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PROPERTY BAROMETER
Review of 2nd Quarter Residential Building Stats

While 2nd quarter residential building completions rose sharply, affordability still constrains levels

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KEY POINTS

- *Last week's release of June 2015 Residential Building Statistics gave us the complete building picture for the 2nd quarter of 2015. The quarter was significantly stronger than the 1st quarter. After a 1st quarter growth rate of 9.8%, the number of residential units completed saw a sharp growth acceleration to 34.8% year-on-year in the 2nd quarter.*

- *To use building statistics as a leading economic/business cycle indicator, such as the SARB (Reserve Bank) does in its Composite Leading Business Cycle Indicator, one needs to examine Building Plans Passed, rather than completions, and preferably excluding the "Houses smaller than 80 square metres" category. Compiling a series for Residential Plans Passed for Houses larger than 80 square metres, Flats and Townhouses, we see a picture of slowing growth, from a relative high of 17.4% year-on-year in the 3rd quarter of 2014 to 4.2% year-on-year in the 2nd quarter of 2015.*

- *While we have seen a year-on-year growth acceleration in the 2nd quarter, the 2nd quarter 2015 total residential completions level of 10,627 remains a lowly 47.6% of the boom time high of 22,348 units completed in the final quarter of 2006. The most recent levels of units completed even remain on the low side compared to pre-boom levels around the year 2000.*

- *The reason for actual building completions levels being so low, even compared with pre-boom levels, has to do with both existing as well as new homes being far less affordable than back before last decade's price boom, when measuring home values relative to average employee remuneration.*

- *The move to address the affordability challenge of post-boom years is reflected in the rising share of units' plans passed in the "Flats and Townhouses" category, with their greater density and lower land use. Whereas in 2010 Flats and Townhouses' plans passed made up 28% of total plans passed, for the 1st half of 2015 this had increased noticeably to 37%. The market will thus increasingly sacrifice outdoor space (stand size) in order to address the affordability challenge that has arisen since the property price boom of last decade.*

- *We believe it realistic to expect positive growth in completions for the years 2015 and 2016 as a whole, following a decline of -8.3% in 2014. After the strong 2nd quarter growth rate, we are likely to revise our current growth forecast of 8.5% for 2015 as a whole upwards.*

However, weakening economic growth over the past 3 years, and more recently rising interest rates too, leads us to believe that the strong double-digit growth in the number of units completed in the 2nd quarter is not sustainable for too long, and would expect growth in 2016 to be back well into in single-digit territory.

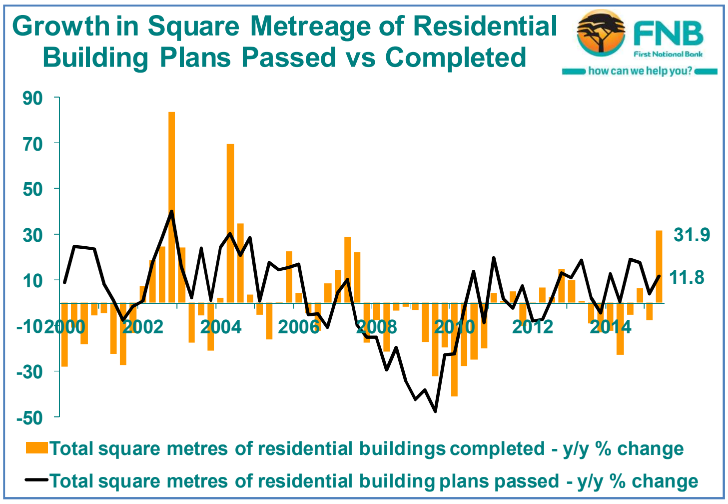
A REVIEW OF THE 2ND QUARTER RESIDENTIAL BUILDING STATISTICS – STRONG GROWTH, BUT OFF A LOW BASE AS AFFORDABILITY CHALLENGES CONSTRAIN BUILDING LEVELS

