The Absa[1] residential property market database for South Africa - key data trends and implications

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1. Introduction

For most working people in South Africa (and probably in most developed countries worldwide), their house and retirement provision account for the bulk of the wealth they have accumulated throughout their working lives. The considerable extent of homeownership among South Africa's working population means that changes in residential property prices may be of particular interest and concern because of the wealth effects that could emanate from fluctuations in property values.

The aim of this paper is to give an overview of the compilation and use of the most comprehensive database on the South African residential property market. This overview is preceded by some background information on the demography, income, and other developmental issues pertaining to the country's provinces (Section 2). Key housing stock and other residential property market indicators will also be given, together with a brief overview of the operation of the mortgage finance market in South Africa (Section 3). Thereafter, a short historical overview of the development of the Absa residential property market (ARPM) database will be provided, as well as the scope of indicators being covered by the information (Section 4). Some analysis pertaining to house and land prices and size trends over time follows (Section 5). Then an attempt is made to reconcile residential property market indicators with other key macroeconomic trends, and a look is taken at the house price levels in South Africa relative to market conditions in a selection of other countries (Section 6). The paper concludes with a synopsis of some key structural issues impacting on the property market in South Africa (Section 7).

2. Demographic, developmental, housing stock and other key characteristics for South Africa

2.1 General overview: South African provinces

The Republic of South Africa covers an area of 1.2 million km^2 - nearly twice the size of the state of Texas in the United States. Since 1994, the country comprises nine provinces, four of which have coastlines. South Africa has eleven official languages. The home language of 55% of the population is isiZulu, isiXhosa, or Afrikaans. The *lingua franca* in most urban areas is English.

There are significant disparities in terms of human development in South Africa; not only between provinces, but also between population groups. The two smallest provinces, Gauteng and KwaZulu-Natal, account for around 40% of the country's population. Gauteng and the Western Cape generate around 56% of South African GDP. Some 55% of the population live in urban areas. Gauteng is the most urbanised province, with 96% of its people living in cities. At the other extreme, only 13% of the population of the Limpopo Province live in urban areas.

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1 Absa Group Limited: One of the "big four" banking and financial services groups operating in South Africa. In March 2003, the Group reported total assets of R269bn ($50bn at a PPP exchange rate of ZAR5,40) and earnings of R3bn ($0,6bn). It had 33,000 employees; a network of 3,300 ATMs; and some 680 branches throughout South Africa. Foreign branches or subsidiaries operate from countries in Africa, Asia and Europe.

2 Chief Economist: Absa Group Limited. Paper presented at the IMF/BIS *Conference on Real Estate Indicators and Financial Stability* held from 27 to 28 October 2003 in Washington DC, USA. The views expressed in this article are those of the author and do not necessarily reflect those of Absa Group Limited.

2.2 Key indicators

Table 1 contains some key indicators pertaining to the demography, income and production of South Africa's provinces in 2002.

Table 1

Selected demographic and other indicators for South Africa's provinces

Province	Population (million)	Population growth (% pa)	Urbanised (%)	Annual household income ($)	GGP ($ bn)	GGP (% of total)	GGP per capita ($)
KwaZulu-Natal	9.6	1.4	46.1	11,812	25.3	13.0	2,634
Gauteng	8.7	1.7	95.8	20,613	71.4	36.8	8,197
Eastern Cape	6.9	1.1	36.5	8,473	13.2	6.8	1,919
Limpopo	5.5	1.4	13.1	7,965	8.7	4.5	1,562
Western Cape	4.5	1,4	89.0	18,563	33.7	17.4	7,543
North West	3.8	1.3	38.2	8,885	12.9	6.7	3,418
Mpumalanga	3.3	1.7	41.7	10,002	15.6	8.1	4,811
Free State	2.9	1.0	71.7	8,404	9.5	4.9	3,242
Northern Cape	0.9	1.0	71.8	12,228	3.6	1.8	3,889
South Africa	*46.1*	*1.4*	*55.4*	*13,011*	*194.0*	*100.0*	*4,207*

GGP = gross geographic product. All figures are 2002 estimates US$ amounts were calculated by applying a PPP exchange rate of R5.15 (calculation according to UBS AG, Zurich).

Sources: Stats SA; Global Insight.

South Africa's high unemployment rate, estimated at around 30% of the economically active population, clearly implies that income will be skewed, and that a significant portion of households are not able to afford even meagre housing facilities.

In fact, more than 40% of dwellings can be classified as "informal housing", whereas a further significant percentage of the "formal" housing market would presumably also be of rather poor quality.

The residential property market in South Africa comprises approximately seven million formal dwellings. There is no firm data, but the value of the residential property market in 2002 was estimated at roughly R750bn[3] ($146bn at a PPP exchange rate of ZAR5.15 to the USD).

The government has succeeded in building nearly 1.5 million low-cost housing units during the period 1994 to 2003. This has provided some support to the construction sector, which suffered from surplus capacity during the late 1980s and early 1990s.

The higher end of the market (houses ≥ $80m^2$) has also experienced a significant increase in activity during the past two to three years, with the number of newly built houses having increased by 24% in 2002 compared with 2001, and the number of townhouse and flat units (apartments) by 47% (see Table 2 and the table in Appendix A).

[3] It is estimated that around 1.5 million homes can be classified in terms of the ARPM classification, with an average price of R358,721 in 2003. Another three million properties could probably be classified under "affordable" housing, with an average price of R71,811 in 2002 (see also Section 6.1).

Table 2

Housing in South Africa

	1995		1999	
	Number	**% of total**	**Number**	**% of total**
Urban housing	5,089,000	56.0	6,503,000	60.4
Formal[1]	3,626,000	39.9	3,824,000	35.5
Informal[2]	443,000	4.9	1,074,000	10.0
Traditional[3]	39,000	0.4	62,000	0.6
Other[4]	981,000	10.8	1,543,000	14.3
Rural housing	3,991,000	44.0	4,268,000	39.6
Formal	1,890,000	20.8	2,352,000	21.8
Informal	233,000	2.6	255,000	2.4
Traditional	1,302,000	14.3	1,111,000	10.3
Other	566,000	6.2	550,000	5.1
Total housing	9,080,000	100.0	10,771,000	100.0
Formal	5,516,000	60.7	6,176,000	57.3
Informal	676,000	7.4	1,329,000	12.3
Traditional	1,341,000	14.8	1,173,000	10.9
Other	1,547,000	17.0	2,093,000	19.4

[1] A house, flat, townhouse or unit in retirement village. [2] Shacks. [3] Ethnic huts. [4] Caravans, tents, etc.

Source: South African Institute of Race Relations (SAIRR).

3. The operation of the mortgage finance market in South Africa

3.1 Home ownership in South Africa

In South Africa, property ownership rates high in the national consciousness. Many of the early battles in the country, involving the Dutch and British settlers, the Voortrekkers and the various tribes with whom they came into contact, were over land ownership. Through the 1900s, one of the biggest debates in national politics was about land tenure.

Numerous pieces of legislation regulated the ownership of land, particularly on a racial basis. One of the major tenets of apartheid was the segregation and separation of land ownership. The so-called Group Areas Act allocated separate residential areas in urban areas to the black, coloured, Indian, and white communities.

Today, home ownership for all is a major political objective and receives a lot of attention. The government has made the provision of housing a priority in its social delivery programmes and assists low-income, first-time homebuyers with a subsidy ranging between R7 800 and R23,100 ($1,500 and $4,400 at a PPP exchange rate).

3.2 The development of the mortgage finance market in South Africa until the mid-1980s

For extensive periods during the nineteenth and twentieth centuries, home ownership in South Africa was financed mainly through building societies.

Building societies have their origins in eighteenth century Britain. The push effects of the Agricultural Revolution and the pull effects of the Industrial Revolution encouraged a mass migration of the British population to the cities and towns. This resulted in a chronic housing shortage, which the middle class traders and craftsmen were determined to overcome through the establishment of “friendly societies”.

These were non-profit-making institutions that promoted thrift among their members for the purpose of procuring houses.

The British Settlers brought this concept to southern Africa and the first building societies were established in Port Elizabeth and Durban in 1855 and 1857 respectively. The first law in Southern Africa that directly controlled these institutions, the Regulation of Building Societies Act, was passed in Natal in 1858.

The early development of the movement was slow and confined to the Eastern Cape and Natal. There was neither a desire nor a need for building societies in the interior of the subcontinent until the discovery of diamonds in Kimberley (Northern Cape) in 1870 and gold on the Witwatersrand (part of the current Gauteng province) in 1886 - events that spawned urban concentrations of the population.

Whereas the very first societies mostly terminated once their objectives were reached, permanent building societies soon became established. Some of the larger building societies even survived until the late 1980s, when changes to legislation and merger activity started to affect these institutions.

One building society, the United Building Society, established in 1889, became a financial institution of significant size. For decades, it was the biggest building society in South Africa. It built up a strong capital base over the years and, in the early 1990s, was used as the merger vehicle to create South Africa's largest banking group at the time, Amalgamated Banks of South Africa Limited (Absa). One other building society and two banks were involved in this merger.

