

PROPERTY INSIGHTS

– How did the Western Cape fare through its severe drought?

20 November 2018

The Western Cape Property Market has no doubt slowed, but the region appears to have remained resilient through its very severe drought, and is coming out the other side in relatively good shape compared to the 2 other major regions.

**FNB COMMERCIAL PROPERTY
FINANCE**

The Western Cape economy appeared to be impacted by its severe drought, experiencing recession back at a stage of 2017 where other major provinces didn't. For a time, the FNB Estate Agent Survey, too, showed signs of sentiment in that province "dipping" worse than others.

**JOHN LOOS:
PROPERTY SECTOR
STRATEGIST
087-328 0151**

But although the province can't escape the impacts of a weak national economy, it appears to have come through its drought period in relatively good shape. reflected in IHSMarkit economic growth estimates as well as certain property market data.

john.loos@fnb.co.za

WESTERN CAPE HAS EXPERIENCED DIFFERENT FORTUNES TO THE REST OF SA IN RECENT YEARS

The information in this publication is derived from sources which are regarded as accurate and reliable, is of a general nature only, does not constitute advice and may not be applicable to all circumstances. Detailed advice should be obtained in individual cases. No responsibility for any error, omission or loss sustained by any person acting or refraining from acting as a result of this publication is accepted by FirstRand Group Limited and / or the authors of the material.

In recent years, the Western Cape Province has in certain ways been "economically different" to the country's other major economic regions. On the one hand, perceptions of great lifestyle and good management aided a very strong inward migration of repeat home buyers, many highly skilled and many affluent, contributing to the region's economy through bringing their skills or their purchasing power, or both. This migration is believed to have greatly contributed to a very strong housing market in that region for some years, up until a slowing not long ago.

First National Bank – a division of FirstRand Bank Limited. An Authorised Financial Services provider. Reg No. 1929/001225/06

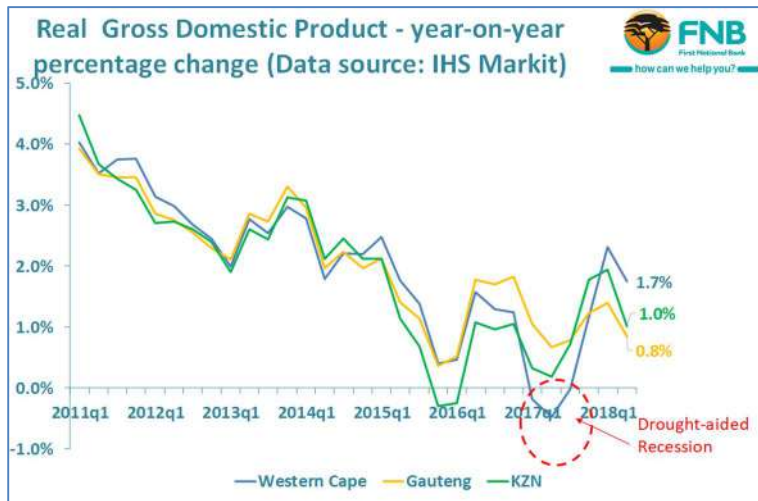
But it also differed from the rest of the country in that it had a very severe drought, necessitating major water saving measures, an event which must surely have had some negative impact on Agriculture, Tourism, and sentiment in general for its inhabitants.

In 2017 we even saw a slowdown in the net inflow of repeat home buyers into the Western Cape, compared with 2016, possibly a partial result of deteriorating home affordability in the region, but probably also due to the unappealing nature of drought along with its economic impact on the region.

But, as the drought pressure alleviates in the Western Cape, we look at the state of the Western Cape's property market compared to the other major regions, and find it still in reasonably good shape.

There are some signs that sentiment in the region has improved mildly, that its economy has recovered somewhat in recent quarters, and that its property market has not been too badly affected. But the region cannot escape the national economic and property downturn entirely. Let's have a look at some key statistics and survey results.