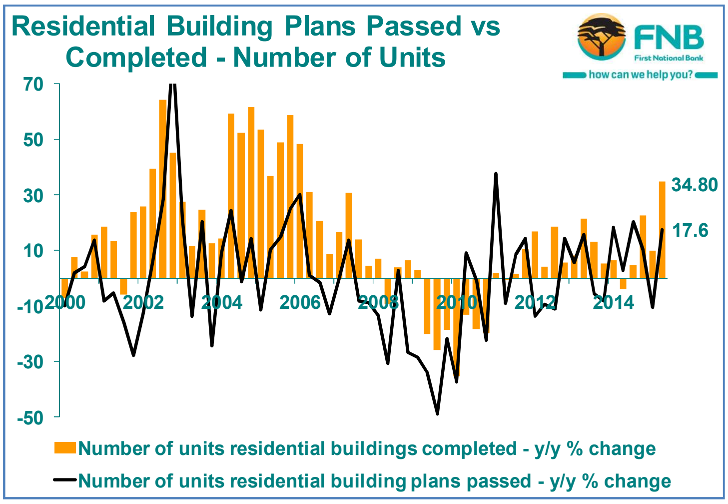
While the strong growth rates in residential building completions recorded for the 2nd quarter of 2015 appear impressive, the actual levels of completions remain low by both boom time highs as well as pre-boom levels. The weakness compared to the boom peaks around 2006/7 is explained by more "competitive" existing home values as late, making it challenging for the new development sector to bring competitively priced new stock to the market. The weakness compared to pre-boom levels, on the other hand, is explained by both the existing and new home prices being significantly less affordable than back them, translating into smaller sized markets for both the existing and new home sectors compared with back prior to the residential boom.

RESIDENTIAL BUILDING COMPLETIONS CAME BACK STRONGLY IN THE 2ND QUARTER OF 2015

After last week's release of June 2015 Residential Building Statistics by StatsSA, we now have the complete building picture for the 2nd quarter of 2015. Certainly, the quarter appeared to be significantly better than a rather weak growth 1st quarter. After a 1st quarter decline of -7.7% year-on-year in square metres of residential buildings completed, the 2nd quarter shot back to positive growth of +31.9%. Similarly, the number of residential units completed saw a growth acceleration, from a low +9.8% in the 1st quarter to 34.8% year-on-year in the 2nd quarter. These 2nd quarter quarterly completions growth rates haven't been seen in over a decade.

Indeed, residential building plans passed growth rates, too, strengthened in the 2nd quarter compared to the prior quarter, albeit less extremely.





HOWEVER, ONE NEEDS TO LOOK AT A SLIGHTLY DIFFERENT STATISTIC FOR ANY INDICATION OF WHERE THE BUSINESS/ECONOMIC CYCLE MAY BE GOING

However, this growth in total completions is not necessarily reflective of any better economic times that may be on their way. To the contrary, economic times ahead look set to be worse.

A significant driver of 2nd quarter growth was the "Dwelling Houses Smaller than 80 square metres" category of buildings. This category saw the number of units completed grow by a massive 58.6% year-on-year in the 2nd quarter. The category is less prone to tracking the business cycle than the others, perhaps including significant "lower income/affordable" housing that could periodically be driven more by the timing of big development projects than by the economic or business cycle.

By comparison, the more business cycle-related categories, namely "Houses larger than 80 square metres" and "Flats and Townhouses", grew by lesser rates of 34.7% and 4.3% respectively.

In addition, if one want to us building statistics as a leading business cycle indicator, and indeed the SARB (Reserve Bank) does, one needs to examine Building Plans Passed, rather than completions, and preferably excluding the "Houses smaller than 80 square metres" category.

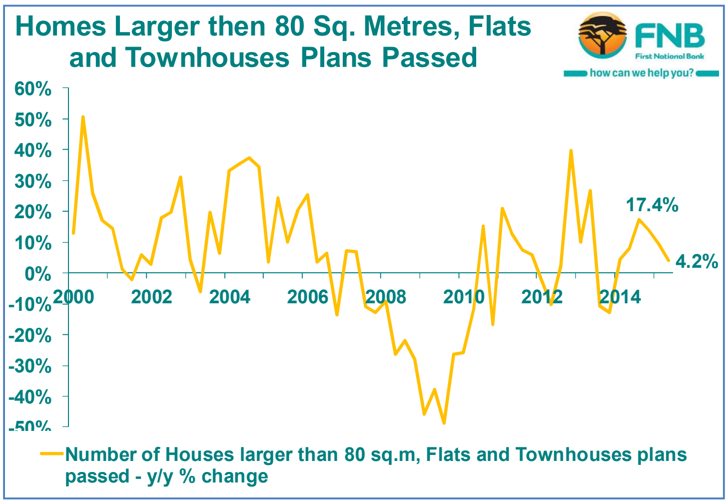
Compiling a series for Residential Plans Passed for Houses larger than 80 square metres, Flats and Townhouses, the series that the SARB indeed uses as one input into its Leading Business Cycle Indicator, we receive a different 2nd quarter picture altogether to the one portrayed by total building plans completed or passed.

