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In This Edition:

TPN RentalMonitor

Tenant performance recovers further but it's tough going in a weak economy

Key Points

- The percentage of total tenants that were recorded as being in good standing with their landlords improved further in the 4th quarter of 2020, in the aftermath of the 2nd quarter "hard" lockdown. From 73.5% of tenants being in good standing in the 2nd quarter, the percentage increased slightly to 74.57% in the 3rd quarter and on to 77.61% in the 4th quarter. While on the right path, this percentage remains noticeably lower than the pre-lockdown 81.52% recorded in the 1st quarter of 2020, in line with an economy and its employment rate that is battling to fully recover after what was a very deep contraction in the 2nd quarter.

- However, the dip in tenant performance in 2020 was less severe than the dip of early-2009 during the Global Financial Crisis recession, despite the fact that the earlier recession was far less severe than the 2020 one. We believe that the big difference in 2020 has been far lower interest rates and debt-servicing costs in 2020 than in 2008/9, and this has likely cushioned the financial blow on the indebted part of the tenant population.

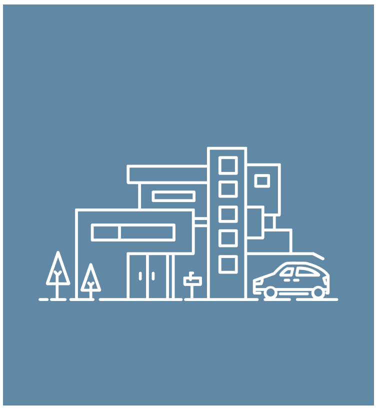
- Tenant performance remains weakest in the lowest rental value band, i.e. the "Less than R3,000/month" segment, which is populated by the most financially fragile part of the tenant population, with very few financial "buffers" with which to weather any storms that translate into income loss. The middle R7,000-R12,000/month segment remains the relative "sweet spot" from a tenant performance point of view.

- The Western Cape tenant population continues to be the best performing of the major 3 provinces (the other 2 being KZN and Gauteng). However, some of the smaller provinces' tenant populations are outperforming all 3 major provinces. The top 4 performing tenant populations are Northern Cape, with 84.02% of tenants in good standing, Mpumalanga with 82.95%, Eastern Cape with 82.5% and Western Cape at 82.41%.

- On a national average basis, TPN's average rental value moved into deflation to the tune of -0.75% in the 4th quarter of 2020, with the 2 large provincial rental markets, Gauteng and the Western Cape, being the drivers of the national average deflation.

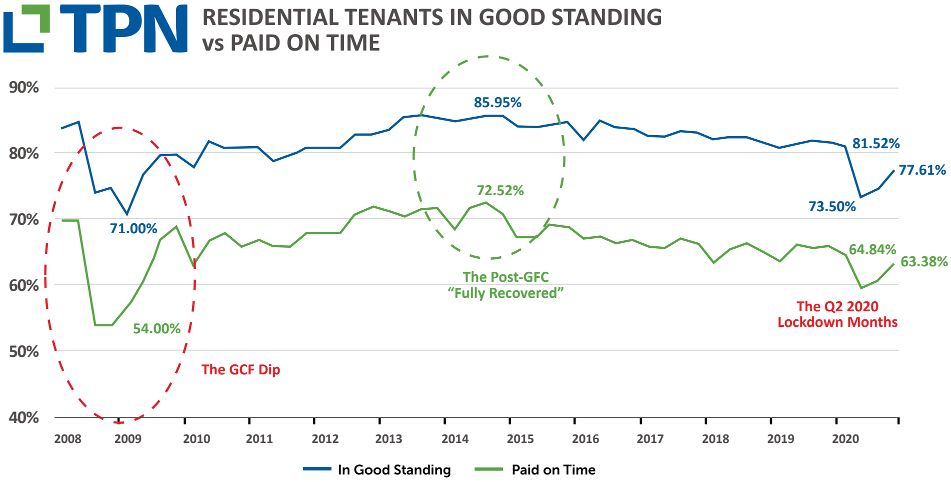
- The rental deflation is explained by an increasing supply of rental space relative to demand, as shown in a rising national average vacancy estimate. The estimate emanates from a TPN survey of letting agents. From a 7.47% rate in the 1st quarter of 2020, the estimated national vacancy rate rose sharply to 12.91% in the 4th quarter of 2020.

- TPN's average national gross yield on residential properties ended 2020 lower than they started the year, with growth in property values achieving higher rates than sliding rental inflation. The downward pressure on yields is sustained by low interest rates, which have contributed to the home buying market being noticeably stronger than the rental market.



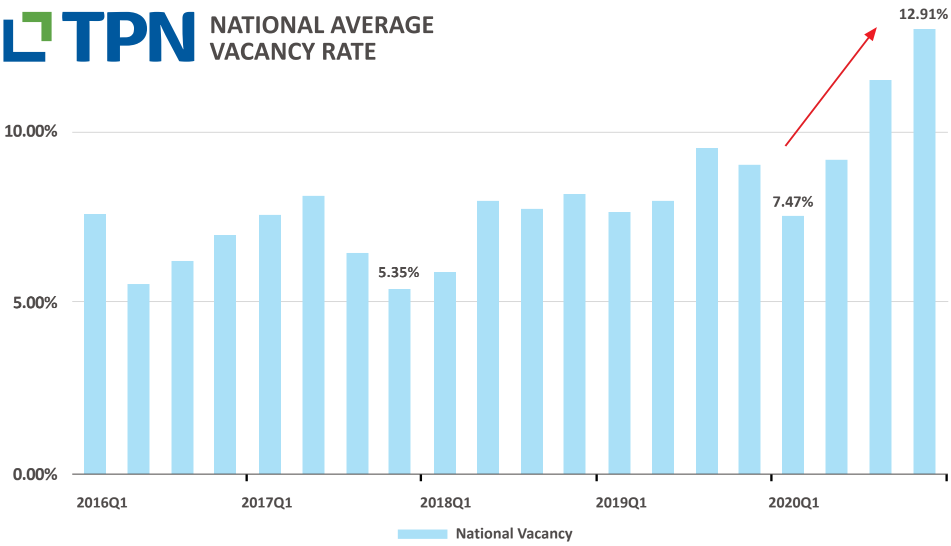
Financial pressure not all visible in tenant payment performance - a part of it is reflected in a steadily rising vacancy rate

Simply viewing the most recent TPN percentage of tenants in good standing, one may perceive a better picture of the residential tenant population's financial situation than is the case in reality. Following the end of "hard" lockdowns in the 2nd quarter of 2020, the percentage of tenants in good standing with their landlords regarding rental payments improved from a 2nd quarter low of 73.5% to 77.61% by the final quarter of 2020.