3.3 The role of banks since the mid-1980s

Legislation pertaining to building societies was frequently changed and augmented over the years, with major acts passed in 1934 and 1965. Nonetheless, certain privileges afforded to and restrictions imposed on the building societies remained. For instance, special tax treatment meant that building societies could offer mortgage loans below market rates, which placed the commercial banks at a competitive disadvantage in this regard.

As part of a comprehensive inquiry into the monetary system and monetary policy in South Africa during 1982 to 1985 (the so-called De Kock Commission), it was recommended that the playing field between banks and building societies be levelled.

The restrictions placed on the way in which building societies could capitalise themselves were especially crucial. These restrictions meant that the societies could only exist as "mutual" institutions.

Changes to the legislation caused these restrictions to be removed, and most of the larger building societies opted for a listing on the Johannesburg Stock Exchange - a process which meant that they lost their "mutual society" status.

The listing process started in 1986 and the United Building Society became the first publicly listed building society. Members' accounts (which were held as so-called subscription shares) were converted into ordinary listed shares.

As the boundaries between building societies and banks started to fade and more of the building societies converted into banks or merged with existing banks, mortgage financing became an important component of banks' balance sheets. By the mid-1990s, there were no building societies in existence, although 11 had been in operation in 1984.

Currently, banks are by far the most important providers of mortgage finance for housing loans in South Africa. By June 2003, mortgage loans comprised 32% of the total loans and advances on the banks' balance sheets, and amounted to R289bn ($52bn).

4. The Absa residential property market database

Currently, there are two well-known sources of systematic residential property market data in South Africa. The deeds office - where all ownership and changes in ownership of fixed property need to be registered[4]; and the Absa residential property market (ARPM) database, a brief discussion of which follows.

4.1 A short history of the ARPM database

As mentioned before, the United Building Society (UBS), which existed for more than a hundred years before merging with three other financial institutions, became a significant player in the mortgage finance market in South Africa, attaining a market share of well over a third of all residential property mortgage loans in the 1980s. With the formation of the Absa Group, this institution retained its leading role in the mortgage finance market, although inroads have been made by other banks (see Table 3).

Table 3

Market shares for loans and advances by South Africa's major banks[1]

	Absa	Nedcor	Standard Bank	FirstRand	Other	Total	Total (R mln)
Mortgage advances	31	24	21	16	8	32	288,583
Overdrafts and loans	17	7	37	30 [2]	9	28	251,386
Credit Cards	25	22	25	22	6	2	15,235
Instalment sales and leases	24	13	22	29	12	12	111,622
Other loans and advances	21	27	18	16	18	26	228,637
Total	24	18	25	22	11	100	
Total (R million)	211,989	164,889	223,531	193,524	101,530		895,463

[1] With the exception of total figures in rand, in per cent of total. As at end March, 2003. [2] No figure available - own estimate.

Source: South African Reserve Bank (DI900 tables).

The UBS house price database came into being at around 1981. At the time, it was decided to destroy old records of home loan applications that were kept at branches. Fresh records were sampled at all major branches throughout the country and captured onto a mainframe database. Between 1981 and 1984, a bigger sample of records was obtained from the branches and added to the database. From 1985, all loan application records were captured electronically and added to the database. Since the late 1980s, the data have been captured directly onto the mainframe system.

4.2 The ARPM database: Capturing, processing and variables

Currently, data are being captured directly by property valuers onto the mainframe mortgage loan database. This is done on site using a mobile device called a Q10TEC. From the mortgage loan

[4] Data from the deeds office suffer from two important deficiencies: (i) Data only become available after a lag of some six months; and (ii) no area size variables for properties are available, which may make comparisons between periods difficult, since it is not possible to ascertain the extent of a shifting of weights from smaller to larger properties or *vice versa*.

database, data warehouse tables are populated via an Oracle staging process. This process is performed weekly and monthly. (See Appendix B for a flowchart of the process).

By the end of August 2003, the ARPM database consisted of nearly 700,000 individual properties. Data are available in monthly time series format for both new (building loans) and existing properties. These categories are subdivided into small ($80m^2$ to $140m^2$), medium ($141m^2$ to $220m^2$), and large ($221m^2$ to $400m^2$) properties. For each of these categories, the following variables can be obtained on a branch/regional basis:

- Building area
- Building value
- Land area
- Land value
- Contract price (for new properties)
- Purchase price
- Value of improvements (such as fencing, patios, swimming pools)
- Sample size

In addition, data are also available for luxury homes (properties with a value in excess of R1,500,000 in constant 2002 prices) and for affordable houses (between $40m^2$ and $80m^2$ in size and R100,000 in value). In all, there are more than 2,000 time series of the aforementioned variables.

From the data warehouse tables, time series are generated by SAS (*Statistical Analysis System*) programs for the variables indicated above. In an attempt to ensure that data are as "clean" as possible, certain filters are applied to rid the data of outliers. Often such outliers are caused by the incorrect capturing of values. The following are the most important filters that will determine whether or not a record is included:

- Building area < 95% of land area
- $0m^2 \leq$ land area $\leq 2{,}000m^2$
- Purchase price ≤ R1,500,000 (in 2002 rand terms; this amount is adjusted backward and forward in time by the CPI)
- $40m^2 \leq$ building area $\leq 400m^2$

To avoid problems arising from the data samples for certain time series being too thin, data in the public domain are only available on a regional basis and not on a branch basis. All time series are also smoothed by an X11 seasonal adjustment process in SAS. The SAS program writes all time series data into delimited text files that can be imported into spreadsheets.

5. Historical trends of key residential property market indicators in South Africa

5.1 Nominal and real price trends

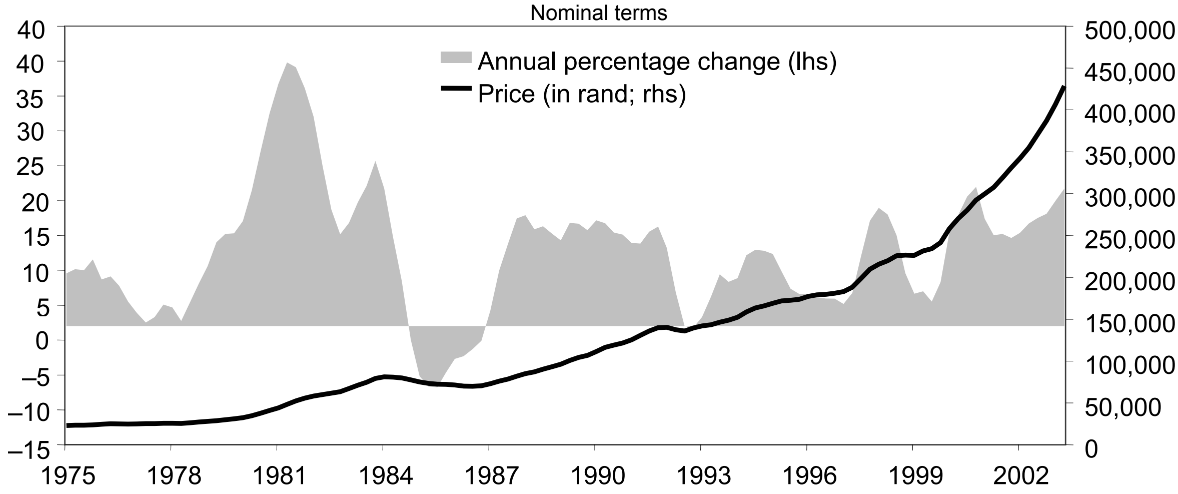
South African house prices have increased from an average level of R23,200 in 1975 to R358,700 in 2002, representing an average annual increase of 11% (Graph 1). However, this must be seen against the background of an average annual inflation rate of 11,5% over this period. Indeed, an analysis of real house prices (Graph 2), reveals some interesting aspects of the economic and socio-political conditions that prevailed in South Africa between the late 1970s and the late 1990s.

The 1970s brought wars in the Middle East, which sent oil prices soaring and presented the world with inflationary problems. In South Africa, the 1976 Soweto student uprising had a material impact on confidence and adversely affected economic performance. From the third quarter of 1976 to the fourth quarter of 1979, house prices declined by a total of 22.4% in real terms.

The early 1980s saw a massive loss of confidence in the dollar and concerns about spiralling inflation in most of the developed world. Consequently the gold price boomed, reaching a high of $676 on average during September 1981, which had huge positive spin-off effects for the South African economy. At that stage, income from gold exports constituted nearly 50% of total South African export revenue. Rising incomes and a reduction in tax rates considerably boosted households' net wealth position. Improved liquidity conditions even facilitated a reduction in mortgage lending rates.