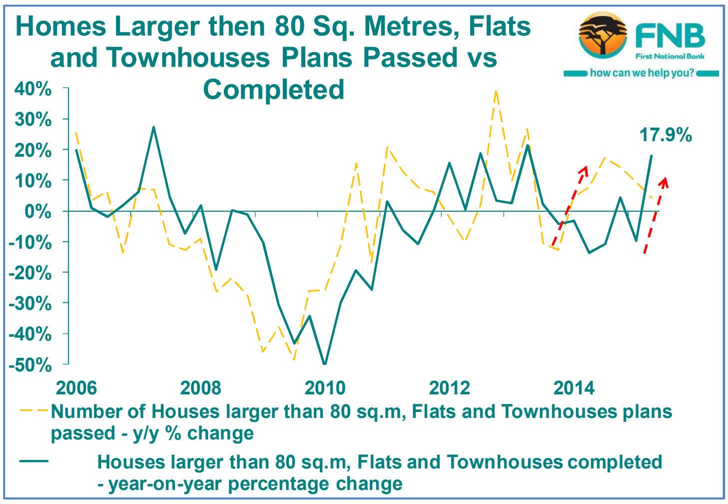
Here, we see a picture of slowing growth, from a relative high of 17.4% year-on-year as at the 3rd quarter of 2014 to 4.2% year-on-year by the 2nd quarter of 2015.

While this is certainly not the only existing leading business cycle indicator, it is one that must be considered, and in recent quarters it has pointed to possibly a less positive "business cycle" picture as its rate of growth slows.

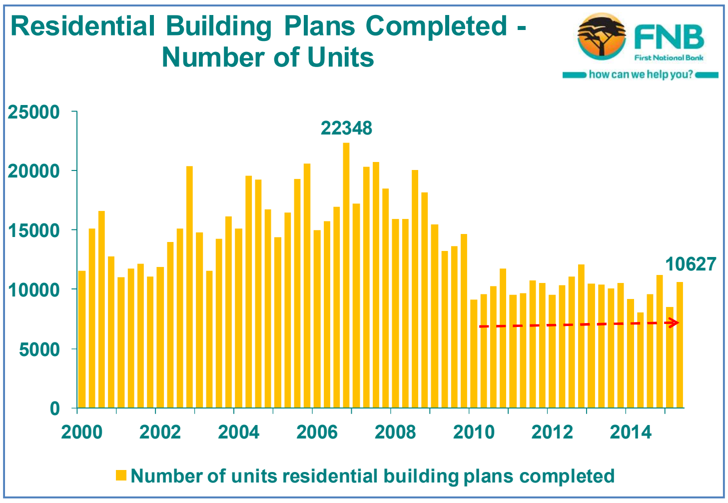
Compiling a building completions time series which also excludes the "Homes smaller than 80 square metres" category, we see a 2nd quarter 2015 growth acceleration in building completions to 17.9% year-on-year. However, this is merely completions lagging trends in plans passed, the recent surge being the lagged response to a "mini-resurgence" in building plans passed growth around late-2013/early-2014.

The most recent slowing in growth in plans passed, excluding homes smaller than 80 square metres, suggests that slower growth in building completions should follow fairly soon, following a good 2nd quarter growth rate.





DESPITE A SOLID ACCELERATION IN GROWTH IN 2ND QUARTER BUILDING COMPLETIONS, THE OVERALL LEVELS REMAIN FAR FROM BOOM-TIME HIGHS



Examining the actual level of total residential building completions, while we have seen a year-on-year growth acceleration in the 2nd quarter, at best the levels of completions have only moved broadly sideways since the post-boom low point reached early in 2010.