This percentage tells a story of lethargic recovery out of the hard lockdown period, in which many tenants experienced a partial or full income loss, many still not fully recovered. While improved, the percentage remains significantly lower than the pre-lockdown 1st quarter 2020 percentage of 81.52%, and it may take some time for it to edge up to that level once more.

But financial pressure also leads to certain rental households "pro-actively" ending their stay in a rental property in certain instances, and seeking alternatives. The alternatives can be either moving into shared accommodation within the rental market in order to reduce rental costs, or perhaps moving back into their family (parents') home for the time being until finances improve. Some combination of this seems apparent when one views the TPN Vacancy Survey results, which has seen the estimated national average vacancy rate rise sharply from 7.47% in the 1st quarter of 2020 to 12.91% by the final quarter of 2020.



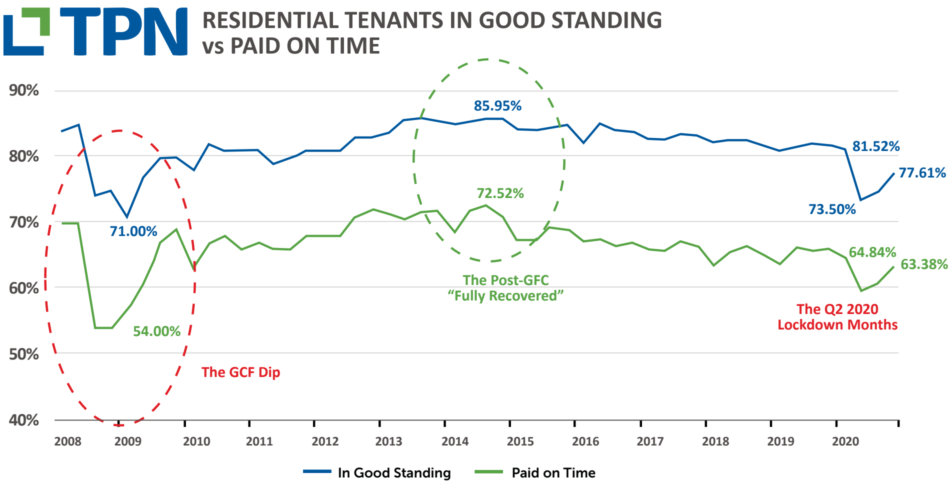
Those households who exit the rental market due to financial pressure will no longer be reflected in the percentage of tenants in good standing, but more likely their impact is reflected in that sharp rise in the vacancy rate. We would thus believe it likely that financial pressure is more severe than what the tenants in good standing percentage shows, and the reader should view that percentage in conjunction with the vacancy rate trend for a more complete picture.

The rising vacancy rate would also be in part driven by increased financial pressure on certain young labour market participants not yet in the rental market who, due to financial constraints, choose to delay their new household formation and remain in their family homes.

In short, the deep recession of 2020, and the weakened employment prospects that it brought, likely slowed the pace of growth in the number of households, possibly even taking the rate into negative territory, either due to slowed new household formation or increased household "shut downs", and this is in part reflected in a rising rental market vacancy rate.

Tenant performance continues to improve following the lockdown dip

The percentage of total tenants that were recorded as being in good standing with their landlords rose further in the 4th quarter of 2020, to 77.61%, compared to the 74.57% of the prior quarter. This is the 2nd consecutive quarter of increase from the low of 73.5% of tenants in good standing in the 2nd quarter. However, the level remains well-below the pre-lockdown 1st quarter percentage of 81.52%, a reflection of the lagged impact of the massive financial knock felt by the tenant population from the 2nd quarter lockdown and resultant severe economic contraction. As expected, the recovery post-lockdown is thus taking some time.

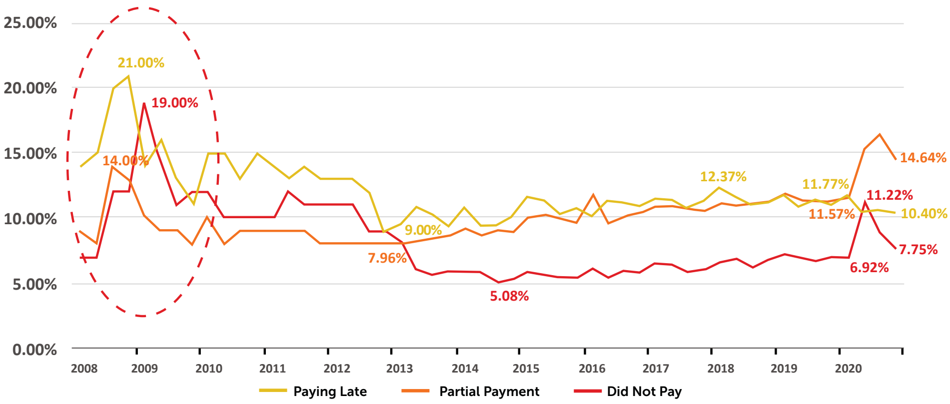


Those tenants that paid on time (those who paid late and those with grace periods making up the rest of the tenants in good standing) amounted to 63.38% of total tenants, which is also a mild improvement on the prior 2 quarters.

Examining the breakdown of those tenants that are battling to keep up with payments is insightful. The percentage not paying at all declined in the 4th quarter, from 8.95% in the 3rd quarter to 7.75%, as did the percentage paying late, from 10.56% to 10.4% over the same 2 quarters.

Those making partial payments also declined from 16.49% to 14.64% over the 2 quarters. Partial payments are the largest component of the 2 categories of tenants not in good standing (the other category being those who did not pay at all).

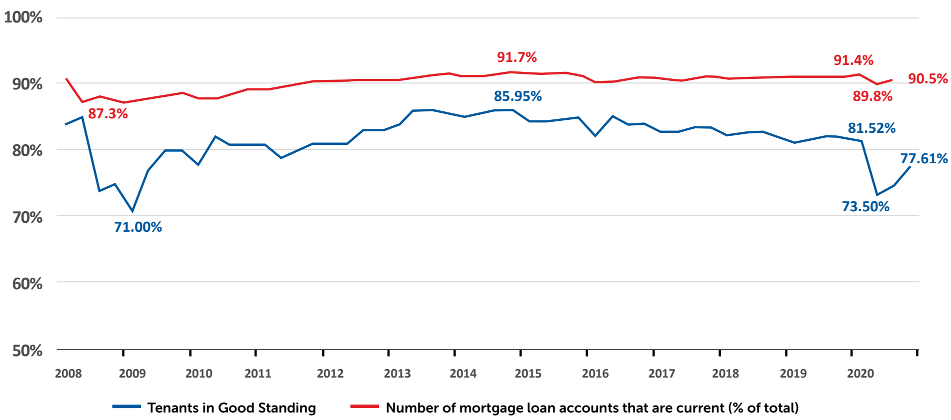
TPN RESIDENTIAL TENANTS PAYING LATE, PAYING PARTIALLY OR NOT PAYING



Tenant performance took a bigger knock than home owner mortgage repayment performance

The tenant population of the residential market is arguably more sensitive to economic trends, which have an impact on employment and income, than the mortgage part of the home owner market. The latter also feels the impact of job loss but is likely more sensitive to movements in interest rates.

