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Price trends with regard to luxury housing

The average price of houses in the luxury segment of the residential property market in South Africa has increased by 113% in total from R1,84 million in the first quarter of 2000 to a level of R3,92 million in the first quarter of 2007. This represents growth in prices of these properties of 11,8% per annum in nominal terms and 6,5% in real terms, i.e. after taking into account the effect of inflation. This price data is based on the total purchase price of houses valued at R2,7 million up to about R10 million (including improvements) in 2006, in respect of which loan applications were approved by Absa. Prices are smoothed in an effort to exclude the distorting effect of seasonal factors and outliers in the data.

During the past number of years house prices at the lower-end and in the middle-market segment were largely influenced by various cyclical and structural factors, especially the economic factors such as interest rates, inflation, growth in household income and the level of household debt. However, the market for residential property at the upper-end of the market appears to be influenced also by other factors. These factors may include political developments, property rights issues, legislation (capital gains tax, property rates and regulations pertaining to future housing developments), living trends (estate living), exchange rate movements, and the performance of other asset classes (equity, bond and money markets, locally and internationally, as well as the commercial property market).

Since the beginning of 2000 up to the first quarter of 2007, nominal price growth in the luxury market segment was much lower (11,8% per annum on average) than in the middle-market segment (19,6% per annum on average). This difference between price growth in the luxury and middle-market categories may to some extent be attributable to the impact the abovementioned additional factors had on the luxury market.

The lower growth in house prices at the upper end of the market is related to a strong supply of properties in the market segment in recent years, whereas demand started to taper off in late 2004, mainly as a result of the high absolute prices caused by strong price growth in 2003 and 2004. However, it should be noted that growth in house prices in the luxury category has come off a relatively high base.

Affordability of luxury housing

Movements in domestic interest rates, and the impact of these on mortgage repayments, should be taken into account when analysing the affordability of housing.

The variable mortgage interest rate of commercial banks declined steadily from an average of 17% in the first quarter of 2003, bottoming out at a level of 10,5% in mid-2006. As a result of inflationary pressures in the economy, as well as factors such as strong growth in private sector credit extension, lending rates, including mortgage rates, were hiked by a total of 200 basis points between June and December last year.

In view of house price trends in the luxury category and interest rate movements since the middle of last year, the gross monthly household income required to qualify for a 100% mortgage on a luxury house of R3,92 million for which the monthly repayment does not exceed 30% of income, was about R148 300 in the first quarter of 2007. This was 22,5% higher than a year ago, when a monthly gross household income of R121 104 was required to qualify for a 100% mortgage on a R3,64 million house (see table below).

However, many affluent households might in the past have been able to negotiate a home loan at a lower interest rate than the variable mortgage rate used in the abovementioned calculations. In reality, this will cause the mortgage repayment and qualifying income in respect of luxury housing to be markedly lower.

Household income trends

Another factor that should be taken into account with regard to the performance of the residential property market in recent years, is the growth in real (after inflation) household disposable (after tax) income, which was 6,6% in 2006 – the highest level of growth recorded since 1980, when it was 8,6%. Over the past few years since 2000, the growth in real household disposable income was 4,7% per annum.

The number of households in the upper income categories increased rapidly over the past ten years, to some extent as a result of factors such as affirmative action and employment equity policies. According to statistics compiled by Global Insight, a total number of 137 204 households in South Africa earned a gross annual income of R360 000 and higher in 1996, which was 1,4% of a total of 9,5 million households at the time. By 2005, the number of households in this income category increased to 807 717, which was 488,7% more than in 1996. The share of these households was 6,3% of a total number of 12,8 million households in 2005.

Against the background of the abovementioned household income-related trends, which should be kept in mind when analysing and interpreting developments in the luxury housing market, the difference in the risk in terms of employment, income, cash flow and debt servicing by high-income households (i.e. luxury housing market) compared with low- and middle-income households (i.e. affordable and middle-segment housing) should also be recognised.

In low-income households, and to some extent also in many middle-income households, employment, income and cash flow are much more important, while proving to be also more volatile, than in high-income households. If low- and middle-income households become unemployed, it may have an immediate and very severe impact on their financial situation, eventually leading to the property possibly being repossessed.

On the other hand, more affluent households, which are able to afford more expensive housing and higher levels of debt, often have more than one source of income. They may also have investment properties that can be sold, or have investments in asset classes other than property which may be utilised to see them through in a period of financial difficulty.

Summary

Although house price growth in the luxury segment has been well below that of some other segments, this category of the residential property market is influenced not only by factors such as economic growth, inflation, interest rates and household income. However, housing at the upper end of the market is sometimes not even financed by means of a mortgage loan, with economic factors playing a lesser, or no role in the decision to purchase a property. It is also evident that, although high-income households' debt levels and/or ratios may be high, the risk in terms of default may under certain circumstances be relatively low.

Affordability of luxury housing taking into account house price and interest rate trends							
Quarter	Nominal house prices ¹		Average mortgage interest rate	Monthly repayment over 20 years (100% mortgage)	Gross monthly income ² (100% mortgage)	q/q % change in repayment & income (100% mortgage)	y/y % change in repayment & income (100% mortgage)
	Rand	y/y % change					
1q2004	R 2 956 657	21.0	11.5%	R 31 531	R 105 101	4.9	-12.0
2q2004	R 3 099 987	22.7	11.5%	R 33 059	R 110 196	4.8	-8.4
3q2004	R 3 215 578	23.3	11.2%	R 33 556	R 111 853	1.5	0.5
4q2004	R 3 330 982	20.8	11.0%	R 34 382	R 114 606	2.5	14.4
1q2005	R 3 308 806	11.9	11.0%	R 34 153	R 113 843	-0.7	8.3
2q2005	R 3 350 536	8.1	10.6%	R 33 601	R 112 003	-1.6	1.6
3q2005	R 3 453 117	7.4	10.5%	R 34 475	R 114 916	2.6	2.7
4q2005	R 3 523 857	5.8	10.5%	R 35 181	R 117 270	2.0	2.3
1q2006	R 3 639 061	10.0	10.5%	R 36 332	R 121 104	3.3	6.4
2q2006	R 3 748 726	11.9	10.7%	R 37 847	R 126 156	4.2	12.6
3q2006	R 3 838 128	11.1	11.3%	R 40 491	R 134 969	7.0	17.4
4q2006	R 3 862 982	9.6	12.2%	R 42 984	R 143 280	6.2	22.2
1q2007	R 3 915 816	7.6	12.5%	R 44 489	R 148 296	3.5	22.5

¹Smoothed purchase price of houses valued at more than R2,7 million in 2006, in respect of which loan applications were approved by Absa

²Gross monthly income required to qualify for a mortgage bond if assumed that the monthly repayment does not exceed 30% of income

Source: Absa