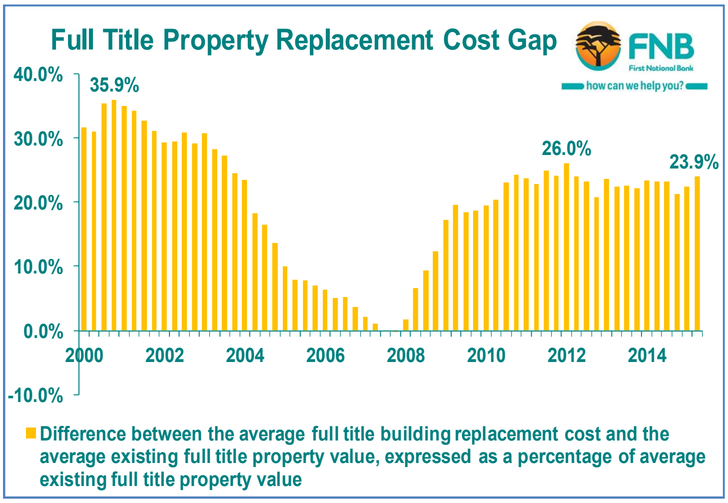
In addition, the 2nd quarter 2015 completions level of 10,627 remains a lowly 47.6% of the boom time high of 22,348 units completed in the final quarter of 2006.

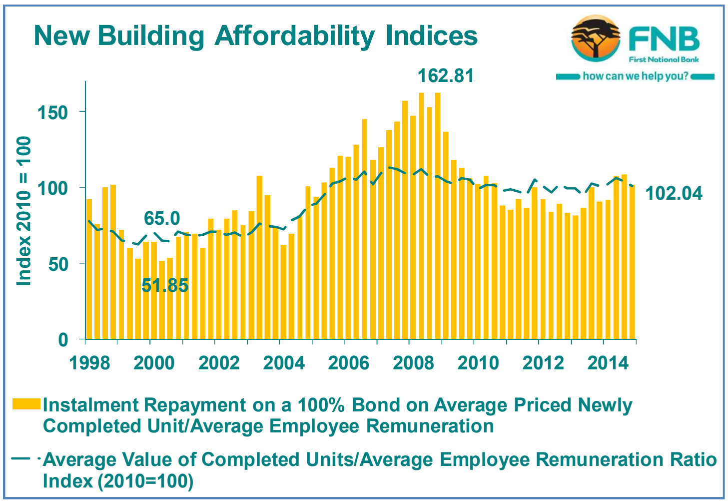
The most recent levels of units completed even remain on the low side compared to pre-boom levels around the year 2000.

THE AFFORDABILITY CONSTRAINT

This ongoing relatively low level of residential building activity has much to do with new residential unit affordability never quite returning to the low levels of early last decade.

Our FNB Full Title Replacement Cost Gap depicts the difference between the average full title replacement cost and the average existing full title property value, expressed as a percentage of the average existing full title property value. It shows a gap of 23.9% as at the 2nd quarter of 2015, meaning the average replacement cost is 23.9% higher than the average existing full title home value. This gap is wide relative to 2007, where it had reached zero at a stage as a result of rampant existing house price inflation during the boom years. Around 2006/7, therefore, it was far easier for the residential development sector to bring new stock to the market that was competitively priced relative to very high existing home values. This explains the very high levels of building completions at that time, and the far lower levels these days.





The Replacement Cost Gap, however, does not explain why residential building completions in 2015 are still noticeably lower than pre-boom times early last decade or in the late-1990s. This is because as at mid-2000 the Replacement Cost Gap was even wider at 35.9%, which one would think would imply even more constrained building completions back then than now. The fact that this is not the case, and that building activity is lower today, is rather explained by the entire residential market, both existing and new homes, being less affordable in 2015 than back in the late-1990s.