TPN RESIDENTIAL TENANTS IN GOOD STANDING vs MORTGAGE LOAN ACCOUNTS THAT ARE CURRENT



Therefore, in the "lockdown" 2nd quarter of 2020, the percentage of rental tenants in good standing with their landlords dropped far more significantly than did the percentage of mortgage borrowers whose accounts were current (up to date with instalment payments).

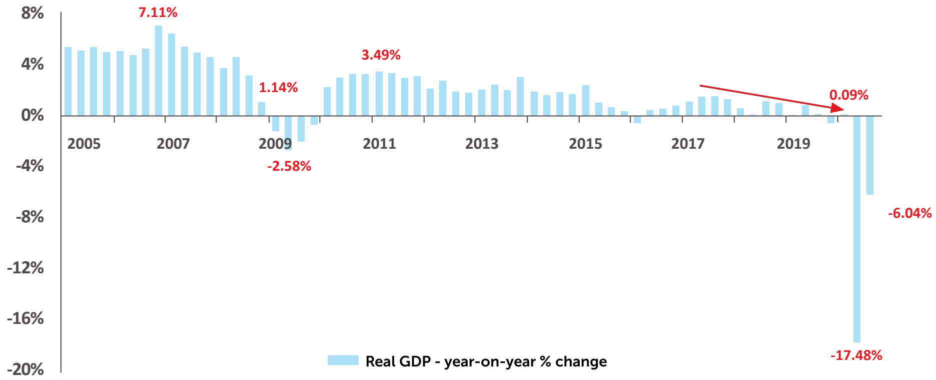
Whereas the percentage of tenants in good standing with landlords dropped from 81.52% in the 1st quarter to 73.5% in the 2nd quarter of 2020, the percentage of mortgage accounts that were current dropped more mildly from 91.4% to 89.8% over the same 2 quarters, according to NCR data. And by the 3rd and 4th quarter of 2020, the percentage of mortgage accounts that were current was already back to above 90%.

However, tenants do have debt of various types, and are therefore sensitive to interest rate fluctuations, even if perhaps less so than mortgaged homeowners.

If one compares the 2020 dip in the percentage of tenants in good standing with the previous big dip back in 2009, what is interesting is that the 1st quarter 2009 low point

for tenants in good standing was 71%, lower than the 2nd quarter 2020 bottom point of 73.5%. And that was despite the economic contraction in 2008/9 being far less severe than the 2020 contraction.

REAL GDP (GROSS DOMESTIC PRODUCT) GROWTH



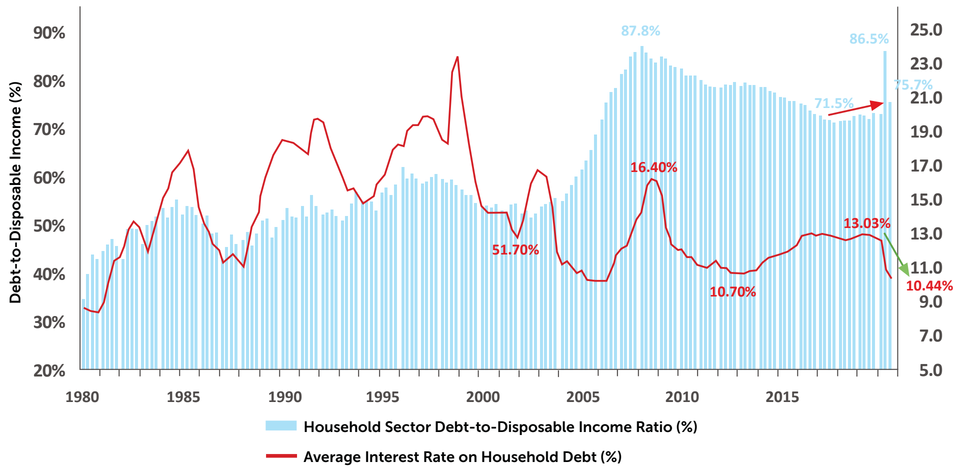
In 2009, the most severe real GDP (Gross Domestic Product) decline was registered in the 2nd quarter of 2009 at -2.58% year-on-year. By comparison, the 2nd quarter 2020 Real GDP decline was a massive -17.48%, and followed up by a still-severe -6.04% year-on-year decline in the 3rd quarter.

It is true that relief measures by both landlords, banks on debt repayments, and Government, appear to have been far more significant in 2020 compared with back in the 2008/9 Global Financial Crisis.

But perhaps the most significant relief measure was the sharp reduction in interest rates early in 2020, while interest rates had not really been rising just prior to that. This is in sharp contrast to 500 basis points worth of interest rate hiking by the SARB from mid-2006 to mid-2008 to far higher levels than 2020 interest rate levels. In addition, household indebtedness was far higher around 2008/9, exacerbating the cost of servicing debt further.

We take a look at the sharp differences in debt-service costs for households back then versus now, and believe that this may be the key difference in tenant performance of late versus 2008/9, because while the tenant population wouldn't have much mortgage debt, it must surely have a significant amount of consumer and vehicle debt.

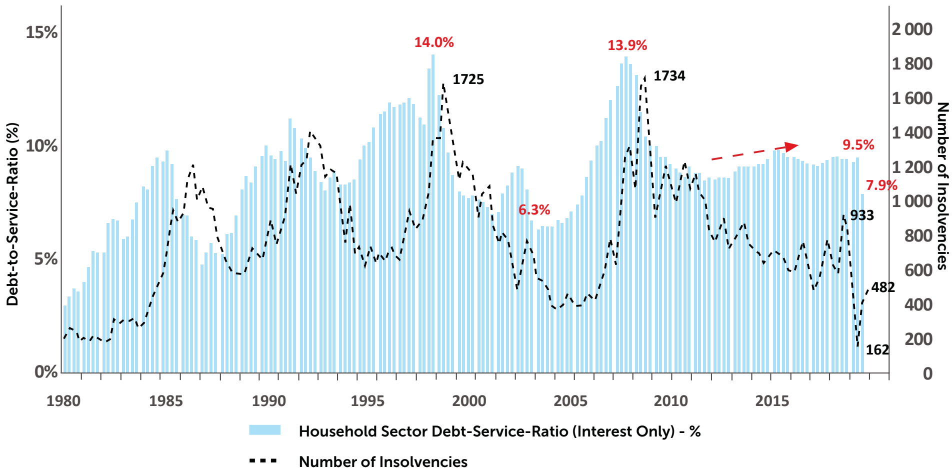
HOUSEHOLD SECTOR DEBT-TO-DISPOSABLE INCOME RATIO vs INTEREST RATES



Even when household disposable income dropped by a massive -13.6% year-on-year in the 2nd quarter of 2020, it was insufficient to lift the Household Debt-to-Disposable Income Ratio to a level higher than the 87.8 peak reached back in 2008. The 2020 high came pretty close, though, reaching 86.5% in the 2nd quarter. However, the ratio receded swiftly to 75.7 in the 3rd quarter as lockdown eased and income partly recovered.