Graph 1

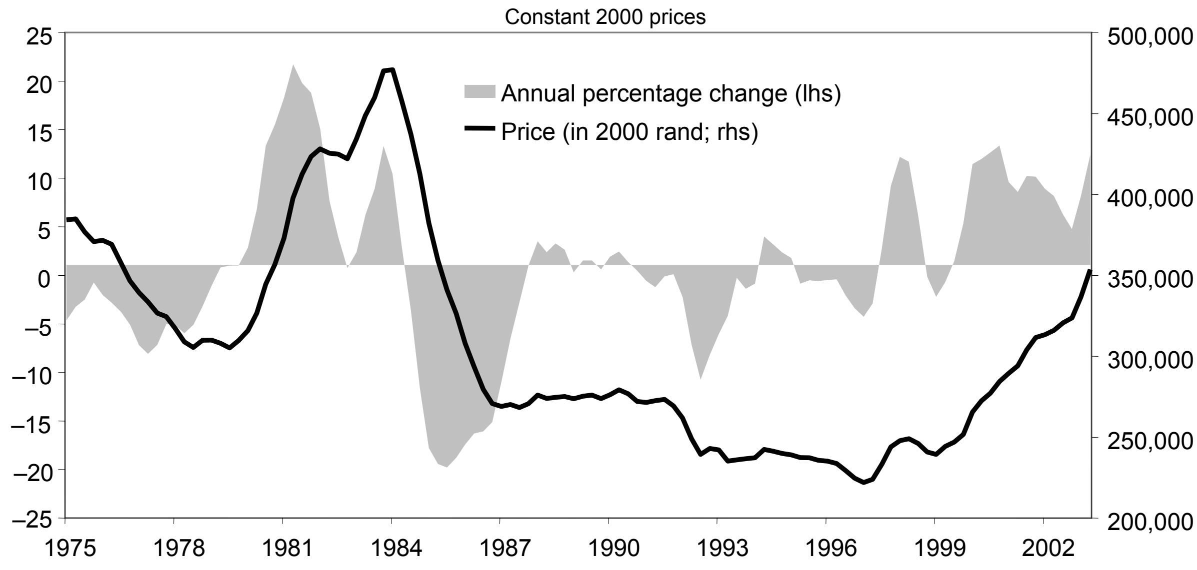
Average house prices in South Africa



However, the good times were about to end when the gold price pulled back and interest rates started to increase. The property market held up quite well during 1981 through to 1983, peaking in the first quarter of 1984. But severe pressure on the balance of payments, which sent mortgage rates soaring, together with increasing political pressure from both domestic and foreign sources, caused the property market bubble to burst. During the period from mid-1984 until the end of 1987, house prices declined by no less than 42% in real terms.

Graph 2

Average house prices in South Africa



From the end of 1986 through to the end of 1991, house prices simply kept pace with inflation. In 1992/93, confidence suffered a setback owing to uncertainty about the political future of the country. With the advent of the new democratic order in April 1994, confidence was restored and house prices recovered somewhat. However, an ongoing exodus of skilled managers and professionals during much of the 1990s served to keep the property market under pressure.

Only in 1998 did the market start to recover on the back of lower inflation and interest rates, higher economic growth, and a much improved fiscal situation. Unfortunately, contagion effects from the Asian crisis caused a massive fall in the value of the rand, which once again caused interest rates to soar by some seven percentage points during 1998.

By late 1999, the situation had more or less stabilised, and the house price boom resumed. By mid-2003, house prices had nearly doubled in nominal terms from their early 1998 values.

5.2 Provincial price trends

Considering the disparities in development, income and urbanisation between South Africa’s provinces, it is not surprising to also find significant differences in average house prices between the regions.

It is to be expected that house prices in the poorer provinces, such as Limpopo, Mpumalanga, KwaZulu-Natal and the Free State, may be below the national average. The dwindling importance of gold mining activity has affected employment and general economic activity in provinces such as the Free State and NorthWest, although the escalation of international platinum prices has possibly more than offset the low gold-price effect in the latter province.

A province such as the Western Cape has benefited from tourism as well as from foreign buyer interest owing to the weaker rand.

Table 4

House prices in South Africa

	Small ($80m^2$ to $140m^2$)		**Medium ($140m^2$ to $220m^2$)**		**Large ($220m^2$ to $400m^2$)**		**All ($80m^2$ to $400m^2$)**	
	2002 ZAR	**Avg annual %ch: ‘92-‘02**	**2002 ZAR**	**Avg annual %ch: ‘92-‘02**	**2002 ZAR**	**Avg annual %ch: ‘92-‘02**	**2002 ZAR**	**Avg annual %ch: ‘92-‘02**
Eastern Cape	188,700	7.8	261,418	8.4	404,570	8.9	281,237	8.9
Free State	169,805	7.3	233,117	8.3	346,138	9.5	266,224	9.5
Gauteng	249,029	8.4	345,075	9.3	546,112	9.7	397,304	10.8
KwaZulu-Natal	178,165	5.1	274,083	6.4	453,218	7.6	290,919	7.5
Mpumalanga	193,686	9.0	243,965	8.9	368,195	9.5	267,064	9.2
Northern Cape	170,487	10.6	210,877	8.6	346,143	9.9	236,656	9.8
Limpopo	184,956	8.8	241,331	7.4	358,669	8.9	259,494	8.9
North West	232,826	10.5	286,096	10.5	379,145	10.7	308,160	10.6
Western Cape	279,199	10.0	396,456	10.0	610,799	10.2	390,560	11.1
South Africa	247,468	8.9	329,623	9.1	509,092	9.6	358,904	10.2

In more localised developments, illegal cross-border inflows of foreign citizens, especially from Zimbabwe and Mozambique, have resulted in an escalation of squatting in and around cities and caused downward pressure on formal property prices in some areas, notably certain suburbs of cities in Gauteng, Limpopo, Mpumalanga and KwaZulu-Natal.

The rising numbers of informal settlements have also been aided by pressures on the agricultural sector and the consequent migration of former farmworkers to urban areas. Table 4 gives an overview of the movement of house prices in recent years in South Africa's provinces.

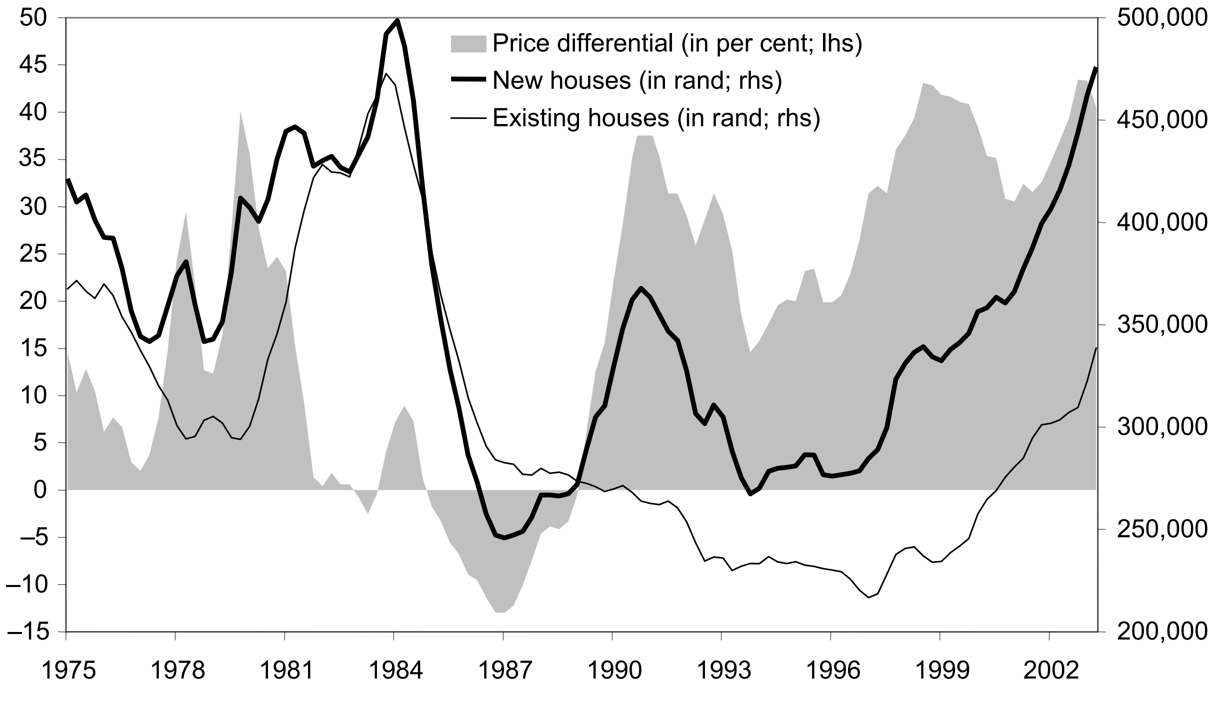
5.3 Building costs and land values

Graph 3 reflects the real price difference between new and existing houses of similar size. During the house price bubble of the early 1980s, new and existing houses cost roughly the same, but lacklustre market conditions and persistently high inflation rates during the late 1980s and early 1990s caused the price differential to become significantly positive. More buoyant market conditions have done little to reduce this differential, which has averaged between 30% and nearly 50% since 1996.

Graph 4, which depicts the building costs as well as the land costs associated with building a new house, shows that a major reason for the persistent price differential is to be found in the dramatic escalation in real land price values since 1994. The rise in land values in turn reflects the expansion of urban areas in South Africa. The development of security villages in suburban areas owing to rampant crime has contributed to the move to smaller but more expensive building plots.