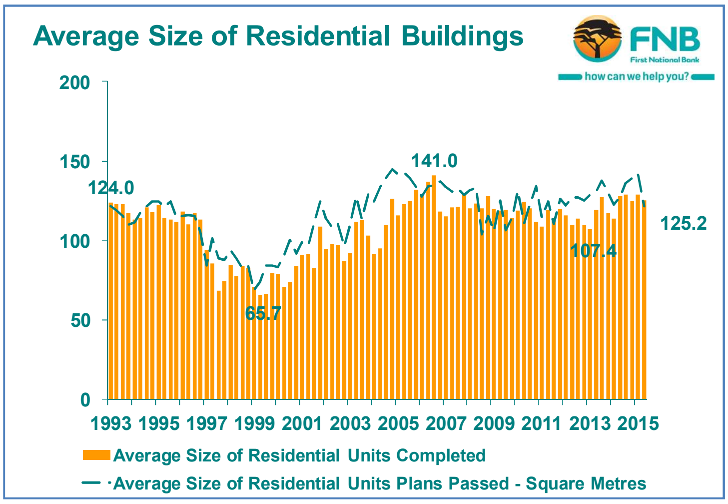
Using SARB Average Formal Sector Employee Remuneration data, we calculated 2 new residential unit affordability indices. The 1st index, namely the Average Newly Completed Home/Average Employee Remuneration Ratio Index, is -10.5% lower (more affordable) than its peak 2007 level, due to wage inflation outpacing new house price inflation for some time subsequent to 2007.

The 2nd index, the Instalment Value on a 100% Bond on the Average-Priced Newly Completed Home/Average Employee Remuneration Index is an even more significant -37.3% down (more affordable) on its peak 2008 level, due to the additional impetus received from big interest rate cuts post-2008.

However, both indices remain significantly higher than the late-1990s or early last decade. The Average Newly Completed Home Price/Average Employee Remuneration Index in the 2nd quarter of 2015 was 55.4% higher (less affordable) than in the 2nd quarter of 2000, while the Instalment/Average Employee Remuneration Index was a massive 96.8% higher (less affordable).

Therefore, while the Replacement Cost Gap of today is narrower than early last decade, the entire residential market, both existing as well as new homes, are significantly less affordable than back before last decade's price boom, and this constrains residential building activity to even lower levels these days than those of the late-1990s and early-2000s

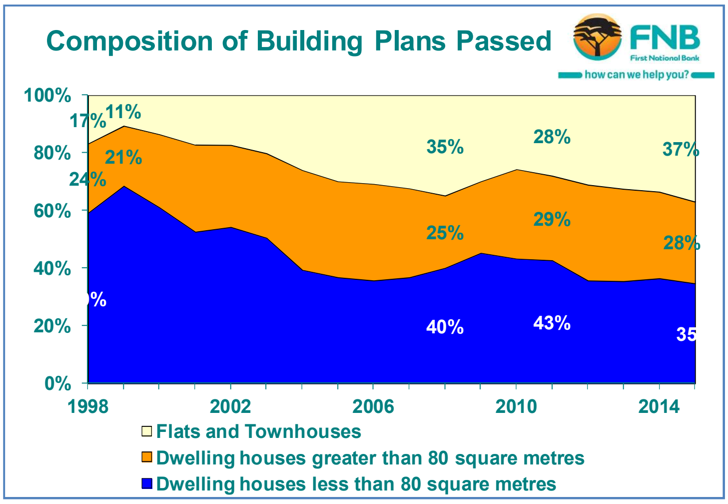
ADDRESSING THE AFFORDABILITY CONSTRAINT



The building statistics point towards gradual moves by the development sector to address the current affordability constraint.

When we examine the average unit size for residential plans passed and completed, it is noticeable that in the better economic times the average size of unit rises. So, from early-1999 to late-2006 the average size of homes completed rose from 65.7 square metres to 141 square metres during the boom years. Then, as the cracks showed in the economy, and interest rates once more rose from 2006 to 2008, this average size of unit completed tapered off gradually to eventually reach 107.4 square metres by early-2013. Then, once more, low interest rates and better property market times encouraged some increase in size, and as at the 2nd quarter of 2015 the average was 125.2 square metres.

However, the 2nd quarter data did show a decline in average size of units' plans passed, from 142.4 square metres in the 1st quarter to 121.4 square metres, which we believe is a sign of things to come in terms of completions, given a weakening economy and the resumption of interest rate hiking.