Interest rate levels between the 2 recessions were massively different, however. In the 3rd quarter of 2008, the average interest rate on household debt peaked at 16.4%, Prime Rate having peaked at 15.5% after 500 basis points' worth of hiking. By comparison, around mid-to-late-2019, just prior to the lockdown, the average interest rate on household debt was around 13%, and by the 2nd quarter of 2020 had dropped to 10.44% as the SARB cut its repo rate aggressively.

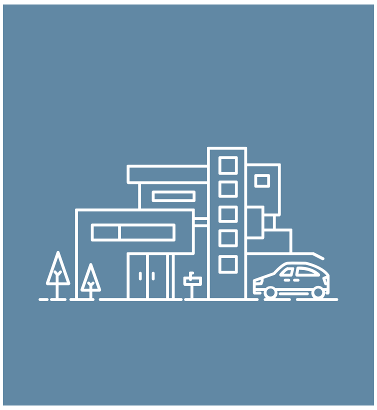
HOUSEHOLD SECTOR DEBT-SERVICE-RATIO vs INSOLVENCIES



The combination of indebtedness level and interest rate level created a very different environment in 2020 for households servicing debt compared to that of 2008/9. This is visible in the Household Debt-Service Ratio, which is the quarterly interest cost on household debt expressed as a ratio of household disposable income. Whereas in 2008 this ratio peaked at 13.9, in 2019 it was never higher than 9.5, and in fact only reached as high as 9.5 in the 2nd quarter of 2020, before dropping to 7.9 in the 3rd quarter of 2020. The household debt-service cost relative to income has thus been kept significantly lower in 2019/20 than was the case in 2008/9.

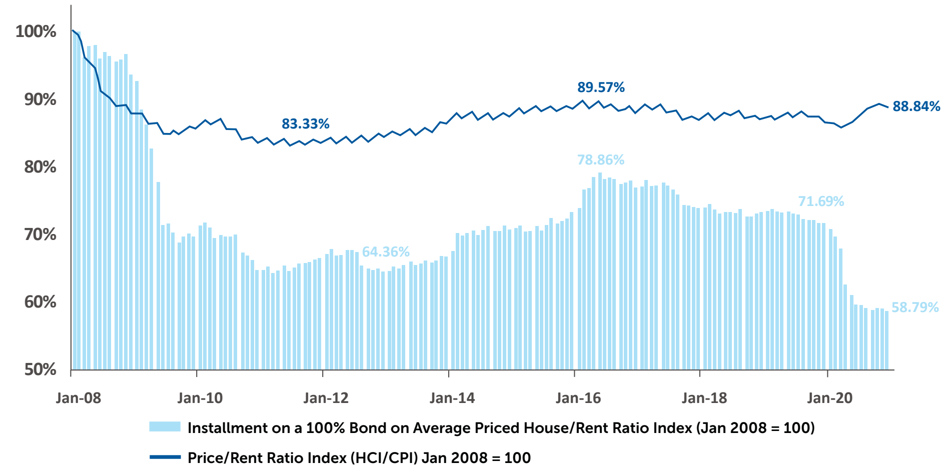
We are of the opinion that the sharp difference in debt servicing cost between 2008/9 and 2020 was likely the key factor in preventing the tenant performance of 2020 from dipping to a level below the dip of 2009 despite the fact that the 2020 economic recession was far more severe than that of 2008/9.

However, the aggressive 2020 interest rate cuts have likely assisted the home buying/owner market far more than the rental market due to the former market's bigger reliance on debt for home buying. Rental inflation as per StatsSA CPI (Consumer Price Index) data has declined to just above 1% year-on-year, which is lower than recent house price inflation of around 3%. This means that the House Price/Rent ratio Index (compiled using the FNB House Price Index and StatsSA rental index) at 88.84 (index January 2008=100) as at December 2020 was not materially different from a multi-year high reached in May 2016. In other words, in recent years there has not been a major change in home buying affordability relative to rental affordability if one merely looks at the price/rent ratio.



Enter major interest rate cuts in 2020, and the relative picture turned against the rental option in favour of the home buying option. We compile an index reflecting the ratio of the "Instalment repayment on a new bond at prime rate on an average priced house/average rental". This index has moved very differently to the price/rent ratio due to the sharp interest rate cuts in 2020. By December 2020, this index was -18% down in December 2019 and -25.5% down on a multi-year high reached in May 2016.

FNB PRICE/INCOME RATIO INDEX
(JAN 2008=100) - USING CPI RENTALS

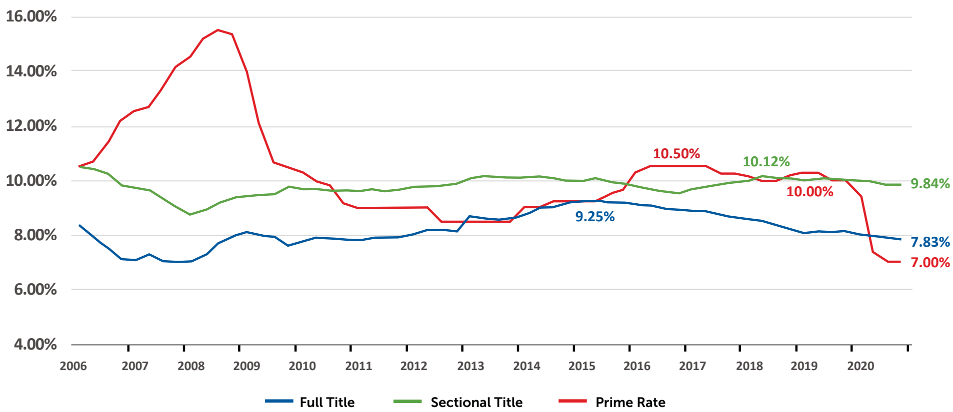


Therefore, while lower interest rates have assisted the tenant population in 2020 in paying rent by alleviating the pressure on debt servicing somewhat, they have at the same time swung things relatively in favour of the more credit dependent home buying alternative, and may have thus taken a portion of the tenant population away from the rental market and into the home ownership market. This may in part be reflected in the rising average rental property vacancy rate nationally.