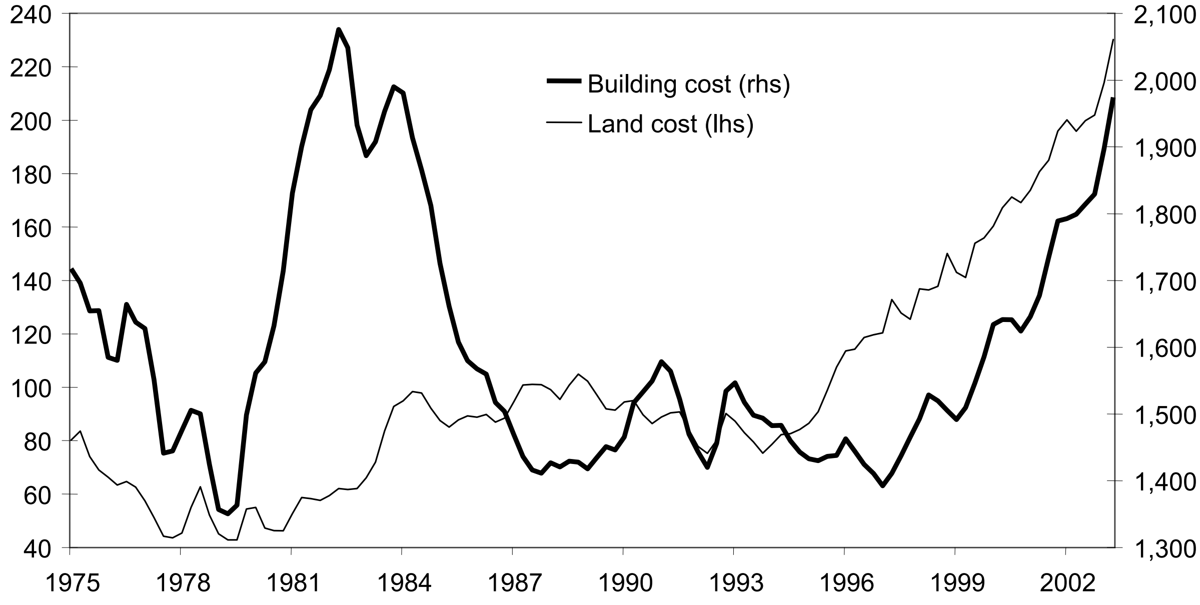
Graph 3

New vs existing house prices in South Africa



Graph 4

Building cost and land value of new houses



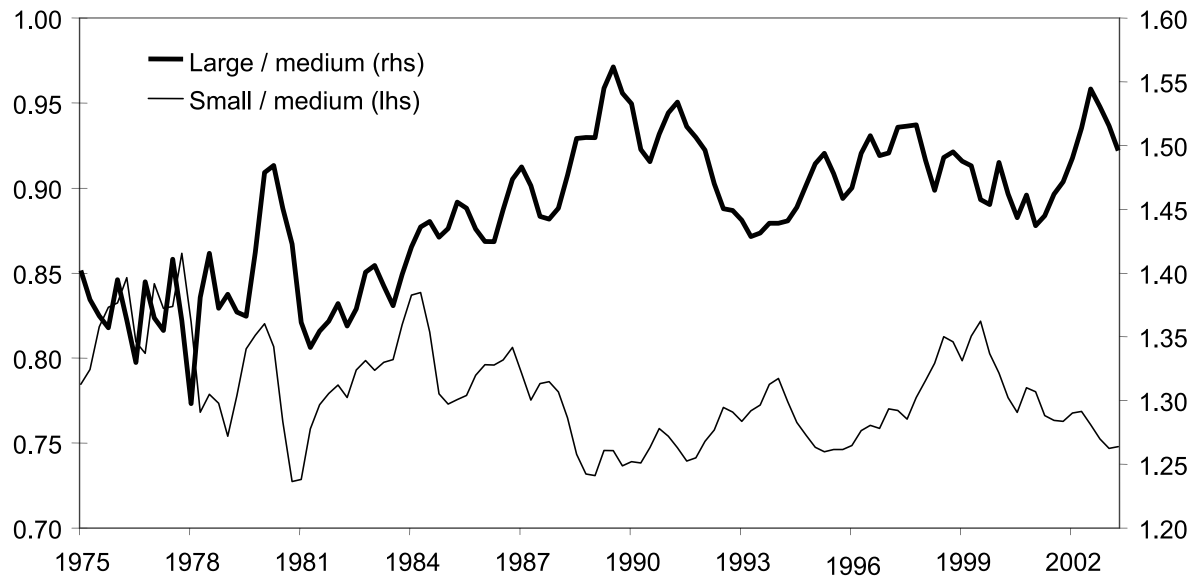
5.4. Size trends

Graph 5 shows the rather interesting relationship between large and small to medium-sized house prices. A comparison of this graph with Graph 1 reveals that, during periods in which nominal house prices increased sharply, the prices of houses in the large category increased more than those of medium-sized homes. The converse tended to be the case with the ratio between the small and medium-sized house prices. "Downscaling" seems to have been prevalent in periods when the property market was under pressure.

Graph 5

Average house prices in South Africa

Large and small vs medium houses

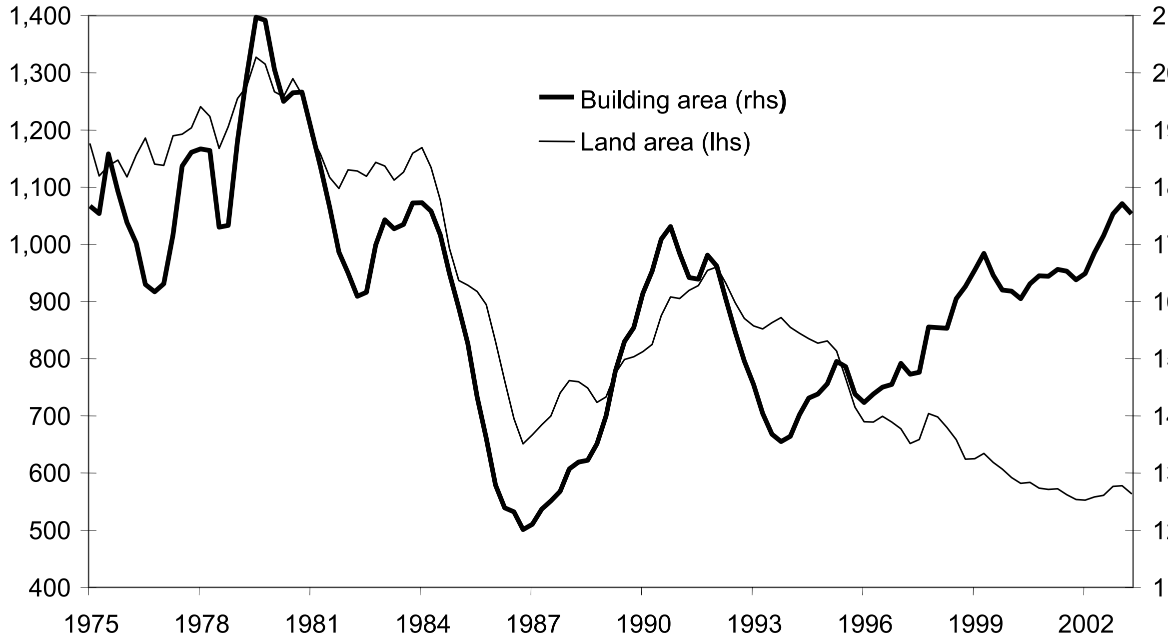


Graph 6 depicts the trends with regard to house sizes and land areas on which new houses are built. Considering the sharp escalation in land values depicted in Graph 4, it is not surprising to find that the plot sizes on which new houses are built have been shrinking over time. The average plot size in 1979 was more than 1,200m^2. This declined sharply after the bursting of the property market bubble. It was only some 640m^2 in 1987. Average plot sizes increased again to nearly 930m^2 in 1991, but have since been decreasing again. They averaged only around 550m^2 during 2002.

Graph 6

Size trends of new houses in South Africa

In square metres



During most of the 1970s, 1980s and first half of the 1990s, building areas followed land areas quite closely. However, they seem to have been trending in the opposite direction since the mid-1990s.