IHSMarkit suggests recently improved Western Cape economic growth, after a recession at a stage of 2017



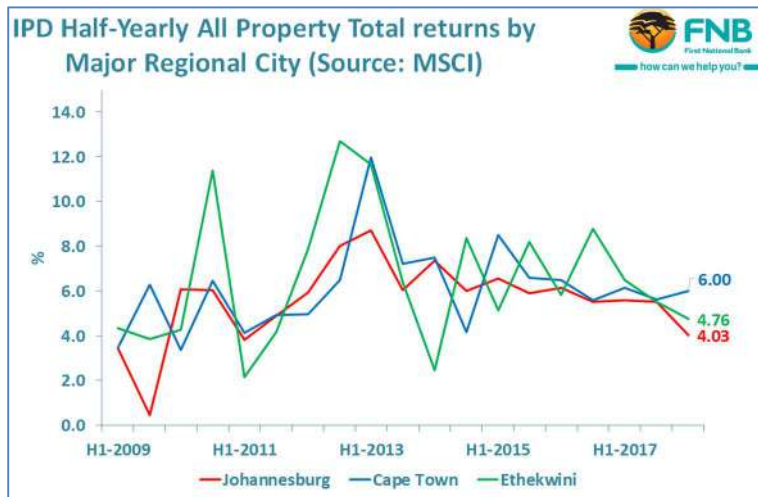
IHSMarkit produces quarterly seasonally adjusted GDP (Gross Domestic Product) estimates by province.

According to these, the major provinces all experienced a year-on-year growth dip in early-2017 before a subsequent mini-recovery, but the Western Cape’s dip was a little worse. Its year-on-year GDP growth went negative, bottoming at -0.5% in the 2nd quarter of 2017 before starting its own “mini-recovery”. By comparison, Gauteng bottomed at positive growth of +0.7% in the same quarter and KZN at +0.2%.

Since then, however, the Western Cape has become the strongest of the Major 3 provinces, growing by +2.3% and +1.7% for the 1st 2 quarters of 2018 respectively. This is not wonderfully strong growth, but outpaces Gauteng’s +1.4% and +0.8% for the respective quarters, and KZN’s +1.9% and +1.0%.

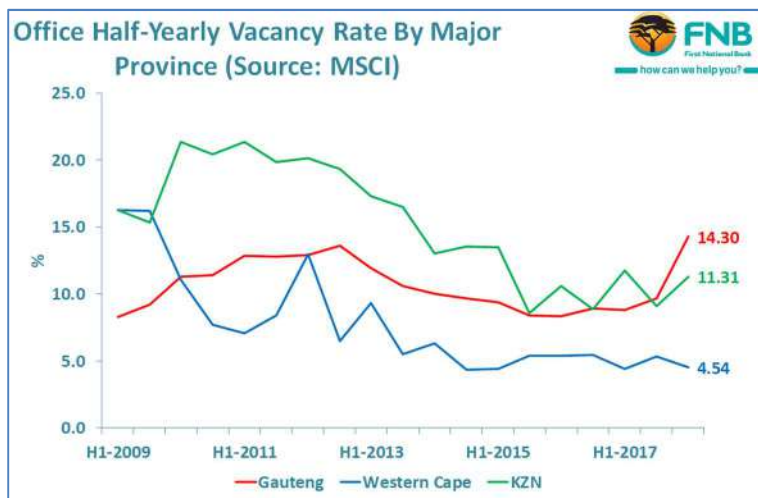
One of the drivers of this relative recovery in the Western Cape was a strong recovery in Agriculture Value Added growth in the 1st half of 2018 off a very low 2017 base.

Despite the Western Cape’s recent economic mediocrity and drought period, its key underlying Commercial Property Market fundamentals until recently have still appeared better than the other major provinces.

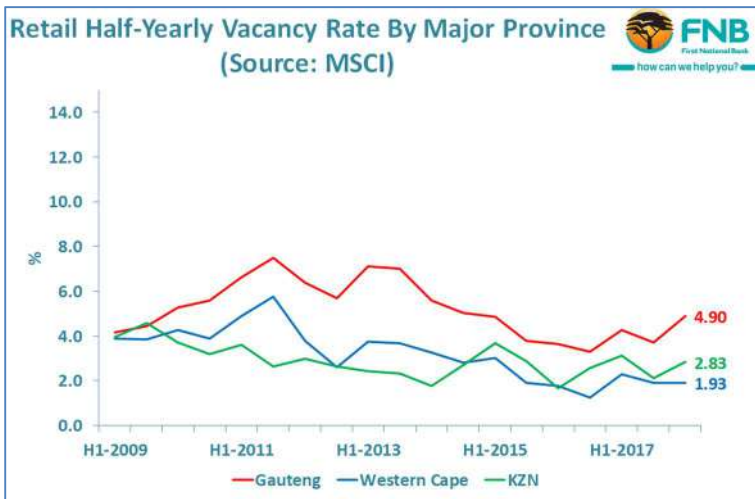


Viewing the 3 major regional cities, Johannesburg, Ethekwini and Cape Town, the IPD half-yearly results for the 1st half of 2018 showed Cape Town’s half-yearly total returns to be the strongest of the 3, measuring 6% compared to Ethekwini’s 4.76% and Joburg’s 4.03%.