Low interest rates keep residential yields low

Residential gross yields have been on a declining trend in recent years, and there is little evidence of a change in this trend just yet. The Average National Sectional Title Gross Yield remained insignificantly higher than the 9.83% of the previous quarter, at 9.84% in the 4th quarter of 2020, but down from a multi-year high of 10.12% as at the 2nd quarter of 2018. The Average National Full Title Gross Yield was slightly down in the 4th quarter, from 7.88% in the previous quarter to 7.83%, and significantly lower than a multi-year high of 9.25% reached in 2015.

TPN **NATIONAL AVERAGE RESIDENTIAL GROSS YIELD**
SECTIONAL vs FULL TITLE



Both average yield estimates were down on their early-2020 levels, a key source of downward "pressure" having been 3 percentage points' worth of interest rate cuts early last year. Lower interest rates have played into the hands of the home buying market relative to the rental market, fuelling relatively solid credit-driven home buyer demand and keeping house price inflation above that of rental inflation, thereby compressing yields further in 2020.

Low end tenants remain the segment with the weakest rental payment performance

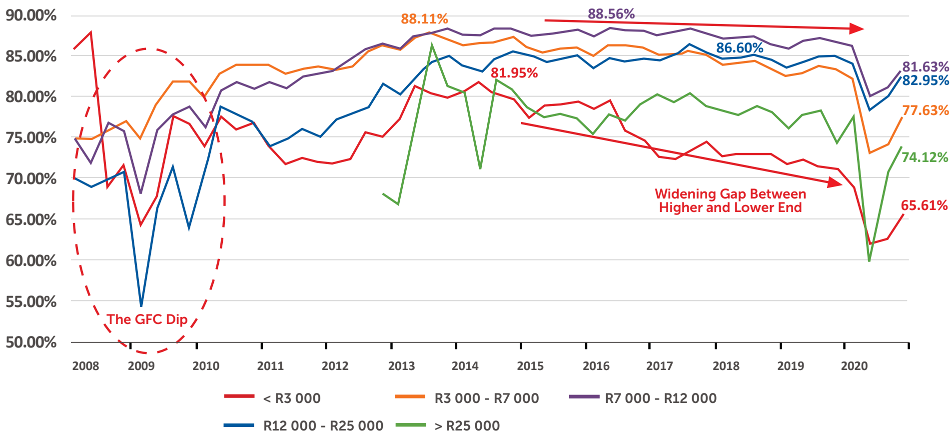
The "Less than R3,000/month" rental segment is populated by the most financially fragile tenant population, with significantly fewer financial "buffers" with which to weather any storms that translate into income loss, or those unexpected household expenses that arise periodically. Therefore, as more-or-less anticipated, this segment's tenant performance continues to be the weakest of all the segments of late, as it has been for most of the period since 2016, in response to a multi-year economic stagnation.

From a lowly 62.12% in the 2nd quarter of 2020, the percentage of tenants in good standing in the "Less than R3,000/month" rental segment has nevertheless improved marginally to 65.61% in the 4th quarter.

By comparison, the 2nd weakest performing segment, i.e. the high end R25,000+/month segment, rebounded off its 2nd quarter low far more strongly, from 60% of tenants in good standing in the 2nd quarter to 74.12% in the 4th quarter. This segment nevertheless remains the 2nd-most poorly performing segment.

The gap between the lowest rental segment's performance and the higher ones remains sharply wider than what it was back around 2014 in better economic times.

TPN PERCENTAGE OF RESIDENTIAL TENANTS IN GOOD STANDING WITH LANDLORDS BY SEGMENT - RENTAL VALUE



At the top end of the performance spectrum in the 4th quarter of 2020 was the very solid R7,000-R12,000/month rental segment. This segment has been known as the top performer from a tenant population point of view since 2013, and it has retained the relative "outperformer status" that it has held since around 2013 in the 4th quarter of 2020, improving further from 81.34% of tenants in good standing in the 3rd quarter to 83.63%.

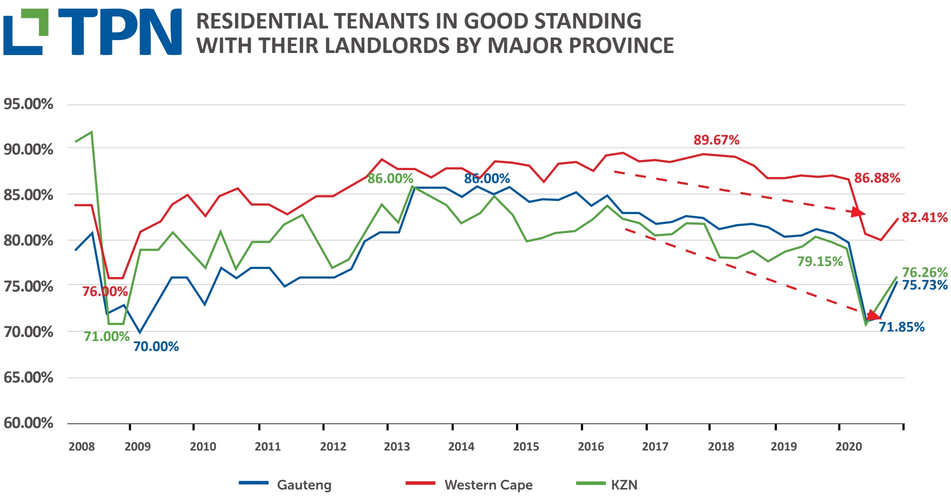
The R12,000-R25,000/month segment was the 2nd best performer, with the percentage of tenants in good standing improving further from 80.23% in the 3rd quarter to 82.95% in the 4th quarter, while the R3,000-R7,000/month segment also improved mildly from 74.28% to 77.63% over the same 2 quarters.

Therefore, the middle segment of the 5 rental value segments remains the relative outperformer of the 5, with the very low end and the very high end showing the weakest tenant performances. At the very low end we believe it is due to this group having few, if any, financial buffers to weather economic and financial "storms, while at the very high end it is more likely to be financial over-commitment.

Gauteng and KZN show slight 4th quarter improvement with Gauteng still the weakest tenant performance of the major 3 provinces

The Western Cape tenants continue to outperform the other 2 major provinces, namely Gauteng and KZN. However, all 3 provinces showed some improvement in the 4th quarter.

From 80.25% of tenants in good standing in the 3rd quarter of 2020, the Western Cape saw an increase to record 82.41% in the 4th quarter.