6. Some uses of house price time series data in South Africa

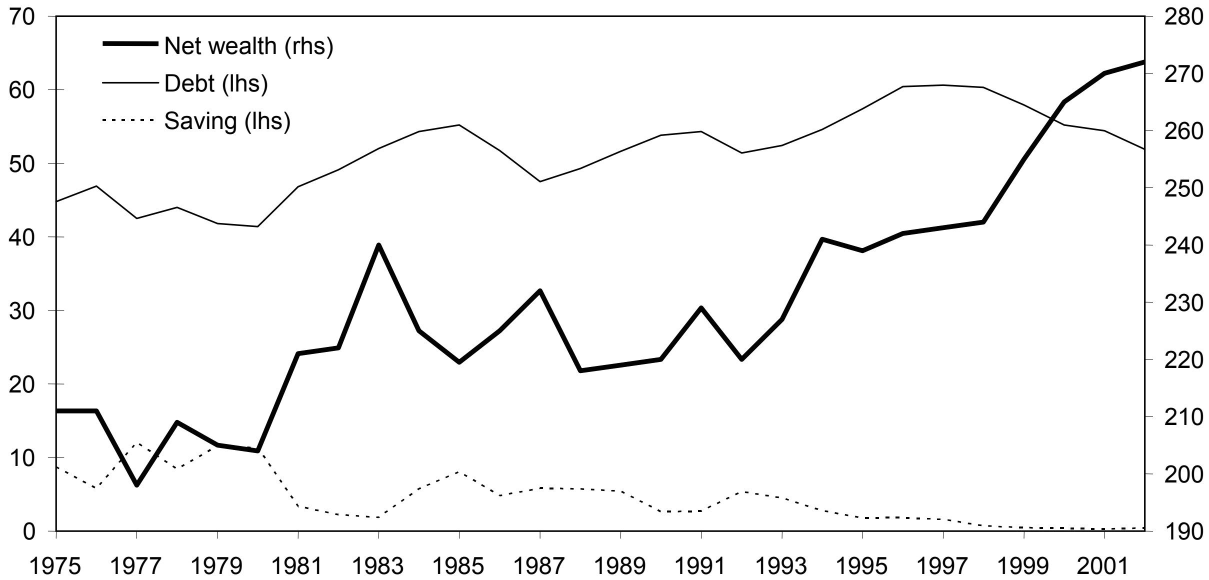
Apart from the obvious reason for interest in house price data, namely as a comparative measure when buying or selling a house, the public, analysts and regulators may also have other uses for time series data on residential property. These could include approximations of national wealth levels; analysing the investment potential of residential properties; evaluating the likelihood of property price bubbles; using property prices as indicators (leading or otherwise) of general economic activity; as an input in the compilation cost of living tables; and as an "early warning" developmental indicator, for instance to point out relative strains that could emerge in regional infrastructural development requirements. The first three of these aspects will be briefly highlighted.

6.1 Analysing household wealth, debt, income and savings levels

South African households have been notorious for their inability to save. According to Reserve Bank figures, household saving as a ratio of household disposable income declined to only 0.2% in 2001, rising marginally to 0.4% in 2002. These figures compare unfavourably with savings ratios of above 10% recorded in the late 1970s (see Graph 7).

Graph 7

Household debt, saving and net wealth



Source: South African Reserve Bank.

Fortunately, increases in net wealth levels (which may be somewhat underestimated)[5] and a slight decrease in household indebtedness since the late 1990s, have ameliorated some of the negative consequences for households' balance sheets, which might otherwise have accompanied this deterioration in their savings levels.

6.2 Analysing the merits of residential property for investment purposes

Property, cash, bonds and equity can be considered the basic pillars of any well-diversified portfolio. However, a problem with direct property investment is that different properties are seldom comparable in terms of value, whereas the location and developments in the immediate vicinity of a specific property can influence its value significantly.

Nevertheless, many investors feel more comfortable with owning a tangible fixed asset, rather than "paper assets" and the gearing that may be achieved with a property investment can also be attractive to some investors.

Apart from the prospective returns, there are clearly a number of factors that ought to be considered when any investment, particularly directly in real estate, is made:

- Risk: The volatility of the return or underlying price can easily be measured for financial assets, but there are other unquantifiable risks involved in direct property investments, such as the risk of not finding suitable tenants.

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[5] The South African Reserve Bank does not publish regular data on household wealth, presumably because figures are regarded as quite "soft". However, from time to time, mention is made of household net wealth figures. This occurred in December 2002, when Graph 7 appeared in an article (Household, debt, wealth and saving) in the SARB Quarterly Bulletin. From the net wealth figures appearing in this graph, gross household wealth can be calculated by adding debt and net wealth together (which came to an estimated R2,216bn at the end of 2002). The gross wealth will, in turn, consist of financial assets as well as tangible assets, which would also include residential property. To arrive at a very rough estimate of financial assets, the following amounts were added together (all figures from the SARB Quarterly Bulletin): individuals' deposits at banks (R175bn); unit trusts' assets at book value (R152bn); accumulated funds in pension and provident funds (R559bn); and unmatured policies relating to pension and other business at long-term insurers (R653bn). The sum of these financial assets came to R1,538bn, leaving around R680bn for tangible assets, such as vehicles, residential property and farmland.

- Homogeneity: Two property investments are hardly ever directly comparable, and using national or regional price data will only approximate actual historical returns achieved on a specific investment. The same applies to investment (rental) income.
- Liquidity: How soon and with what ease can an investment be liquidated. It is well accepted that direct property investments are fairly illiquid.
- Tax implications: In South Africa, dividends are not taxed, but rental and interest income are, as are capital gains.
- Costs: These are nearly always a factor with all types investments. They can be substantial in the case of property. Such costs include transfer duties, bond registration fees and agent's commission. Maintenance and repair costs should also to be considered, but are normally deductible for tax purposes.
- Gearing: As mentioned before, this aspect could make property investments quite attractive, but sharp increases in interest rates could affect the return on the investment. In South Africa, fixed-rate mortgages are not available for terms exceeding two or three years.

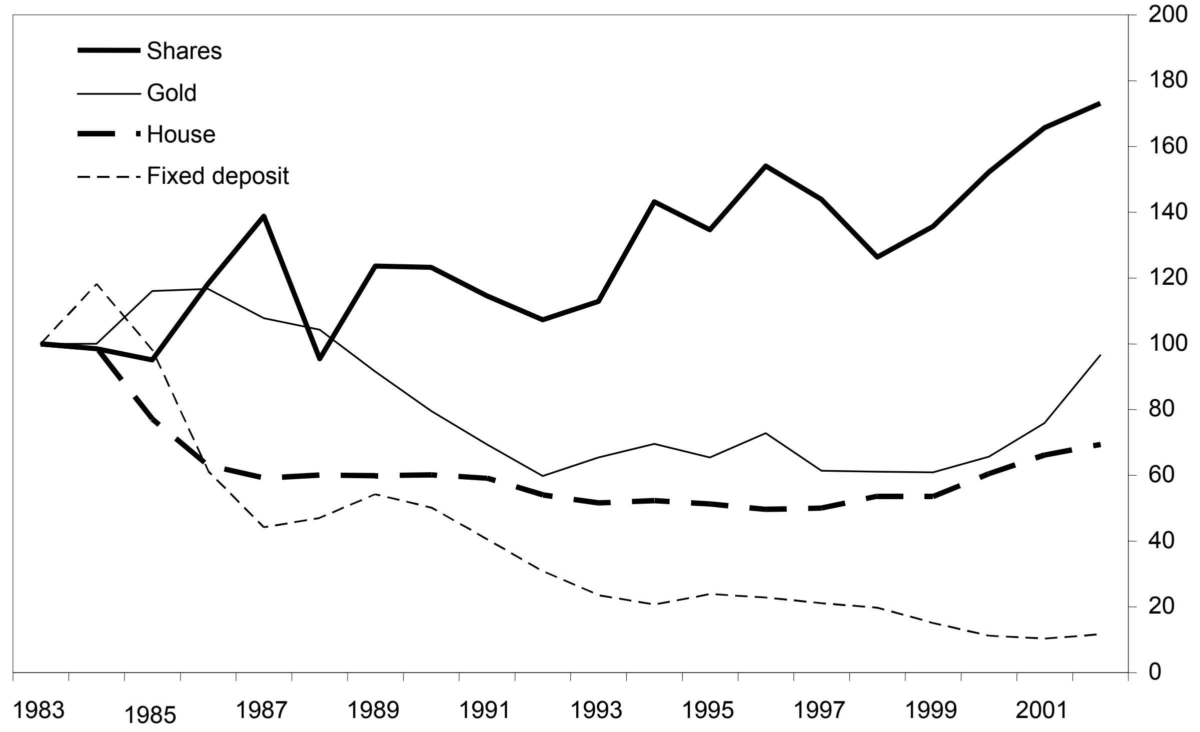
Graph 8 shows the South African experience with regard to the capital growth of various asset classes over the past number of years. For ease of comparison, gross internal rates of return were calculated for all types of investments, although the above factors should evidently be considered at all times.

It is clear that the capital growth component of a residential property investment was not as high as the capital growth that could have been achieved on a share portfolio based on the all-share index of the JSE Securities Exchange. However, gross income (with costs and taxes not deducted - see Graph 9) still made residential property a fairly solid contender among the asset classes considered here.

Combining the data from Graphs 8 and 9 into gross internal rate of return figures (ie, no adjustments were made to allow for deductions such as maintenance costs and commissions or for taxation), shows that residential property could be regarded as the best performing asset class over 20, 15, 10 and five year periods (see Graph 10).