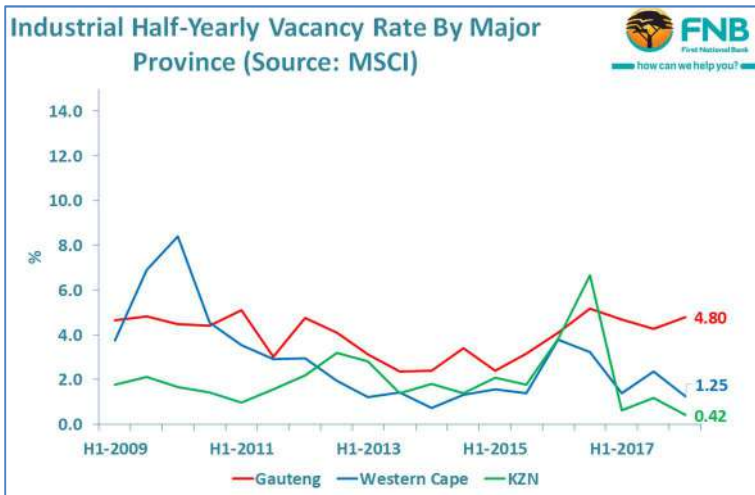
Admittedly all 3 cities have seen lower total returns slow from their post-Financial Crisis highs reached around 2012/13.



Arguably the key indicators when viewing the demand-supply fundamentals are the various Commercial Property Vacancy Rates. Recently, the release of IPD half-yearly Commercial Property performance data indicated the Western Cape to have by far the lowest Office Property vacancy rate to the tune of 4.54% in the 1st half of 2018. In addition, this rate had not shown an increase yet. By comparison, KZN Province had an office vacancy rate of 11.31%, while Gauteng had the highest of the Big 3 provinces at 14.3% and rising steadily.

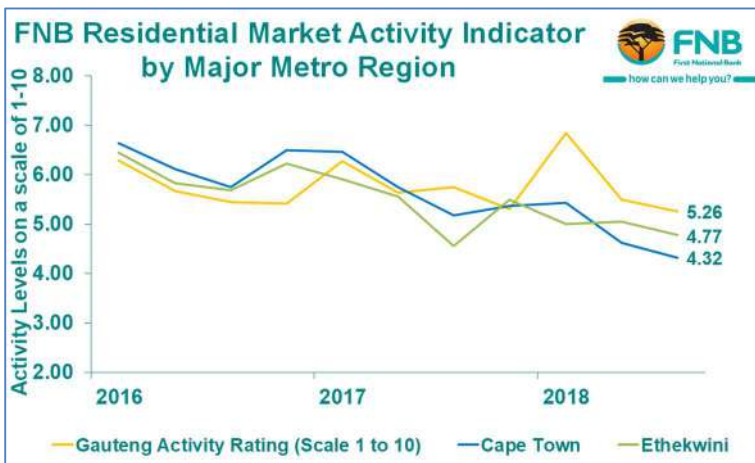


In the area of Retail Property, too, the Western Cape had the lowest vacancy rate to the tune of 1.93%, compared to KZN's 2.83% and Gauteng's 4.9%, Gauteng's recent vacancy estimates rising the most noticeably.



It was only in the area of Industrial and Warehouse Property that the Western Cape's low vacancy rate of 1.25% was bettered by KZN's very low 0.42%, Gauteng once again the worst of the 3 at 4.8%

The mini-economic recovery of late-2017 appeared insufficient to boost housing market activity in the Western Cape.

