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### In a nutshell

#### Focus article:

#### **Building a new house versus buying an existing house**

- ▶ The strong growth in house prices during the past more than six years was the result of a strong demand for housing in the country, both new and existing, backed by a number of favourable factors supporting the market.
- ▶ The upsurge in the demand for residential property was not only for new or existing owner-occupied housing, but also came from many first-time and existing property investors, as well as speculators in the residential market.
- ▶ There are a number of advantages and disadvantages that should be kept in mind when building a new house and buying an existing house.
- ▶ There are also a wide range of aspects that need to be considered and checked when building a new house and buying an existing house.
- ▶ All factors, positive and negative, legal and financial, must be thoroughly investigated and considered, as the acquisition of property is normally a costly and lengthy process.
- ▶ Various indicators with regard to new and existing housing such as building statistics, building costs, size trends and price developments, point to a strongly performing residential market in recent years.
- ▶ It is evident from these property market indicators that the market for both new and existing housing has cooled off in recent times.

#### **Recent house price trends**

- ▶ House prices in the affordable segment of the market increased by only 0,5% year-on-year in nominal terms in the third quarter of 2006. This represents a price decline of 4,7% in real terms.
- ▶ Nominal house price growth of 13,8% year-on-year was recorded in the middle segment in the third quarter of 2006. In real terms, house price growth came to 7,9% year-on-year in the third quarter of the year.
- ▶ In both the small and medium-sized categories of housing, nominal year-on-year price growth levelled out in recent times. This can be ascribed to a probable shift to smaller, cheaper housing as a result of the affordability of housing and the higher interest rates since June this year.
- ▶ In the luxury segment of the market, house prices increased by a nominal 7,6% year-on-year in the third quarter of 2006. In real terms, house prices in this segment of the market increased by a real 2,1% year-on-year in the third quarter of the year.

#### **Outlook**

- ▶ CPIX inflation is forecast to move above the 6% level towards the end of 2006, causing interest rates to rise by 50 basis points at each of the Monetary Policy Committee meetings in December this year, and in February and April next year. This will bring prime and variable mortgage interest rates to a level of 12,5% by end-2006 and 13,5% by mid-2007.
- ▶ Nominal growth in house prices of 13,7% is projected for this year, which will come to growth of 8,2% in real terms.
- ▶ In 2007, nominal house price growth of around 6% is expected, with prices declining in real terms for the first time since 1999.

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## Focus article:

# Building a new house versus buying an existing house

### Introduction

From the beginning of 2000 up to the third quarter of 2006, residential property prices in South Africa increased by about 20% per annum in nominal terms and around 14,5% per annum in real terms. This strong performance was the result of a wide range of economic, social, cyclical and structural factors supporting the market. It stands in sharp contrast with the nominal price growth of about 8% per annum recorded between 1985 and 1999, which represents a decline of around 3,5% in real terms over the period.

The abovementioned price performance during the past more than six years was the result of a strong demand for housing, both new and existing, backed by a number of favourable factors supporting the market. This upsurge in the demand for residential property was not only for new or existing owner-occupied housing, but also came from many first-time and existing property investors, as well as speculators in the residential market.

In view of the strong growth in the construction of new housing and the high sales turnover of existing houses during recent years, this article focuses on the merits of building a new house versus buying an existing one.

The analysis starts by outlining the advantages and disadvantages of building a new house or buying an existing one. This is followed by a number of factors to bear in mind when building a new house or buying an existing house. The article ends with an overview of historical trends with regard to new and existing housing in South Africa.

### The advantages and disadvantages of building or buying a house

#### Building a new house

##### Advantages:

- ▶ Designed and built according to owner's specific needs and preferences.
- ▶ Own choice of fittings and finishes.
- ▶ New and modern fittings and finishes.
- ▶ Low initial maintenance.
- ▶ Modern architectural design in line with the latest trends in homebuilding.
- ▶ The positioning of the house, garden, pool, lapa, paving and other structures on the stand, taking into account wind directions and personal preferences.
- ▶ Housing in the immediate area may also be new, modern and of the same architectural design, which may create a feeling of coherence in the neighbourhood.
- ▶ A one-year roof leak warranty from a building contractor registered with the National Home Builders Registration Council (NHBRC).

- ▶ A five-year major structural defect warranty from a building contractor registered with the NHBRC.
- ▶ When buying from a developer, value-added tax (VAT) and transfer duty are normally included in the price.