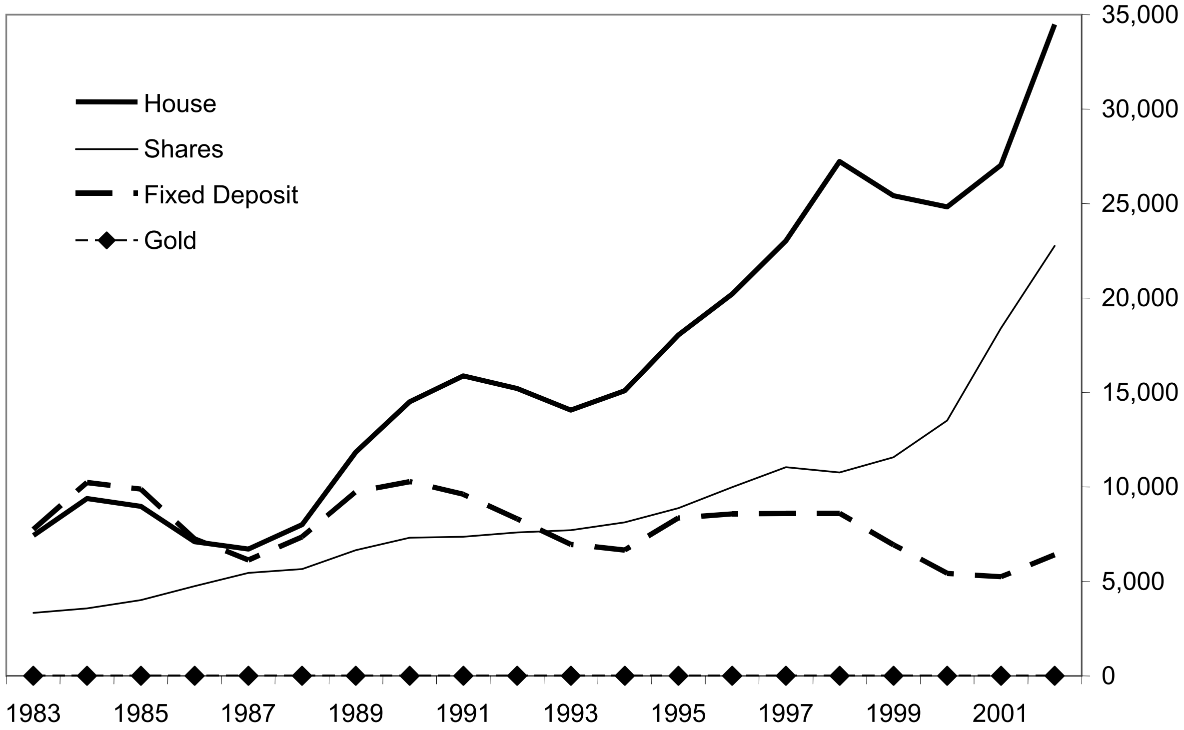
Graph 8

Real capital values



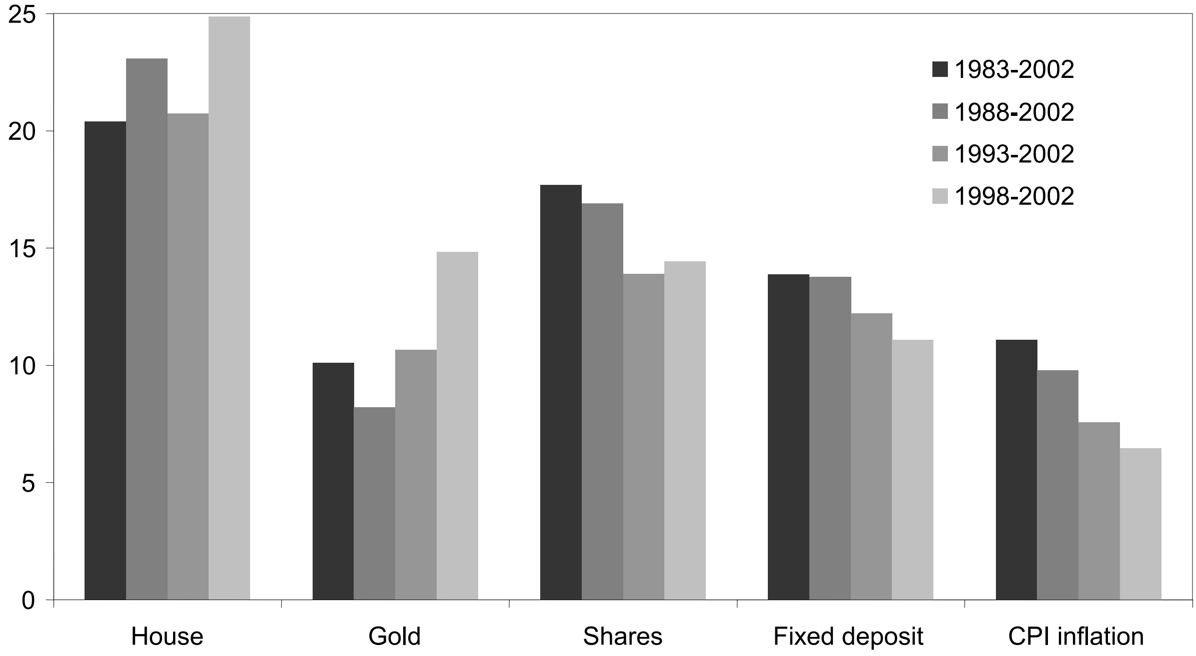
Graph 9

Nominal income per annum



Graph 10

Gross internal rates of return and inflation



6.3 Determining if there is a property price bubble: South African vs some international evidence

Market bubbles are usually unwelcome developments because of the macro-economic distortions that they may cause once they burst. Monetary policy is usually slow to react or may even not react at all to an impending bubble and the fall-out of a market crash may prove difficult to contain with monetary policy measures alone.

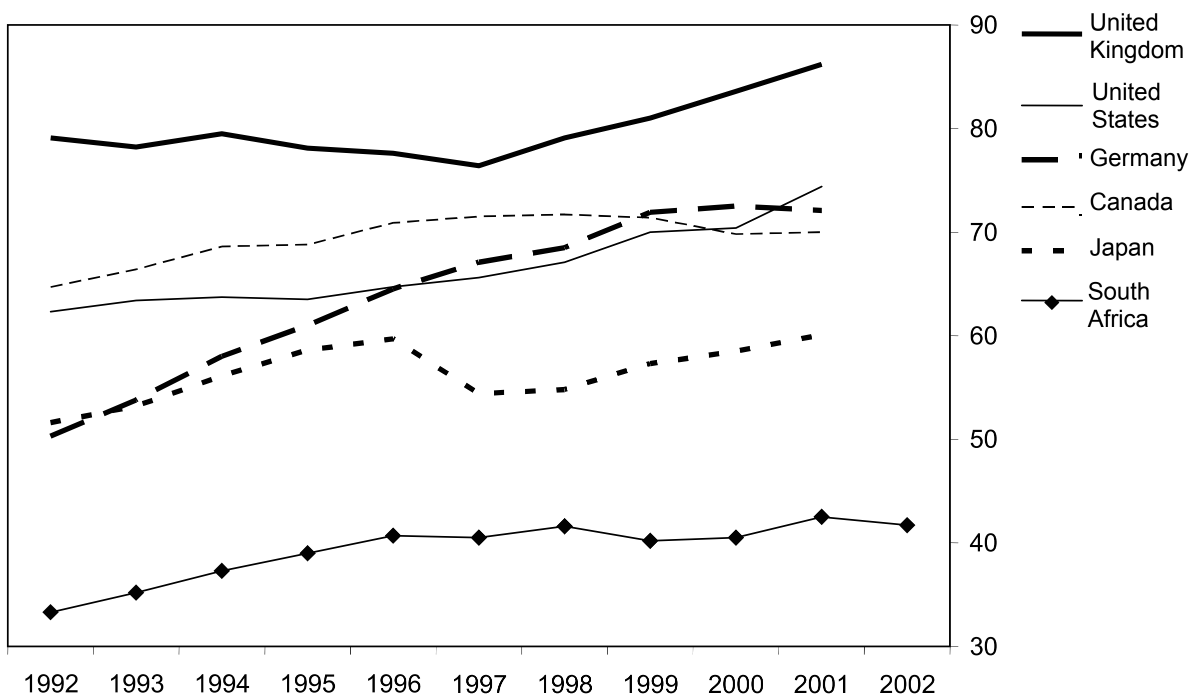
Part of the problem is that bubbles are often not detected until it is too late. The wealth effects associated with the bursting of an asset bubble - more specifically a property market bubble - may be more severe the higher the level of indebtedness in an economy.

As pointed out in Section 6.1, the level of household debt to disposable income in South Africa was around 53% by mid-2003, having reached a peak of 61% in early 1998. Compared with some developed economies such as Japan, the United Kingdom and the United States, this level cannot be considered particularly high. Mortgage debt levels in many developed countries are likewise significantly higher than in South Africa. However, allowing for nominal interest rates that are some two to three times higher in South Africa than in most of these countries would bring the country's mortgage debt level roughly on a par with that of the United States (see Graph 11).

Graph 12 shows the movement of house prices in selected countries, relative to average income levels, since 1975. It is clear that, according to this measure in 2002, house prices in Australia and the United Kingdom roughly equalled their previous peaks, whereas relative house prices in the United States exceeded their previous peaks since 1975 by a considerable degree. In contrast, South African house prices relative to income levels remained far below their previous peak reached in 1983. Graph 13 indicates that, in real terms, house prices are still some 25% below their 1983 peak.