However, while it is early days, and such a quarterly decline in average size of plans passed is not yet "conclusive evidence", the moves to address the affordability constraint are perhaps more visible in the trends in the composition of the 3 property categories.

On average, the Flats and Townhouses building category should utilise less land, i.e. possess a smaller average stand size, than "Dwelling Houses".

The move to address the affordability challenge of post-boom years is thus reflected in the rising share of units' plans passed in the "Flats and Townhouses" category.

Whereas in 2010 Flats and Townhouses' plans passed made up 28% of total plans passed, for the 1st half of 2015 this had increased noticeably to 37%. The market appears more prepared to sacrifice outdoor space than under roof space, and so the plan to address the affordability challenge is more focused on the average stand size aspect and "densification" of residential units.

CONCLUSION

While the strong growth rates in residential building completions recorded for the 2nd quarter of 2015 appear impressive, the actual levels of completions remain low by both boom time highs as well as pre-boom levels.

The weakness compared to the boom peaks around 2006/7 is explained by more "competitive" existing home values as late, making it challenging for the new development sector to bring competitively priced new stock to the market. The weakness compared to pre-boom levels, on the other hand, is explained by both the existing and new home prices being significantly less affordable than back them, translating into smaller sized markets for both the existing and new home sectors compared with back prior to the residential boom.

Looking forward, though, we believe it realistic to expect positive growth in completions for the years 2015 and 2016 as a whole, following a decline of -8.3% in 2014. After the strong 2nd quarter growth rate, we are likely to revise our current growth forecast of 8.5% for the entire 2015 upwards.

However, weakening economic growth over the past 3 years, and more recently rising interest rates too, leads us to believe that the strong double-digit growth in the number of units completed in the 2nd quarter is not sustainable for too long, and would expect growth in 2016 to be back well into single-digit territory.