KZN, by comparison, saw its percentage increase slightly from 73.55% to 76.26% over the same 2 quarters, while Gauteng's lowly 71.85% 3rd quarter level rose to 75.73% in the 4th quarter.

This noticeable quarterly improvement elevates Gauteng off the "bottom of the log", its tenant performance now the 2nd weakest performing of the 9 provinces, with the Free State now the weakest province.

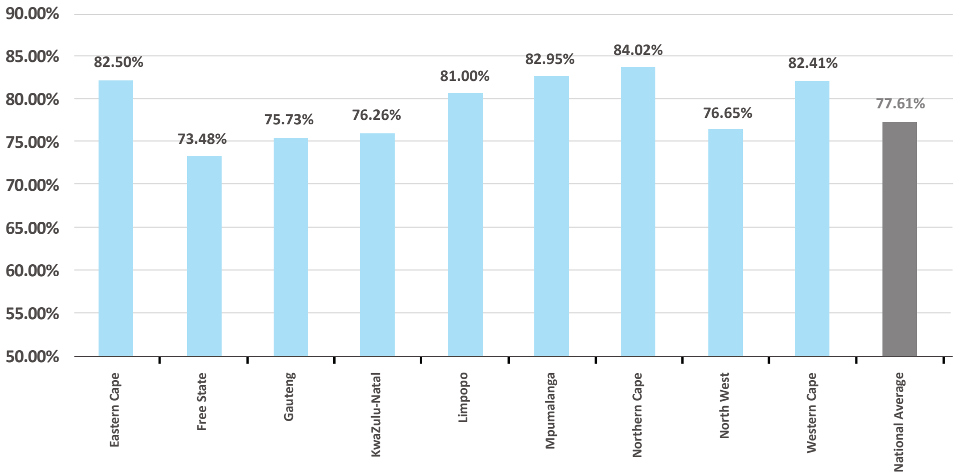
Free State aside, certain of the smaller provinces have seen their tenant payment performances hold up better through the 2020 lockdown period.

These include Limpopo, Mpumalanga, North West and Northern Cape, while the Eastern Cape remains a relatively good performer despite having weakened significantly.

The top 4 performing tenant populations are Northern Cape, with 84.02% of tenants in good standing, Mpumalanga with 82.95%, Eastern Cape with 82.5% and Western Cape at 82.41%.

However, when examining how many percentage points lower the good standing percentages were in the 4th quarter compared to the 1st quarter of 2020, in order to assess the potential lockdown impact over the year, we find the provinces with the smallest declines in the percentage of tenants in good standing over the period were North West (-0.2 percentage points lower), Mpumalanga (-0.4 percentage points lower), Northern Cape (-2 percentage points down) and Limpopo (-2.2 percentage points lower).

TPN RESIDENTIAL TENANTS IN GOOD STANDING BY PROVINCE



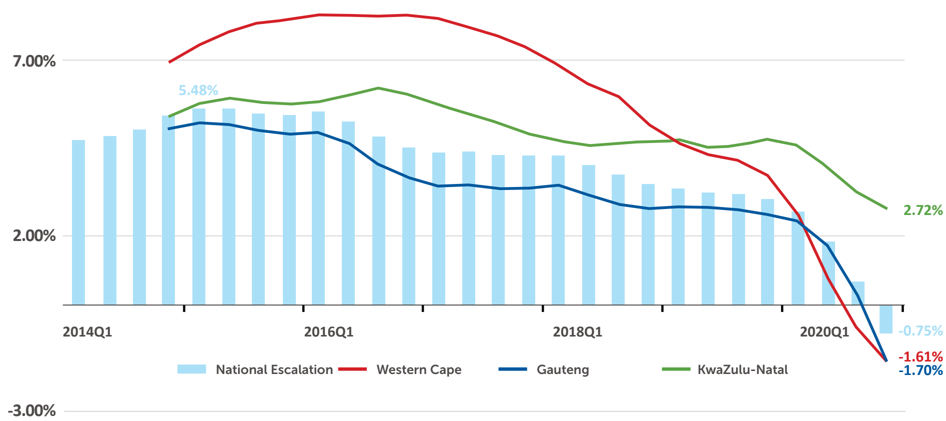
We are of the opinion that certain of these minor provinces may have experienced less of a negative impact on their economies emanating from the lockdown period than the large economic regions, and that this may make the difference for their tenant populations. The smaller provinces have a significantly greater share of Agriculture in their GDP than the provinces that have major metros in them, and Agriculture was a far less affected industry in terms of being locked down than many others. In addition, good rainfall and reports of good crop projections suggest a realistic chance that many of their economic regions may outperform the major city economic regions in the near term. Many of the more rural regions may thus have had less disruption to their economies, and possibly less household income loss as a result.

Rentals head into deflationary territory

Average rentals across South Africa saw their inflation convert to deflation in the 4th quarter of 2020.

On a national average basis, TPN's average rental value deflated by -0.75% year-on-year in the 4th quarter of 2020. This represents the 1st quarter of deflation following 13 consecutive quarters of slowing year-on-year inflation.

TPN RENTAL ESCALATION BY PROVINCE



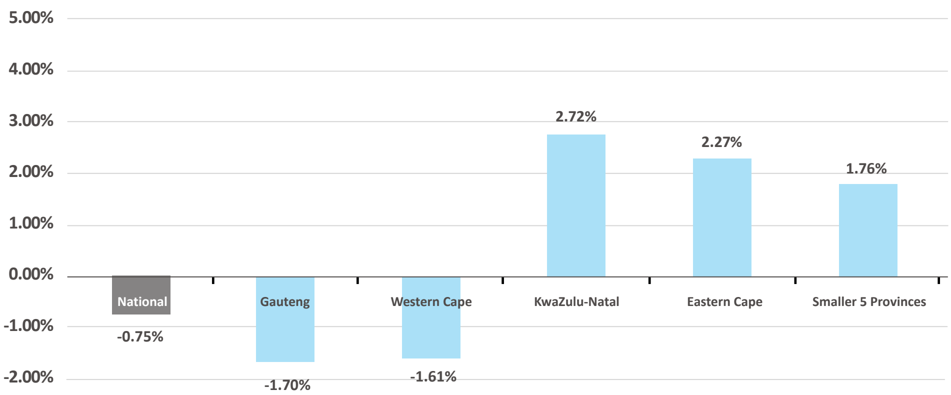
This move into deflation continues a broad trend of rental market weakening, first in the form of slowing inflation from a multi-year high of 5.49% in rental inflation as at early-2015.

The Western Cape market was the 1st major region to move into rental deflation, 2 quarters ago, with Gauteng following suit for the 1st time in the 4th quarter of 2020.