##### Disadvantages:

- ▶ Uncertainty about the quality of workmanship and material at the time of contracting.
- ▶ Uncertainty about the duration of construction and final date of delivery owing to possible weather, material, equipment and labour disruptions.
- ▶ Location may be a disadvantage as many new developments and vacant plots are on the outskirts of the major urban areas, which often is the only location where suitable land may be available. These areas may be far from places of work, shopping centres, public transport and schools. Traffic congestion and time spent on the road may be regarded as a drawback in this regard. Security in remote areas may also be a concern, which may lead to higher-than-normal insurance premiums.
- ▶ The future development of major arterial routes, adding to levels of noise pollution and the development of low-cost housing or the formation of informal settlements on vacant land in the near vicinity may cause property values to stagnate or even decline.
- ▶ Relatively small stand sizes (see section below on historical trends in new housing).
- ▶ If it is a new area, vacant stands in the vicinity may create a security risk. There may also be uncertainty about the type, design and size of housing that will be erected on these stands, which may influence property values. Aspects such as privacy and views may be compromised by the building of a new house and other structures on adjacent stands.
- ▶ Additional expenses with regard to services provided by an architect or engineer, and land preparation and excavation, with unforeseen ground formations, need to be taken into account before the start of construction.
- ▶ Banks are reluctant to provide finance for owner-built housing and insist on the use of an NHBRC-registered building contractor.

#### Buying an existing house

##### Advantages:

- ▶ The structure, fittings and finishes can be physically inspected for quality, defects and poor workmanship before buying.
- ▶ Expert opinion is available if there is uncertainty about the structural aspects of a property.

- ▶ Renovating may be worthwhile if the property can be bought at a reasonable price.
- ▶ If the property is in an older, established neighbourhood, it may be near major arterial routes and amenities such as central business districts, shopping centres, schools, places of work and public transport.
- ▶ There is less chance of stands still being vacant in the area, which is an advantage with regard to security and the level of insurance premiums.
- ▶ Certainty about factors such as privacy and views, as well as the type, size, age and condition of other properties in the neighbourhood, which may have an influence on current and future property values.
- ▶ The average land area of older properties is larger than that of newly-built properties (see section below on size trends in new housing), which is a positive factor for people wanting sufficient space for their children to play or wishing to add on to existing structures.
- ▶ The average total building area of older houses, including the average size per room, tends to be larger than in the case of newer houses (see section below on size trends in new housing).
- ▶ The seller of an existing property is usually obliged to provide the buyer with an electrical compliance certificate. The seller normally pays for the cost of any repairs to the electrical installation.

#### **Disadvantages:**

- ▶ An existing property is sold *voetstoots* without a warranty.
- ▶ The price of an existing house excludes transfer duty payable to the state. Although transfer duty rates have been substantially cut in recent years, transfer duty may still add up to a sizable sum of money, depending on the

value of a property. Currently, in the case of an individual, no transfer duty is payable on a property priced at up to R500 000, whereas, in the case of a R2 000 000 property, transfer duty of R105 000 will be payable.

- ▶ Architectural design of the house, fittings, finishes and other structures may not be in line with the latest fashion trends and personal preferences.
- ▶ The positioning of structures on the stand may not be optimal with regard to wind directions, or not be according to personal preferences.
- ▶ Visible wear and tear may require major repairs to or total replacement of fittings and finishes.
- ▶ Renovations may prove costly.
- ▶ Uncertainty about the condition of security, plumbing, sewage, pool, irrigation, and gate and garage door automation systems, which may break down unexpectedly, cause a security risk, and which may be expensive, disruptive and time-consuming to repair or replace.
- ▶ Owing to the age of fittings, finishes and the abovementioned systems, running costs may be high owing to frequent maintenance.
- ▶ An overgrown garden may have to be cleaned out and the rubble removed, with the possibility of having to establish a new garden and irrigation system from scratch, which may have huge cost implications.
- ▶ Old, dilapidated and deteriorating properties in the area may have a negative effect on the current level of and future growth in property values.

#### **Factors to consider when building or buying a house**

All factors, positive and negative, legal and financial, should be thoroughly investigated and considered