Building Plans Passed

Residential Buildings	2012	2013	2014	Q4-2014	Q1-2015	Q2-2015	Apr-15	May-15	Jun-15
Dwelling houses less than 80 m.sq (Number	17 793	17 894	20 717	4 409	4 012	6 114	1 848	2 309	1 957
Y/Y % change	*-21.2*	*0.6*	*15.8*	*3.3*	*-35.3*	*50.9*	*79.9*	*38.3*	*44.4*
Dwelling houses less than 80 m.sq (m^2)	867 330	886 304	1 000 827	211 662	193 697	282 302	84 953	104 864	92 485
Y/Y % change	*-20.4*	*2.2*	*12.9*	*-3.7*	*-36.7*	*38.8*	*61.7*	*26.2*	*36.5*
Dwelling houses less than 80 m.sq (R'000)	2 704 622	2 941 897	3 665 079	908 774	796 875	963 310	272 300	391 335	299 675
Y/Y % change	*-1.9*	*8.8*	*24.6*	*12.1*	*-20.9*	*31.1*	*37.5*	*37.1*	*19.1*
Dwelling houses larger than 80 m.sq (Numbe	16 582	16 203	17 121	4 249	4 049	4 242	1 270	1 488	1 484
Y/Y % change	*6.8*	*-2.3*	*5.7*	*10.0*	*3.2*	*1.0*	*0.3*	*6.7*	*-3.4*
Dwelling houses larger than 80 m.sq (m^2)	3 883 451	4 229 594	4 593 003	1 168 917	1 116 292	1 148 360	345 299	374 039	429 022
Y/Y % change	*3.3*	*8.9*	*8.6*	*16.3*	*7.7*	*5.4*	*7.4*	*9.9*	*0.3*
Dwelling houses larger than 80 m.sq (R'000)	21 011 671	24 351 101	28 319 334	7 422 344	6 986 339	7 345 666	2 180 900	2 351 079	2 813 687
Y/Y % change	*11.3*	*15.9*	*16.3*	*24.9*	*12.2*	*12.3*	*12.4*	*16.2*	*9.1*
Flats and Townhouses (Number)	15 445	16 350	18 971	4 832	4 475	6 262	2 791	1 437	2 034
Y/Y % change	*4.9*	*5.9*	*16.0*	*18.0*	*15.6*	*6.4*	*109.2*	*-54.8*	*48.5*
Flats and Townhouses (m^2)	1 495 616	1 531 217	1 873 555	496 088	475 737	587 436	237 527	158 885	191 024
Y/Y % change	*6.7*	*2.4*	*22.4*	*34.6*	*26.8*	*14.5*	*79.5*	*-36.2*	*45.5*
Flats and Townhouses (R'000)	8 642 600	9 605 023	13 185 006	3 640 596	3 386 706	4 144 577	1 756 503	1 086 984	1 301 090
Y/Y % change	*20.9*	*11.1*	*37.3*	*45.1*	*39.7*	*16.4*	*101.8*	*-38.6*	*41.2*
Total units plans passed (Number)	**49 820**	**50 447**	**56 809**	**13 490**	**12 536**	**16 618**	**5 909**	**5 234**	**5 475**
Y/Y % change	***-5.7***	***1.3***	***12.6***	***10.3***	***-10.5***	***17.6***	***62.9***	***-16.2***	***28.5***
Total building plans passed (m^2)	**6 246 397**	**6 647 115**	**7 467 385**	**1 876 667**	**1 785 726**	**2 018 098**	**667 779**	**637 788**	**712 531**
Y/Y % change	***0.0***	***6.4***	***12.3***	***17.8***	***4.0***	***11.8***	***31.9***	***-5.2***	***13.7***
Other Residential Buildings (m^2)	151 257	184 436	199 151	60 670	38 238	60 051	3 635	47 658	8 758
Y/Y % change	*62.0*	*21.9*	*8.0*	*151.2*	*-42.4*	*103.1*	*-22.1*	*730.0*	*-54.3*
Other Residential Buildings (R 000)	787 573	1 405 583	1 213 717	398 130	237 998	477 541	22 027	391 166	64 348
Y/Y % change	*77.0*	*78.5*	*-13.7*	*260.4*	*-23.9*	*111.1*	*-34.4*	*1092.7*	*-59.7*
Total Residential Buildings (R 000)	**33 146 466**	**38 303 604**	**46 383 136**	**12 369 844**	**11 407 918**	**12 931 094**	**4 231 730**	**4 220 564**	**4 478 800**
Y/Y % change	***13.4***	***15.6***	***21.1***	***32.0***	***14.4***	***16.9***	***39.1***	***2.7***	***14.5***
Additions and Alterations									
Dwelling houses (m^2)	3 125 614	3 143 857	3 199 308	821 459	714 097	781 787	247 256	259 158	275 373
Y/Y % change	*-1.1*	*0.6*	*1.8*	*2.6*	*-1.8*	*4.7*	*3.0*	*5.1*	*5.9*
Dwelling houses (R'000)	15 869 459	16 773 444	18 274 354	4 806 880	4 186 082	4 596 881	1 439 444	1 521 390	1 636 047
Y/Y % change	*5.0*	*5.7*	*8.9*	*10.3*	*5.8*	*9.3*	*5.6*	*10.2*	*12.0*

