

MONEY & INVESTING

RESIDENTIAL PROPERTY OUTLOOK

Crouch before the leap

A shortage of development land, construction skills and materials, combined with relentless growth of the black middle class, mean that house prices and rents will grow for at least the next five years.

This is despite a slowing US house market, the effects of which have yet to be felt; the danger of risk aversion spreading among investors; and lower commodity prices which could drag down SA's economy.

Standard, Absa and FNB property economists all believe that high local interest rates will be the only real influence in a slowdown of property price growth by the end of 2007, to between 6% and 12% above 2006 prices.

But that is merely the crouch before the leap, with prices rising by up to 18% in 2010, according to FNB's John Loos. Experience of property markets in other

countries that have hosted the soccer World Cup indicates that prices are likely to continue rising after 2010, which would give SA's house market an unprecedented decade-long boom.

Another bonus for residential property investors is double-digit rent increases over the next five or more years, as predicted by Neville Schaefer, CEO of national letting agents Trafalgar.

Loos says the biggest driving force of all in the final stages of this decade will be building cost rises and land scarcity.

"By 2008, preparations for 2010 and other infrastructure projects will be sucking in vast amounts of construction sector resources," he says. "The resulting supply-side constraint is expected to restrict the pace of residential building when demand is growing steadily."

Standard Bank property economist

INVESTING IN A SANDTON FLAT - PROJECTIONS

Year	Rent (R)	Capital gain (R)	Total return (%)
2007	67 200	221 818	23,7
2008	75 264	368 436	16,2
2009	84 296	532 649	16,2
2010	94 411	716 567	16,2
2011	105 741	922 555	16,2
2012	118 429	1,15m	16,2
2013	124 351	1,26m	10,3
2014	130 568	1,37m	10,3
2015	137 097	1,49m	10,3
2016	143 952	1,62m	10,3
2017	151 149	1,75m	10,3
	357,7% capital return	R1 581 435 net capital gain	0,33 compound total return /year

SOURCE: FM RESEARCH, FNB, TRAFALGAR

Elna Moolman expects inflation and interest rates to remain higher than among SA's trading partners, and doesn't expect the prime overdraft rate to drop below 10,5%. But she doesn't think this will reduce demand, as salaries will rise.

The latest rental index released by Trafalgar, the national residential property manager, shows rentals rising in Johannesburg by an annualised 18%. And high interest rates are likely to increase rental demand, as first-time home buyers hit affordability problems. "I foresee substantial double-digit rent increases over the next five years or longer," says Schaefer.

All of this is good news for serious residential investors. A steady market, with rents rising at double the inflation rate, indicates good compounding returns. The one big drawback will be low initial yield and cash outflows for a few years if you borrow the purchase cost.

For instance, a two-bedroom flat in central Sandton for about R1m including bond and transfer costs is probably the

best long-term bet for a residential investor. The rent is low at R5 000/month, a hangover from the oversupply of flats from 2004 to 2006. Deduct a levy of R1 000/month and your initial rent will be R4 000/month or R48 000/year, giving an initial yield of just under 4,8% — but Schaefer's 12% increase in gross rent will raise the net rent 15% to R55 200 net.

Loos forecasts an 11,6% increase in value. The purchase yield on the flat would have to rise from 4,8% to 4,95% to achieve that, implying that rising interest rates will push down the value if the rent remains the same.

Assuming that rents rise by 12%/year to 2012 and 5% after that, and purchase yields remain at 6%, in 10 years you will have a flat worth R2,5m and a net annual income after bond repayment of R24 000 on a cash outlay of zero.

But more important is that you would have received a compound annual return of 30% over the decade.

It's the old story of property: the

wealth-creating power of compounding returns.

Could you do better? Listed property fund Redefine CEO Brian Azizollahoff thinks his fund could beat that over the next decade. "I think 30% is conservative," he says. Possibly so, but you would only be able to borrow about 50% of the R1m purchase price of Redefine shares, and you are unlikely to pay the low residential mortgage rates.

UK property economists Capital Economics warn that falling US house prices could reduce US GDP growth to 1,5% this year, drag commodity prices down, scare investors off emerging markets like SA, and depress our economy.

Absa and Standard Bank property economists Jacques du Toit and Elna Moolman both think Capital Economics is too gloomy.

The advantage of buying into the residential market in 2007 is that you are probably buying at the peak of the interest-rate cycle and in the middle of SA's long-term property recovery. **Ian Fife**