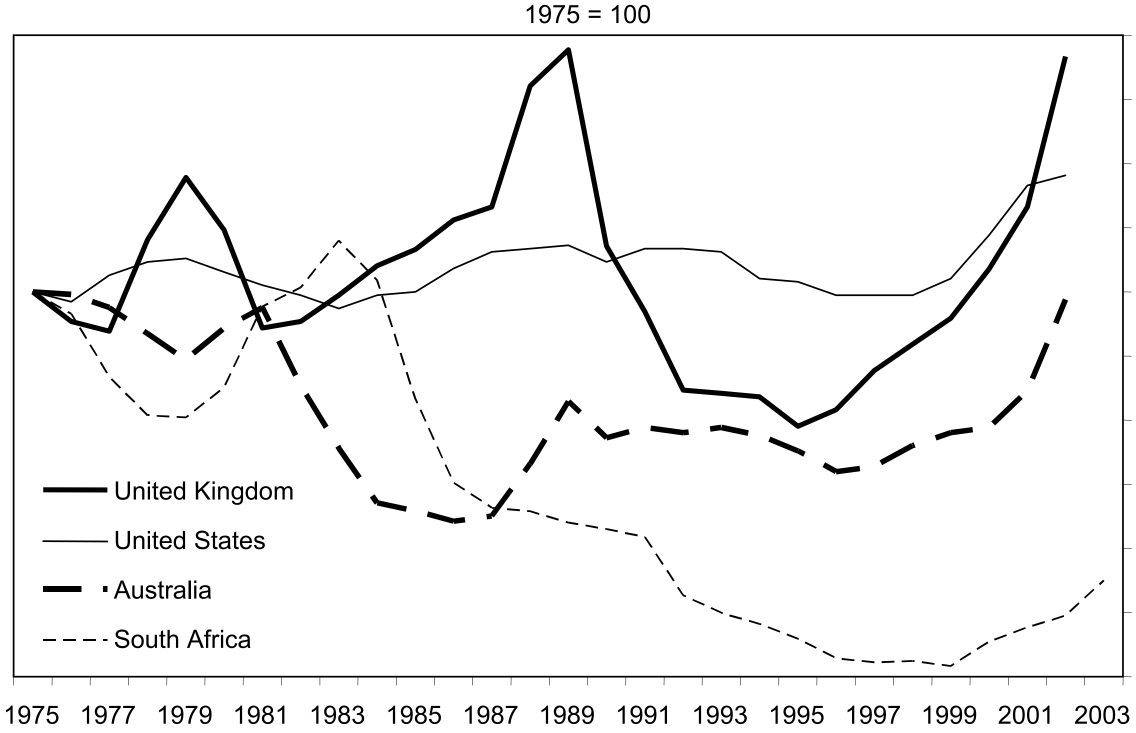
Graph 11

Mortgage debt



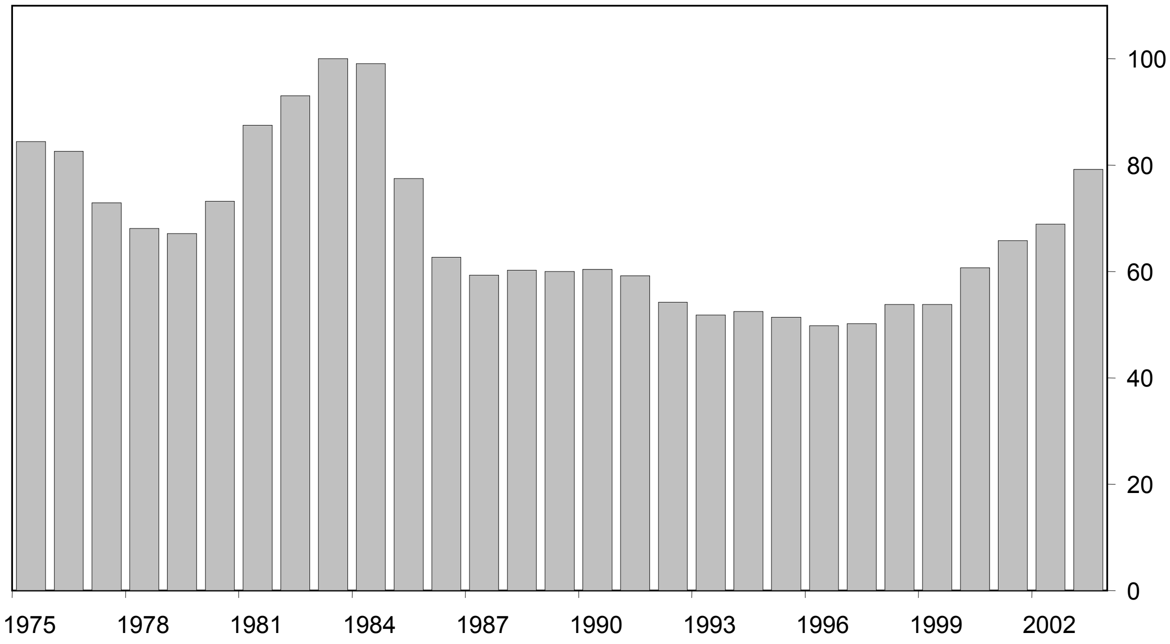
Graph 12

House prices to average income



Graph 13

Real house prices



7. Driving forces impacting on the residential property market in South Africa

What follows is a non-exhaustive list of factors that have recently been influencing, or that are in future expected to influence, residential property market trends in South Africa.

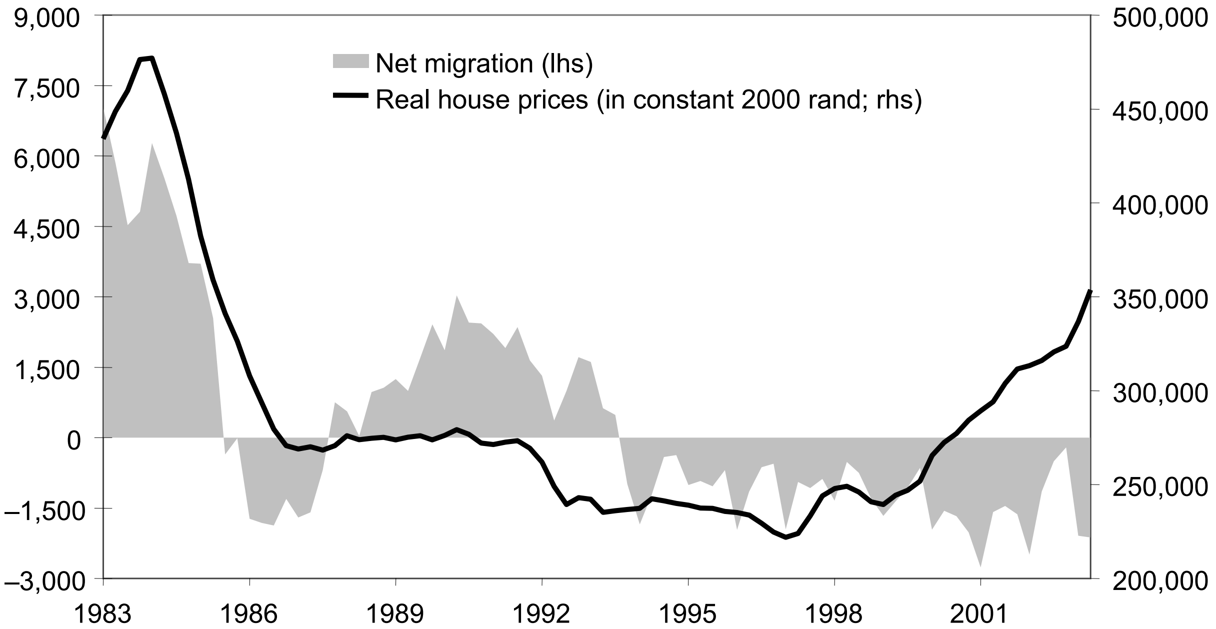
7.1 Migration trends

According to official statistics, some 87,800 people have emigrated from South Africa during the period January 1994 to June 2003, whereas only 42,800 people immigrated to South Africa during the same period. However, unofficial estimates (obtained by, for instance, comparing the data of foreign-destination countries) put the emigration figures at two to three times this number.

This so-called brain drain was, prior to 2001, caused by the pull-effects of skills shortages in many developed economies as well as the push effects of an underperforming economy, crime and affirmative action policies in South Africa. Consequently, a relative oversupply of residential properties for most of the 1990s, resulted in declining real property prices (Graph 14).

Graph 14

Net migration and real house prices



Source: Stats South Africa.

With weaker global economic conditions and increased geo-political risks after 11 September 2001, the net migration loss from South Africa seems to have abated somewhat.

7.2 Black economic empowerment

One of the major tenets of the government's current socio-economic policy is to enable so-called "historically disadvantaged" people to participate in the mainstream economy. Thus far, significant strides have been made in changing the racial composition of the workforce at all levels and of all organs of government, including the state-owned enterprises. The creation of a "black middle class" has supported the demand for properties in previously whites-only residential areas.

In addition, negotiated private sector "industry charters" will specify targets for certain percentages to be achieved for historically disadvantaged people to be included in employee numbers, procurement contracts and ownership. Social responsibility efforts (also in terms of "community reinvestment") and training will also receive special attention.