Although the Western Cape has relatively strong tenants in terms of their rental payment performance, affordability may be curbing that province's demand for rental homes more than the other major provinces. Up until 2018 the Western Cape had far higher rental inflation compared to Gauteng and KZN, translating into a far more significant affordability deterioration at the time.

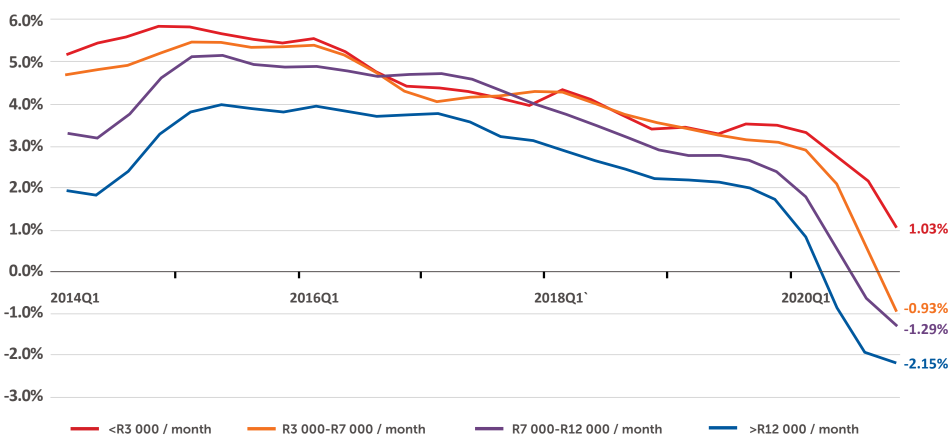
As at the 4th quarter of 2020, the Western Cape's rental deflation measured -1.61% year-on-year, its 2nd quarter of deflation since TPN provincial rental data began back in 2015, while Gauteng's rate of rental deflation was -1.7%.

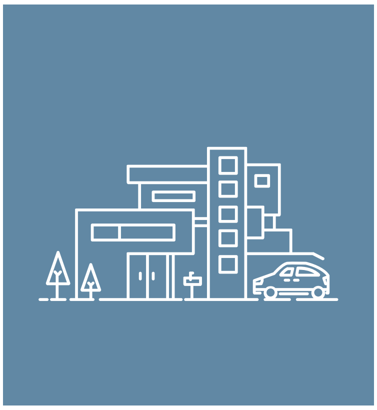
TPN AVERAGE RENTAL BY PROVINCE Q3 2020 YEAR-ON-YEAR PERCENTAGE CHANGE



By rental/month value bands, the "Less Than R3,000/month segment has the highest rental inflation at 1.03% year-on-year, while the highest (for rental inflation purposes) value segment of R12,000+/month has the lowest in negative territory to the tune of -2.15%. We expect these relative positions to change in the near term, given that the lowest segment has of the most severe tenant financial pressure along with a high estimated vacancy rate.

TPN RENTAL ESCALATION BY RENTAL VALUE BAND

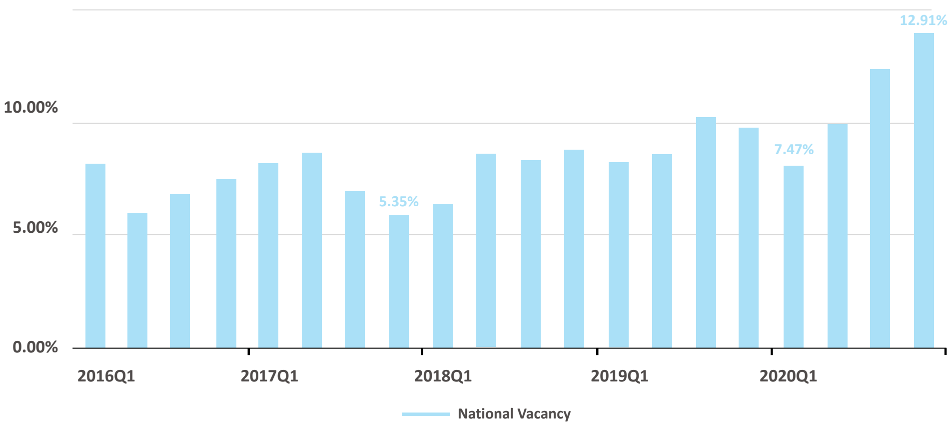




Further rise in the national vacancy rate into the 4th quarter points to further national rental deflation to come

The weakening rental inflation nationally is explained by an increasing supply of rental space relative to demand, as shown in a rising national average vacancy estimate. The estimate emanates from a TPN survey of letting agents.

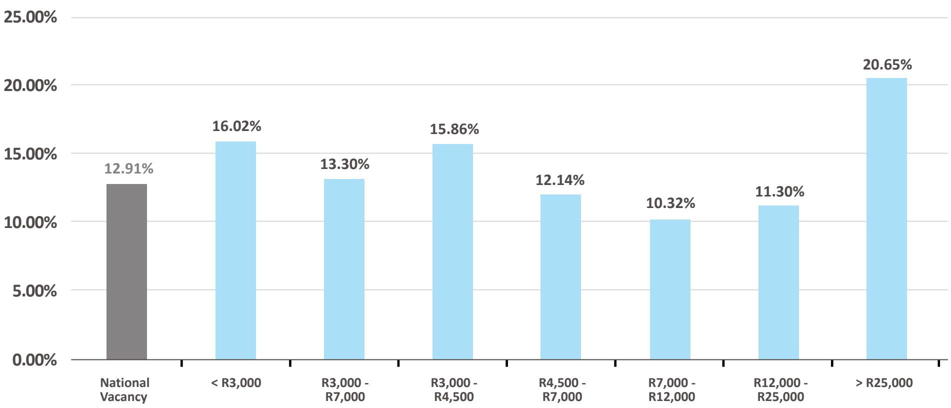
TPN VACANCY RATE NATIONAL



From a 7.47% rate in the 1st quarter of 2020, the estimated national vacancy rate rose sharply to 12.91% in the 4th quarter of 2020.

This is a very significant increase, and as mentioned, points to a sharp slowdown in new household formation and even certain household "shutdowns" as the population experiences severe financial pressure caused by the deep recession of 2020.

