants, like home owners, were also affected by recession and high interest rates back then. The more recent apparent improvement in tenant quality also bodes well for an improvement in the rental market.

Not surprisingly, therefore, StatsSA rental estimates have started to show a rental inflation acceleration.



Given the lack of supply growth in rental stock, and reason to believe that significant financial barriers to entry to home ownership exist at present, it came as little surprise that we started to see an upward turn in StatsSA's CPI home rental inflation survey numbers. Done on a 3-monthly basis, inflation in actual residential rentals rose from 4.5% in June to 5.6% year-on-year in the September survey. This represents a turnaround from a steadily de-accelerating rental inflation rate since back early in 2009.

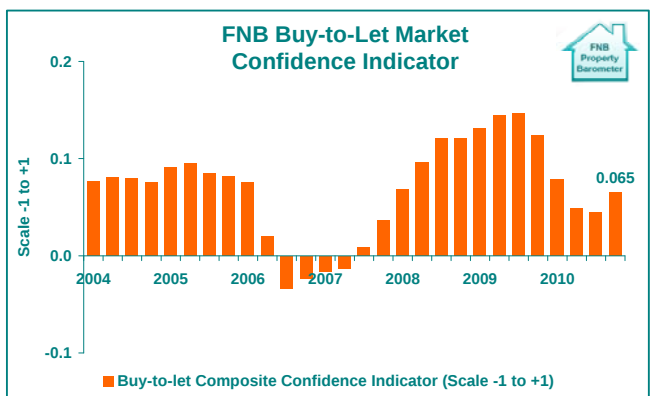
The initial rental inflation rise nevertheless points to a still-financially pressured household sector, with "smaller being better", and thus the fastest rental inflation acceleration took place in the flats category (8.6%, up from 6%). By comparison, townhouse rental inflation measured 4.4%, moderately up from 4% in the previous quarter's survey, while house rental inflation was virtually unchanged from the previous survey.

Rental inflation rise in 2011 will be important for an ultimate recovery in buy-to-let demand.

A lack of buy-to-let demand in recent years especially through 2010, implying slow growth in rental stock, is crucial to our belief that we will see some acceleration in rental inflation through 2011. In addition, given our expectation that consumer price inflation will gradually rise further through 2011, after 2 successive months of increase late in 2010, it looks increasingly unlikely that the SARB will cut interest rates any further for the time being at least, and sideways movement in rates through 2011 is anticipated. This may put the brakes on 1st time home buying, keeping more would-be home buyers in the rental market and thereby supporting rental demand.

An expected rise in rental inflation in turn has 2 possible effects. Firstly, given very low expected house price inflation, we believe that gross yields on residential property will rise through 2011, and this is a key pre-requisite to larger numbers of investors returning to the market at some future stage. Secondly, however, it can have the shorter term effect of contributing to rising consumer price inflation which could ultimately mean rising interest rates (although FirstRand only expects interest rate hikes to commence early in 2012).

In the 4th quarter 2010 FNB Estate Agent Survey an increased portion of the sample of agents expected an improvement in 1st quarter 2011 buy-to-let buying. This drove the FNB Buy-to-Let Confidence Indicator slightly higher to 0.065 (scale +1 to -1) from a previous quarter's low point of 0.045.



This is an interesting turn in estate agent sentiment after 5 previous quarters of deterioration. In our own opinion, any noticeable improvement buy-to-let buying may take somewhat longer. However, we do believe that the fundamentals that ultimately drive the buy-to-let market, i.e. a stronger rental market and higher yields on residential property, should improve significantly through the course of 2011, setting the buy-to-let market up for strengthening at a later stage.