Since there is still an enormous shortage of black people possessing the required qualifications and skills, these objectives may be difficult to achieve in the short to medium term. However, in the longer term they are likely to further assist with the expansion of a black middle class, provided that economic growth is sufficient. If productivity and economic growth do not increase meaningfully, these socio-economic measures may prove to be only redistributive in nature.

7.3 Security issues

Crime[6] has shown a rapidly increasing trend over the past number of years, which has seen a rapid expansion in the development of so-called "security villages" - fenced-in units containing anything from four or five to hundreds of properties with 24-hour security control. Consequently, the prices of such units - usually a small plot with a sizeable house - have also increased rapidly in some urban areas. The development of golf estates for upper-income households has also been benefiting from similar trends.

7.4 Growth, income and employment

Conceptually, disposable income and employment changes should feature high on the list of factors that could potentially impact on a county's residential property market. In South Africa, neither of these variables have shown significant growth since the mid-1980s, mostly because of low economic growth, especially during the period from 1985 to 1993. However, household disposable income per capita has, with the exception of 1998 and 1999, increased every year since 1995, whereas formal sector employment recorded a slight increase in 2002 - the first such rise since 1990.

Regrettably, very rigid labour market conditions, brought about by the restrictive labour laws introduced over the past number of years, as well as a highly unionised and militant work force render the probability of substantial increases in employment unlikely. Therefore the process of capital intensification in the economy is expected to continue, which might not aid efforts to reduce unemployment figures.

7.5 Foreign buying of South African properties

An undervalued currency (especially during 2002), heightened global political risks, and the well-known natural beauty and desirable climate of South Africa have caused foreigners - especially from the United Kingdom and the rest of Europe - to display a growing interest in South Africa as a holiday destination.

Some, lured by the relatively low property values, have bought properties particularly in coastal regions, such as the Western Cape and KwaZulu-Natal. This had a noticeable impact on the prices of properties in some of these areas in recent years.

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[6] Rampant crime can mainly be ascribed to the following:

- A largely underqualified, understaffed, and underpaid police force;
- An inefficient criminal justice system;
- Lax border controls, which are leading to an enormous influx of poor, unemployed people from neighbouring African states, and even those further afield;
- The perceived lenient treatment of criminals and sometimes insufficient sentences for serious crimes; and
- Increased drug-trafficking and the establishment of foreign crime syndicates in South Africa.

7.6 Monetary and fiscal policies

Significant progress has been made in lowering inflation and restoring fiscal discipline over the past decade or so. The budget deficit as a percentage of GDP has averaged only 1.9% since 1998/99, whereas the debt-to-GDP ratio declined to just 41.3% in June 2003. Consequently, the cost of debt servicing has been reduced, making it possible to increase the extent of social service delivery. Also, during the past three budgets, the government announced relief for homebuyers by reducing transfer duties on properties.

However, the introduction of capital gains tax in October 2001 may still impact negatively on the residential property market. This tax also applies to all residential properties, except on the primary dwelling of a taxpayer. When a primary dwelling is sold, the first R1 million in capital gain will not be subject to capital gains tax.

Inflation rates that have been persistently higher than those of South Africa's trading partner nations necessitated a fairly restrictive monetary policy over the past number of years. Over the past decade, nominal mortgage rates, which are linked to short-term rates, have fluctuated between 13% and 24% and have at times caused substantial problems, with households finding it difficult to afford higher interest payments.

However, conditions appear to becoming more favourable for a structurally lower inflation rate of between 3 and 6% over the next few years, after the introduction of an inflation-targeting regime for monetary policy. This could also imply an era of somewhat lower interest rates, which might lend further support to the property market.

7.7 Investment returns

South Africa did not escape the fallout from the weakness that has characterised the US and other stock markets since early 2000, even though the local stock market has not really been overvalued since the emerging market crisis of 1998. The South African bond market performed excellently, with bond yields falling from 18.3% (September 1998 average) to around 9% currently, but this bull run also seems to be losing steam. With the South African equity market's price-earnings ratio seemingly unable to improve above the recent level of 12 (compared with 18.2 reached in May 1998), investors appear to have given up hope, for now, of a strong recovery in South African shares - at least while the US market remains overvalued and the rand relatively strong.

Solid property returns - especially in view of declining interest rates - have again highlighted the value of property in portfolios, and investments in residential properties have benefited from the search for low risk-high return assets. Of course, property is unlikely to outperform other investments indefinitely, but it may do so over the next year or two.

8. Conclusion

The Absa Group's fairly comprehensive residential property database, based on around a third of properties being mortgaged in South Africa, facilitates an improved analysis of trends and cycles in the economy. In particular, it may be used to compare current prices with previous peaks, as well as with income levels.

Although residential property prices in South Africa seem to have followed the rising trend prevailing over the past number of years in most other developed markets, prices in South Africa are still below the peak reached in the early to mid-1980s.

Various factors are influencing property prices in South Africa. Some of these - notably structurally lower interest rates - could support property prices over the next few years.

Appendix A

New residential buildings completed

Number of units and total value in rand

	Houses (<80m²)							
	2001 Number	2002			2001 R'000	2002		
		Number	% change	% of total		R'000	% change	% of total
Western Cape	5,792	7,457	28.7	20.4	265,614	312,207	17.5	25.4
Eastern Cape	2,820	3,331	18.1	9.1	122,013	189,827	55.6	15.5
Northern Cape	126	116	–7.9	0.3	9,076	5,187	–42.8	0.4
Free State	2,155	2,896	34.4	7.9	49,875	70,689	41.7	5.8
KwaZulu-Natal	2,307	2,430	5.3	6.6	103,023	97,506	–5.4	7.9
North West	2,510	1,826	–27.3	5.0	61,630	35,208	–42.9	2.9
Gauteng	7,986	16,303	104.1	44.5	299,744	455,506	52.0	37.1
Mpumalanga	3,165	2,010	–36.5	5.5	64,123	42,295	–34.0	3.4
Limpopo	426	231	–45.8	0.6	22,480	18,944	–15.7	1.5
South Africa	*27,287*	*36,600*	*34.1*	*100.0*	*999,579*	*1,227,369*	*22.8*	*100.0*
	Houses (≥80m²)							
	2001 Number	**2002**			**2001 R'000**	**2002**		
		Number	**% change**	**% of total**		**R'000**	**% change**	**% of total**
Western Cape	4,099	5,659	38.1	39.1	1,169,702	1,769,314	51.3	38.0
Eastern Cape	943	648	–31.3	4.5	172,903	159,558	–7.7	3.4
Northern Cape	165	60	–63.6	0.4	36,079	15,146	–58.0	0.3
Free State	317	373	17.7	2.6	65,145	74,308	14.1	1.6
KwaZulu-Natal	1,618	1,388	–14.2	9.6	479,379	423,434	–11.7	9.1
North West	577	803	39.2	5.6	144,952	206,809	42.7	4.4
Gauteng	3,421	4,939	44.4	34.2	1,182,440	1,873,542	58.4	40.2
Mpumalanga	354	407	15.0	2.8	65,074	94,836	45.7	2.0
Limpopo	159	178	11.9	1.2	34,743	43,845	26.2	0.9
South Africa	*11,653*	*14,455*	*24.0*	*100.0*	*3,350,417*	*4,660,792*	*39.1*	*100.0*
	Flats and townhouses							
	2001 Number	**2002**			**2001 R'000**	**2002**		
		Number	**% change**	**% of total**		**R'000**	**% change**	**% of total**
Western Cape	1,860	2,436	31.0	23.3	299,930	411,201	37.1	21.9
Eastern Cape	244	364	49.2	3.5	31,743	35,511	11.9	1.9
Northern Cape	80	46	–42.5	0.4	8,950	12,543	40.1	0.7
Free State	195	356	82.6	3.4	25,551	60,447	136.6	3.2
KwaZulu-Natal	780	741	–5.0	7.1	149,134	185,063	24.1	9.8
North West	169	612	262.1	5.9	16,600	89,314	438.0	4.8
Gauteng	3,544	5,670	60.0	54.2	611,453	1,055,292	72.6	56.1
Mpumalanga	149	207	38.9	2.0	16,021	26,440	65.0	1.4
Limpopo	72	26	–63.9	0.2	11,435	4,123	–63.9	0.2
South Africa	*7,093*	*10,458*	*47.4*	*100.0*	*1,170,817*	*1,879,934*	*60.6*	*100.0*

Source: Stats South Africa.

Appendix B

ARPM Database Process Diagram

INPUT FROM WAREHOUSE TABLES

TABLE NAMES

LCTAPLIC
LCTSTAT
MLMLOAN
MLVLTN

extract approved home loans

OUTPUT FROM WAREHOUSE

Stored in file MORTGAGE.VALUES
Control file with one record for each property where a home loan has been approved

UPDATE PROCESS

Determine which new loans have been approved in a given period and match against control file to determine if they have been counted previously.
If not, append to MORTGAGE.VALUES

FILTERS

BUILDING AREA < 95% of LAND AREA
0 ≤ LAND AREA ≤ 2,000
7,500 ≤ PURCHASE PRICE ≤ 1,500,000 (2002 real)
40 ≤ BUILDING AREA ≤ 400
Assign to area, new/existing, small/medium/large

De-seasonalise using PROC X11

Download to PC

Excel: Create Quarterly Housing Review - Tables and Graphs

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