<b>Residential building statistics</b>											
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	1H 2006
<b>Number of units completed</b>											
New houses of <80m <sup>2</sup>	11 971	39 687	36 988	47 670	37 860	27 287	36 353	29 555	38 200	28 049	10 496
<i>y/y % change</i>	18,3	231,5	-6,8	28,9	-20,6	-27,9	33,2	-18,7	29,3	-26,6	-15,5
New houses of ≥80m <sup>2</sup>	16 580	13 198	13 034	10 643	10 734	11 653	14 459	15 296	17 864	23 143	10 004
<i>y/y % change</i>	3,6	-20,4	-1,2	-18,3	0,9	8,6	24,1	5,8	16,8	29,6	0,5
New flats and townhouses	18 354	15 060	11 907	8 402	7 527	7 093	10 473	11 862	14 618	23 496	10 459
<i>y/y % change</i>	5,4	-17,9	-20,9	-29,4	-10,4	-5,8	47,7	13,3	23,2	60,7	17,7
<b>Total</b>	<b>46 905</b>	<b>67 945</b>	<b>61 929</b>	<b>66 715</b>	<b>56 121</b>	<b>46 033</b>	<b>61 285</b>	<b>56 713</b>	<b>70 682</b>	<b>74 688</b>	<b>30 959</b>
<i>y/y % change</i>	7,7	44,9	-8,9	7,7	-15,9	-18,0	33,1	-7,5	24,6	5,7	-1,0
<b>Number of units for which plans were passed</b>											
New houses of <80m <sup>2</sup>	20 290	42 981	49 063	54 934	49 816	36 800	46 401	42 424	36 559	38 905	18 668
<i>y/y % change</i>	27,3	111,8	14,2	12,0	-9,3	-26,1	26,1	-8,6	-13,8	6,4	10,9
New houses of ≥80m <sup>2</sup>	23 610	22 281	19 966	16 709	20 782	21 175	24 393	24 645	32 152	36 086	17 084
<i>y/y % change</i>	-6,6	-5,6	-10,4	-16,3	24,4	1,9	15,2	1,0	30,5	12,2	2,7
New flats and townhouses	24 639	19 385	13 925	8 494	11 059	12 006	14 746	16 896	24 038	32 213	15 162
<i>y/y % change</i>	-13,9	-21,3	-28,2	-39,0	30,2	8,6	22,8	14,6	42,3	34,0	21,4
<b>Total</b>	<b>68 539</b>	<b>84 647</b>	<b>82 954</b>	<b>80 137</b>	<b>81 657</b>	<b>69 981</b>	<b>85 540</b>	<b>83 965</b>	<b>92 749</b>	<b>107 204</b>	<b>50 914</b>
<i>y/y % change</i>	-1,8	23,5	-2,0	-3,4	1,9	-14,3	22,2	-1,8	10,5	15,6	10,8

Source: Statistics South Africa

before building or buying property, as it is a costly and lengthy process.

The financial implications of acquiring property will impact an individual or a household for many years into the future. Therefore, the impact of a possible increase in interest rates should be taken into account if a property will be mortgaged.

A tax clearance certificate from the South African Revenue Service (SARS), stating that the tax affairs of the prospective owner of a property are in order with SARS, is one of many documents needed before the property can be registered at the Deeds Office.

The following aspects also need to be considered and checked when building a new house or buying an existing one:

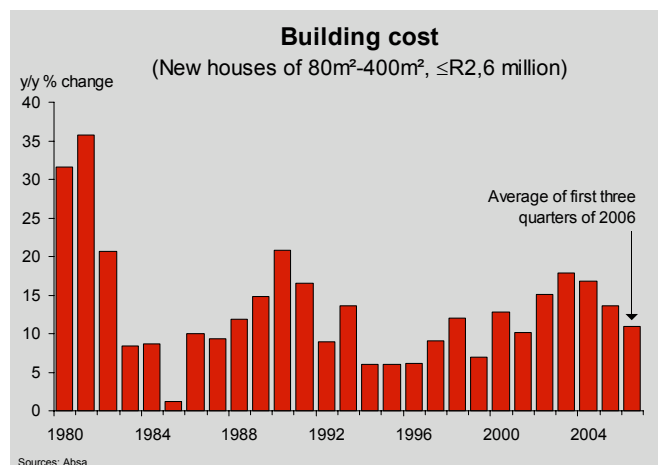
### **Building a new house**

- ▶ Make use of a reputable building contractor or developer by obtaining reliable references and checking up on previous projects (quality of workmanship, delivery times). A contractor should ideally be registered at the NHBRC and be a member of the Master Builders Association.
- ▶ Obtain a detailed and signed quotation from the building contractor or developer.
- ▶ Obtain a signed contract between the new owner and the building contractor or developer.
- ▶ Ensure the material is specified in the quotation and contract.
- ▶ Obtain certainty that the land is zoned for residential development.
- ▶ Apprise yourself of any servitudes and restrictions that may be stipulated in the title deed.
- ▶ Apprise yourself of the physical location, address and stand number as stipulated in the title deed.
- ▶ Apprise yourself of the size of the stand as stipulated in the title deed.
- ▶ Check the exact borders of the stand, making sure perimeter walls of the properties bordering the stand are in the correct position.
- ▶ Apprise yourself of the availability of municipal services (water, sewage, electricity and refuse removal).
- ▶ Obtain a full set of building plans, officially approved by the local government.
- ▶ Ensure you have knowledge of all building restrictions and regulations as stipulated by the local government.
- ▶ Examine the slope and ground formation of the stand, which may necessitate levelling and excavation operations, special draining systems, retaining walls, concrete reinforcement, special construction methods and the involvement of an engineer. These aspects may have significant cost implications.
- ▶ Check the views onto and from the site.

### **Buying an existing house**

- ▶ Apprise yourself of the physical state of the property, involving expert opinion if there are any uncertainties.