TPN AVERAGE VACANCY BY RENTAL/MONTH VALUE BAND Q3 2020

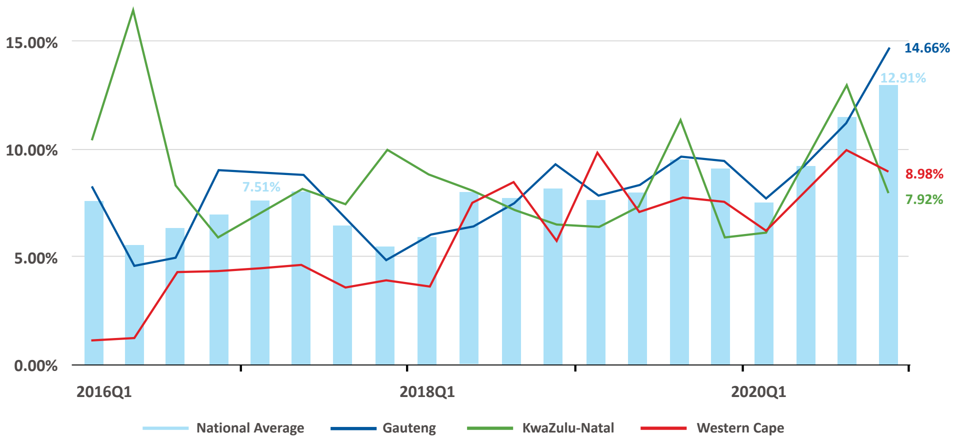


The 2 segments with the weakest tenant payment performance, i.e. "Less than R3,000/month and R25,000+/month have the 2 highest vacancy rates as well at 16.02% and 20.65% respectively.

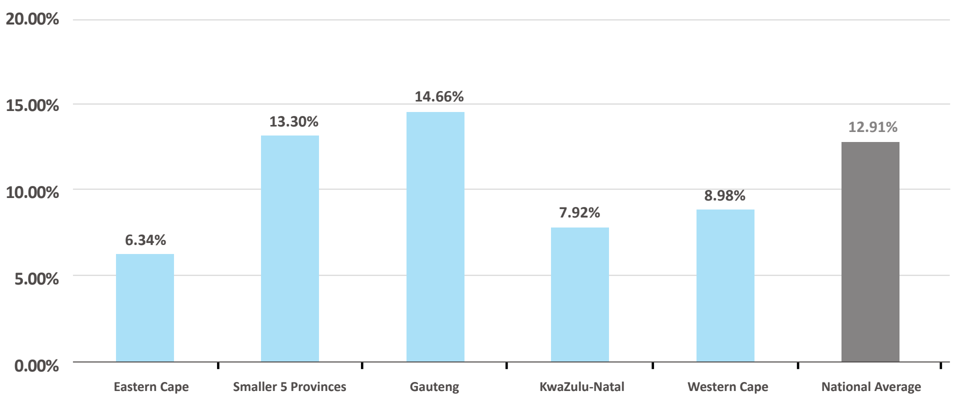
By major province, Gauteng has the highest estimated average vacancy rate in the 4th quarter, to the tune of 14.66%, followed by Western Cape's 8.98% and KZN's 7.02%.

While quarter to quarter vacancy rates by province can be a little volatile, Gauteng having the highest vacancy rate appears to be consistent with it having the most significant rental deflation rate as well as the weakest tenant performance of the Big 3 provinces.

TPN VACANCY RATE BY MAJOR PROVINCE



TPN AVERAGE VACANCY BY MAJOR PROVINCE Q3 2020



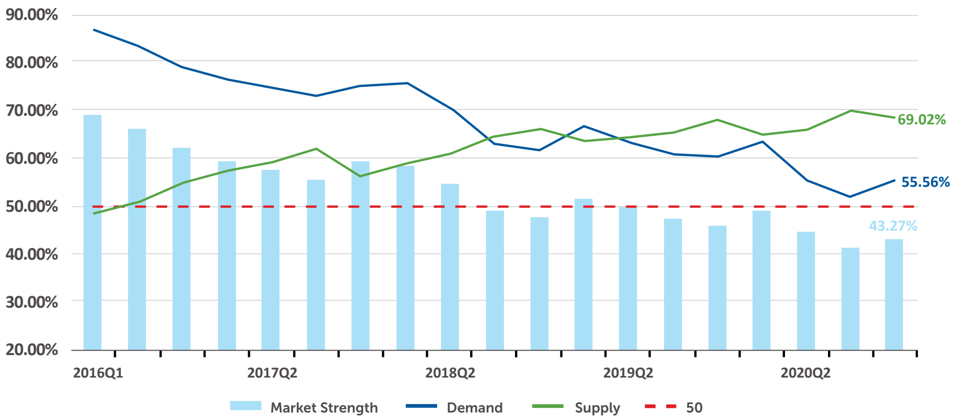
Rental Market Strength Index points to supply still significantly outstripping demand

One of the surveys that TPN does of letting agents relates to their perceptions of rental market strength. In this, agents are asked to give an indication of their perception of both rental home demand as well as supply, providing a simple "weak", "average" or "strong" answer for each. We give a numerical rating to each category, 100 for "strong", 50 for "average" and zero for "weak", the average demand and the average of the supply responses thus being somewhere between 0 and 100.

The Market Strength Index, also on a scale of 0 to 100 reflects the gap between the Supply Rating and the Demand Rating (scaled to 0 to 100) where above 50 reflects demand exceeding supply and vice versa for a rating below 50.

The multi-year weakening in the economy has been reflected in a steady decline in the TPN Rental Market Strength Index since its inception in 2016, at which stage it was near to 70, to 41.3 by the 3rd quarter of 2020, where demand was significantly below supply according to the survey respondents. The 4th quarter of 2020 saw a slight increase in this index to 43.27, but that level remains well below the 50 “balanced” level, suggesting that supply still far exceeds demand, and that further rental deflation is likely in the near term.

TPN RENTAL MARKET STRENGTH INDEX



Conclusion

The recent set of TPN indicators point to further improvement in the payment performance of the residential tenant population. However, “full” recovery to pre-lockdown levels of tenants in good standing has not yet been achieved, reflecting just how severe the deep economic contraction of the 2nd quarter and its resultant tenant employment and income loss actually was.

Nevertheless, the dip in tenant payment performance in 2020 was slightly less severe than the 2009 low point in tenant payment performance despite the 2020 recession being far more severe than that of 2008/9. We believe that the key difference between then and now was that interest rates and the cost of servicing household debt was far higher in 2008/9 than in 2020. This has cushioned the blow significantly for households this time around. And while tenants may not have that much mortgage debt, they would have significant consumer and vehicle debt.

The 4th quarter was significant in the sense that the TPN average rental moved from slowing inflation into deflation territory. This move was expected, given that the average national rental property vacancy rate has been rising significantly for some time, and continued to rise in the 4th quarter of 2020.

There exists a realistic chance that the StatsSA measure of rental inflation, a major part of the CPI (Consumer Price Index) will also go into deflationary territory. While not good news in a sense for landlords, it is a key factor in keeping CPI inflation low at near 3% levels, and this in turn helps keep the pressure off the SARB to hike interest rates any time soon.