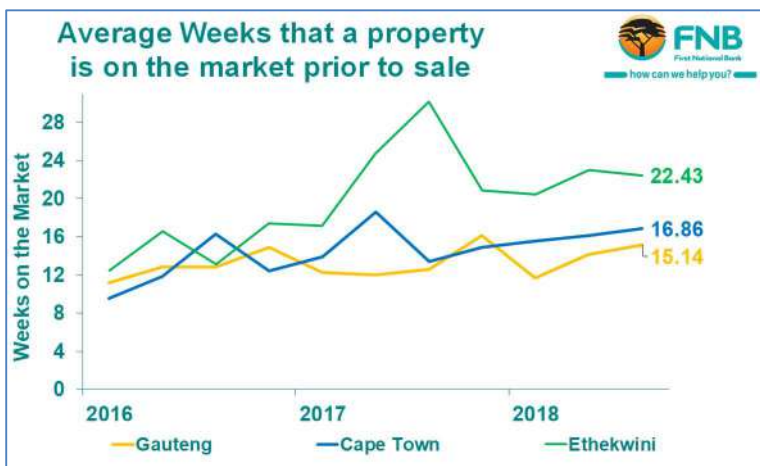


The mini-recovery in economic growth late in 2017 has not led to any meaningful strengthening in the province's Housing Market. This does not surprise us, as despite estimates of a mildly stronger economy in the region in 2018, its housing market had become relatively in-affordable in recent years, and this has continued to dampen activity.

Therefore, according to the FNB Estate Agent Survey, where respondents rate market activity on a scale of 1 to 10, Cape Town had the lowest activity rating of the 3 major metropolitan regions, to the tune of 4.32 as at the 3rd quarter 2018 survey, compared to Ethekwini Metro's 4.77 and Gauteng's

5.26, Gauteng being the most affordable housing region in terms of Average House Price/Per Capital Income.

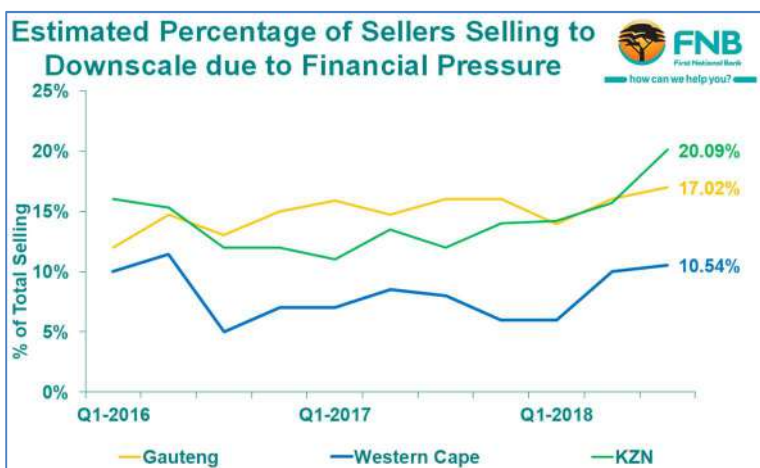
But Cape Town does not appear to be massively “over-supplied” compared to the other major regions



Despite the agent experience of slowing market activity, Cape Town’s balance between housing supply and demand does not appear to be the weakest.

Its average time of homes on the market has been rising, as have the other regions, a sign of weakening demand relative to supply. But at 16.86 weeks estimated average time of homes on the market prior to sale, Cape Town is stronger than Ethekwini Metro’s 22.43 weeks estimate, and only mildly weaker than Gauteng’s 15.14 weeks.

And the Cape Town Metro does seem to maintain significantly better household financial health than the other major regions

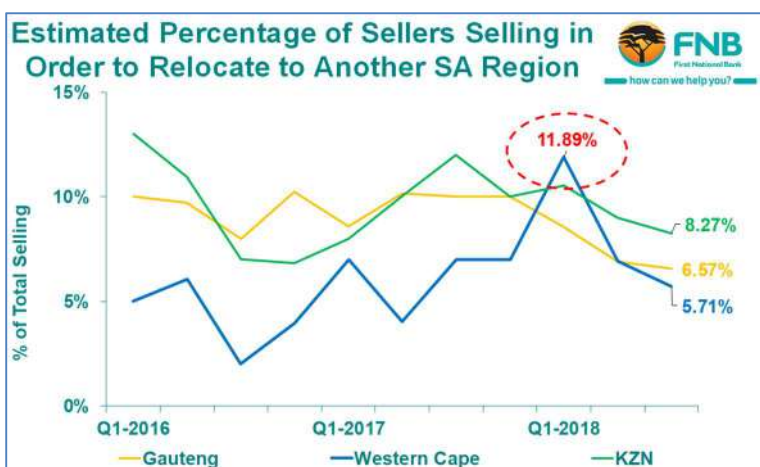


Despite a weakening housing market in Cape Town, however, financial strength of home-owning households in the region appears significantly better than other major regions.

