

Property Outlook for 2008

Although the property market is currently experiencing a downturn, the forecast for next year is positive, according to industry leaders, with strong growth predicted in the lower end of the market as well as the commercial and retail property classes and a recovery expected by 2009. Here's the lowdown from FNB's John Loos, Property24's Richard Gahagan and Sable Homes' Jo Pelsler.

"At double-digit house price inflation, it's still a pretty good situation for a downturn, and 2008 is expected to bring the turning point."

So says John Loos, property strategist at FNB, who released his outlook for the market in 2008 this week, in which he evaluated the underlying strength of the market during the current downturn.

In his report Loos states that when the downturn began the prospect of a market collapse similar to the mid-1980s (where house price deflation plunged to -9% around mid-1985) may have loomed large in some minds, following a boom significantly greater than that of 2 decades ago.

However, he notes that although on a declining trend, we are still experiencing real house price inflation above 12% (i.e. double-digit nominal house price inflation exceeding consumer price inflation by a significant margin), and theorizes that the possibility exists that we may be approaching the bottom of the cycle.

2007 revisited

Loos began the year forecasting 11.7% average house price inflation for 2007, but actual figures look set to be nearer to 14.5%. This took place despite interest rates rising significantly further in 2007 than what had previously been expected.

In 2007, the market was "under attack" on 5 fronts:

- Rising interest rates were the most prominent force of evil, rising by a further 200 basis point this year, after 200 basis points' worth of hikes late last year.
- Real economic growth began to slow gradually after peaking in the final quarter of 2006.
- The National Credit Act caused some anguish around June following its implementation, although much of this may well have been temporary teething problems.
- Less obvious was that, after significant transfer duty reduction in 2006, which may have helped cause a mini-surge in demand last year, the Minister of Finance was far less forthcoming in 2007.
- The same goes for personal tax relief, which was quite impressive in 2006 before all but drying up this year. As in the case of interest rates, a trend change from cutting to sideways is a negative force, so the same holds true in the case of transfer duty and tax reduction, where reverting back to almost no reduction in 2007 following a significant stimulus the year before dampened the market.

Therefore, by the current decade's standards, things could not get much worse it would seem. And still the market as a whole achieved impressive capital growth under the circumstances, sparking further cries of in-affordability and a misguided search for scapegoats such as a poor tiny group of foreign buyers.

The explanation for what Loos believes can be termed 'a good downturn' lies in the state of the economy, which despite slowing, still records real growth above 4%, solid by historic standards. This is the result of not only a very moderate approach to interest rate hiking but also due to a myriad of positive structural changes in the economy post-Apartheid that keep SA on a longer term accelerating growth path (ignoring the short term cyclical slowdown), not to mention a strong commodity super-cycle upswing in progress.

Urban land scarcity is also mounting as demand not only for residential property but also commercial and industrial space grows steadily while infrastructure provision lags. The combination of high building cost inflation and land price inflation caused by such supply constraints, and healthy long term residential demand is, I believe, the secret behind house price inflation that has even surpassed the expectations of some of the property bulls.

Building cost inflation appears to have undergone some cyclical slowing, but this is expected to be short-lived as 2010 approaches and the infrastructure drive gather further steam. The high points for 2007 were the lower end of the market, especially the so-called affordable areas, which dramatically outperformed the higher-priced end of the market in terms of house price inflation. Within the affordable segment, township markets would seem to have been the star performer, with rapid price inflation off a low base as upgrades continue, as the retail goes in, and as perceptions towards these areas continue their normalisation trend. In terms of regions it appeared to be the inland provinces holding up better despite also experiencing a general slowdown, and one would probably have wanted to be more exposed to areas dominated by primary residential demand as opposed to more strongly holiday property-driven areas.

"It's now time for consolidation after what has been nothing short of an exhilaratingly good time in the market over the past five years," says Property24 MD Richard Gahagan. "The downturn – whilst not palatable – will strengthen the market in the longer term as the surviving participants become stronger and more experienced in combating the tougher market conditions."

So where to in 2008?

Loos believes that this month's interest rate hike of 50 basis points (bringing the total amount of hiking since the up-cycle started 18 months ago to 400 basis points) was possibly the last in the cycle, and that SA will now enter a lengthy period of sideways movement lasting until at least the second half of next year, although he admits such predictions are not without risk.

While he expects that house price inflation will dip into single-digit territory briefly in 2008, "after a short lag I believe that improving demand growth is likely to translate into a turnaround in house price inflation for the better," says Loos

With a lag, the projected improvement in demand is expected to lead to house price inflation bottoming at around 9% year-on-year in the second quarter before embarking on a gradual return to double-digit inflation by the end of next year.

The turnaround is not expected to arrive in time to prevent average house price inflation for 2008 from coming in lower than the 14.5% expected for this year, and a single-digit average for next year of 9.6% is forecast,

Besides 2008 being expected to bring about the bottom turning point in the cycle, what else does Loos expect to see?

"I expect a narrowing in the performance gap between the higher vs lower priced end of the market, although the affordable segment is still expected to show superior returns," says Loos. "I expect a stronger recovery in coastal markets strongly holiday property-driven in the second half of the year, coming off a low base. Township upgrades will remain the buzzword and interest will surge in property of all categories along the Gautrain route."

"We must see the increase in demand in the lower segment of the market as the important area of focus," says Gahagan, "as this is the foundation from which growth will permeate to the upper income segments and eventually result in these segments' upturn."

Commercial Property

With the great consumer boom past its best, and a significant growth in supply of new retail stock in recent years, a few years of slowing in the commercial market is expected (but with a soft landing nevertheless). Office and industrial space, on the other hand, are expected to resume their boom times. These two sectors may have experienced a mild speedbump in the form of a cap rate increase in the second half of the year on the back of rising interest rates, but their low vacancy rates and strong rental inflation are expected to see to it that any lull was short-lived.

2008 is expected to be a two-horse race between these two property classes, leaving retail property and even a gradually turning residential market in their wake.

Banks may develop housing stock

Jo Pelsler, MD of leading developer Sable Homes, believes that 2008 may well be the year that the banks re-enter the property market as residential developers for the first time in decades, thanks to the pressure to facilitate the provision of housing stock at the lower end of the market.

The banks are working on their commitment to lend billions of rands to lower income homebuyers, but there are not enough affordable houses available for them to meet this target – and rising inflation and interest rates, not to mention building costs, are scaring off private developers.

"So in order to get the numbers up, the banks may well decide to re-enter the market themselves as developers in that sector of the market – although they will probably opt mostly for mixed-use projects where the commercial element carries the residential."

Affordability crisis affects demand

Meanwhile, says Pelsler, those buying new homes now need to check out their developers – and their contracts – very carefully so they don't end up facing serious problems.

"The market is in an affordability crisis that is negatively affecting demand and at the same time developers are finding it more difficult to get project financing. This creates the risk that projects which appeared to be sound will be cancelled and that off-plan buyers will lose their deposits and/ or time in the market.

"Alternatively, even when projects go ahead, they may proceed very slowly and buyers may end up living on a 'building site' for a long period – or living without the communal facilities they were expecting, such as swimming pools, gardens or even security fences."

As to the prospects for the development sector, Pelsler believes things will improve by 2009.

"Lack of stock in the rental market and high demand are driving rentals up and this will eventually give rise to a situation where it is once again cheaper to buy than to rent. In the meantime, there is lots of infrastructure delivery on the cards that will enable the provision of affordable units in infill developments close to workplaces, which is where buyers want to be to avoid ever-increasing traffic congestion.

"And together, these factors will help to create a more positive environment for developers."