Buildings Completed

Residential Buildings	2012	2013	2014	Q4-2014	Q1-2015	Q2-2015	Apr-15	May-15	Jun-15
Dwelling houses less than 80 m.sq (Number)	20 023	17 436	15 444	5 108	3 527	4 398	1 226	1 923	1 249
Y/Y % change	*2.7*	*-12.9*	*-11.4*	*9.1*	*-4.7*	*58.6*	*81.9*	*92.3*	*13.6*
Dwelling houses less than 80 m.sq (m^2)	902 955	808 514	764 268	262 594	181 719	216 352	60 756	96 016	59 580
Y/Y % change	*-0.4*	*-10.5*	*-5.5*	*19.6*	*3.7*	*56.7*	*68.6*	*101.8*	*9.5*
Dwelling houses less than 80 m.sq (R'000)	2 337 344	2 315 435	2 767 020	1 036 210	689 527	824 117	233 839	350 948	239 330
Y/Y % change	*1.8*	*-0.9*	*19.5*	*53.9*	*30.6*	*63.8*	*55.1*	*103.9*	*32.7*
Dwelling houses larger than 80 m.sq (Number)	11 569	11 538	10 750	3 169	2 708	3 180	997	1 117	1 066
Y/Y % change	*1.0*	*-0.3*	*-6.8*	*4.6*	*12.2*	*34.7*	*37.0*	*34.3*	*33.1*
Dwelling houses larger than 80 m.sq (m^2)	2 805 442	2 859 082	2 776 600	837 946	705 112	812 560	267 560	276 795	268 205
Y/Y % change	*1.2*	*1.9*	*-2.9*	*14.6*	*15.7*	*38.1*	*44.3*	*45.2*	*26.3*
Dwelling houses larger than 80 m.sq (R'000)	14 577 590	15 910 377	17 061 655	5 212 601	4 321 373	5 139 233	1 702 761	1 739 917	1 696 555
Y/Y % change	*9.0*	*9.1*	*7.2*	*21.4*	*19.6*	*45.2*	*49.7*	*55.5*	*32.1*
Flats and Townhouses (Number)	11 386	12 511	11 849	2 950	2 247	3 049	789	1 031	1 229
Y/Y % change	*19.3*	*9.9*	*-5.3*	*4.2*	*-27.0*	*4.3*	*-48.4*	*61.6*	*62.4*
Flats and Townhouses (m^2)	1 104 767	1 218 234	1 166 426	301 585	205 617	301 776	79 190	122 350	100 236
Y/Y % change	*10.9*	*10.3*	*-4.3*	*6.0*	*-20.6*	*-0.3*	*-40.6*	*38.7*	*23.6*
Flats and Townhouses (R'000)	5 848 247	7 203 121	7 592 393	2 036 477	1 427 587	2 064 571	484 151	908 981	671 439
Y/Y % change	*20.7*	*23.2*	*5.4*	*13.6*	*-17.0*	*8.0*	*-43.8*	*60.8*	*38.5*
Total units completed (Number)	**42 978**	**41 485**	**38 043**	**11 227**	**8 482**	**10 627**	**3 012**	**4 071**	**3 544**
Y/Y % change	***6.1***	***-3.5***	***-8.3***	***6.5***	***-7.7***	***31.9***	***2.8***	***64.8***	***33.4***
Total building space completed (m^2)	**4 813 164**	**4 885 830**	**4 707 294**	**1 402 125**	**1 092 448**	**1 330 688**	**407 506**	**495 161**	**428 021**
Y/Y % change	***2.9***	***1.5***	***-3.7***	***13.5***	***4.7***	***29.3***	***14.8***	***51.7***	***23.0***
Other Residential Buildings (m^2)	45 645	88 659	88 528	24 532	5 434	49 655	25 735	20 273	3 647
Y/Y % change	*-69.5*	*94.2*	*-0.1*	*368.7*	*-76.1*	*162.6*	*42.9*	*5424.0*	*585.5*
Other Residential Buildings (R 000)	306 248	492 628	519 920	172 198	35 945	324 519	187 653	119 693	17 173
Y/Y % change	*-64.5*	*60.9*	*5.5*	*636.0*	*-72.2*	*258.2*	*117.9*	*6362.9*	*558.7*
Total Residential Buildings (R 000)	**23 069 429**	**25 921 561**	**27 940 988**	**8 457 486**	**6 474 432**	**8 352 440**	**2 608 404**	**3 119 539**	**2 624 497**
Y/Y % change	***7.9***	***12.4***	***7.8***	***24.7***	***8.1***	***38.2***	***16.7***	***67.9***	***34.5***
Additions and Alterations									
Dwelling houses (m^2)	1 466 959	1 722 368	1 120 747	278 357	260 453	309 016	106 535	105 712	96 769
Y/Y % change	*-16.8*	*17.4*	*-34.9*	*-20.8*	*-24.4*	*35.8*	*52.3*	*30.0*	*26.8*
Dwelling houses (R'000)	6 867 590	8 228 378	6 130 061	1 542 307	1 383 593	1 648 768	567 256	548 296	533 216
Y/Y % change	*-12.7*	*19.8*	*-25.5*	*-14.8*	*-21.4*	*25.8*	*39.2*	*17.6*	*22.2*