Agents in the region estimate that 10.54% of sellers are selling in order to downscale due to financial pressure. While this percentage has risen from 6% just 2 quarters earlier, it remains well below Ethekwini’s estimate of 20.09% and Gauteng’s 17.02%.

This suggests that there has been some financial deterioration for households as a group in the Western Cape, but the damage through the drought and economic contraction period in 2017 was not severe.

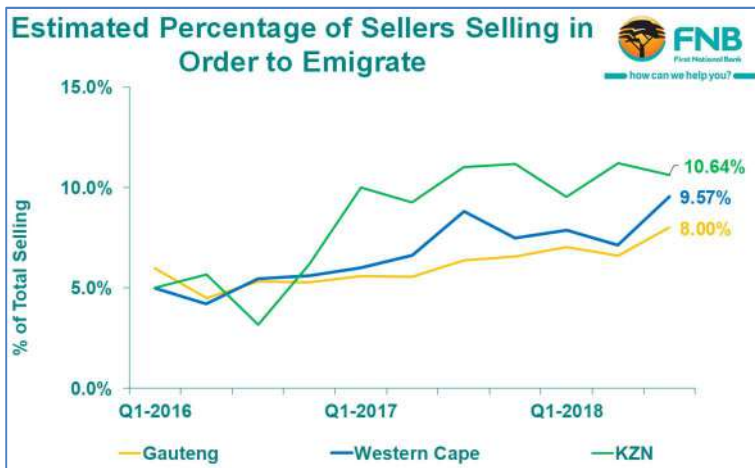
Another key reason for selling homes, selling in order to leave for another SA region, appears to reflect the mildly improved Western Cape economy, and sentiment, in 2018 to date



In the Estate Agent Survey section on “reasons for selling”, the estimated percentage of sellers “selling in order to relocate to another part of South Africa”, began to show some rather concerning signs for Cape Town during 2017. Cape Town typically has the lowest estimated percentage of sellers selling in order to leave for another SA region, but its estimate rose sharply from 4% in the 2nd quarter of last year to 11.89% by the 1st quarter of 2018, to become the highest of the 3 main metro regions.

However, perhaps reflective of the IHSMarkit estimates of stronger economic growth in 2018 in the Western Cape, along with alleviation of drought conditions, this estimate has quickly dropped back to being the lowest, at 5.71% in the 3rd quarter of 2018, compared with Gauteng’s 6.57% and Ethekwini’s 8.27%.

Emigration rates, however, still appear to be on the rise in Cape Town as well as the other 2 major regions



Interestingly, though, while estimated selling in order to “semi-grate” has subsided sharply in recent quarters, estimated selling in order to emigrate has not.

All 3 major metro regions’ estimates of selling in order to emigrate have been on a broad rising trend, Gauteng estimated at 8% of total sellers as at the 3rd quarter Estate Agent Survey, Cape Town at 9.57% and Ethekewini at 10.64%.

Why would the “semi-gration” rate from Cape Town slow sharply but not the emigration rate? Probably because emigration is often more linked to households’ concerns not only with their region

but with the broader South African environment, its weak economic conditions as well as longer run policy uncertainty.

While the Western Cape’s emergence from drought may well have lifted its economic growth back up to a rate higher than other major South African regions, rendering those regions once again relatively unattractive for Capetonians in terms of employment opportunities, there are many economies abroad which boast significantly higher growth rates, and thus more attractive opportunities, than the Western Cape.

CONCLUSIONS

The Western Cape has come through its drought period in relatively good shape considering. IHSMarkit estimates are that the province went through a short recession in the 1st half of 2017, but has experienced some recovery since. Through its “dip”, which was more pronounced than those growth dips of Gauteng and KZN, it still managed to sustain the lowest Commercial Property vacancy rates of the Major 3 Provinces, being outdone only in the area of Industrial Property by the KZN region.

In our FNB Residential Market surveys, we see financial stress in the City of Cape Town housing market still significantly lower than in Gauteng’s metros or in KZN’s Ethekewini, although having deteriorated somewhat. We also see the estimated percentage of sellers selling in order to semi-grate (relocate to another SA region) having returned to being the lowest of the major metro regions, after a brief earlier spike driven by 2017 economic weakness and drought perhaps. This suggests that the relatively good sentiment by Western Cape inhabitants towards the region, relative to others, is returning.

But like the other regions, the Western Cape’s emigration estimate appears to be rising, arguably more a reflection of the broader South African economic weakness and policy uncertainty.