- ▶ Apprise yourself of the stand size and building area of all structures.
- ▶ Examine the possibility of extensions to the house and outbuildings, or the building of a pool, lapa or carport, taking into account existing structures and the availability of space on the stand, without transgressing building restrictions and regulations.
- ▶ Apprise yourself of the possibility of adding value to and possible over-capitalisation of the property when doing renovations and extensions.
- ▶ Take account of the position of the house on the stand with regard to wind directions.
- ▶ Take note of the direction and extent of the run-off of rainwater in the event of heavy downpours.
- ▶ Take note of the extent to which structures such as walls and foundations are or may be impacted by root systems of large shrubs or trees in the garden.
- ▶ Obtain certainty that building restrictions and regulations have not been violated by obtaining a full set of approved building plans for all structures on the stand.
- ▶ Obtain certainty that all municipal accounts for property tax, electricity, water, sewage and refuse removal have been fully paid by the owner. A clearance certificate, stating that all accounts have been fully settled, and which is valid for a period of 120 days, must be issued by the municipality.
- ▶ Apprise yourself of the existence of any business rights on the property or other properties in the area and the possibility of such rights being granted in future.
- ▶ Take note of other properties in the area already being used for business purposes, which may impact traffic volumes, noise pollution and security.
- ▶ Apprise yourself of any future plans by the local government to widen streets, open up cul-de-sacs or rezone vacant land in the vicinity for high-density residential developments or commercial use, which may impact traffic volumes, noise pollution and security.
- ▶ Apprise yourself of the extent of traffic congestion and noise pollution in the area by visiting the property at different times during the space of a week.
- ▶ Take note of trends in property values in the area.



## Historical trends in new and existing housing in South Africa

### Building statistics for new housing

The building statistics for new residential buildings regularly published by Statistics South Africa are a source of information with regard to the trends in the demand for and supply of new housing in the country (see table on p.3).

From these statistics, it is evident that the planning phase (reflected by data for plans passed by local government institutions) and the construction phase (reflected by data for buildings completed) of new housing saw various cyclical movements over the past number of years.

Building statistics for affordable residential property at the lower end of the market (houses of less than 80m<sup>2</sup>) have shown a very erratic trend over the past number of years that does not correlate well with broad macroeconomic trends. This may be the result of various factors influencing the delivery and financing of housing in this segment of the market. These factors include expensive development land and the high cost of and delays in rezoning land for high-density, middle-class residential developments. These have contributed to a sharp increase in holding costs. The effect has been to put profit margins of contractors and developers under pressure in this segment of the market.

The number of new houses larger than 80m<sup>2</sup> and new flats and townhouses completed increased significantly between 2002 and 2005. However, in the first half of 2006, the growth in the number of these residential buildings completed was relatively low compared with the same period last year. From 2002 up to mid-2006, a total number of 151 674 new houses larger than 80m<sup>2</sup> and new flats and townhouses were completed.

With regard to the number of building plans approved by local governments for these residential buildings, growth peaked in 2004, which is also in line with trends in overall house price growth.

The abovementioned developments resulted from a strongly growing housing market in the past few years. Recent building statistics and price growth data confirm a slowdown in the market.

### Building costs for new housing

The growth in the cost of building a new house was on a gradual upward trend from 6% on average in 1995 to 17,8% in 2003.

Since 1997, the rise in building costs has been above the headline inflation rate, which can be regarded as a reflection of an active building and construction sector over the past number of years. Factors such as a strong demand for building materials and skilled labour in view of the demand for new housing have also contributed to this development.

However, the year-on-year growth in building costs peaked in 2003 and has since been on a declining trend. This can be ascribed to the large number of developers and building contractors active in the housing market over this period, leading to greater competition.

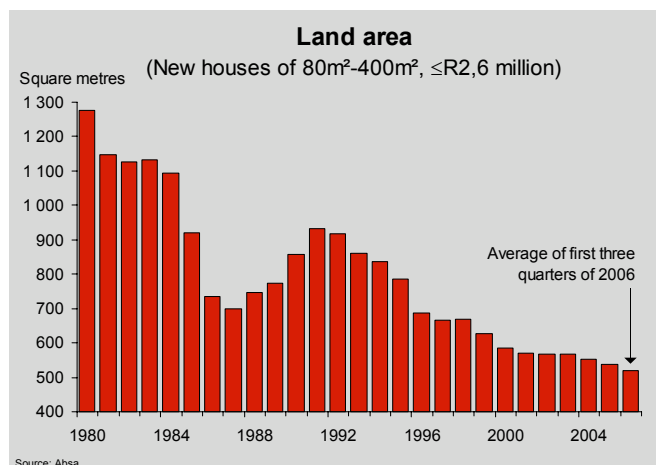
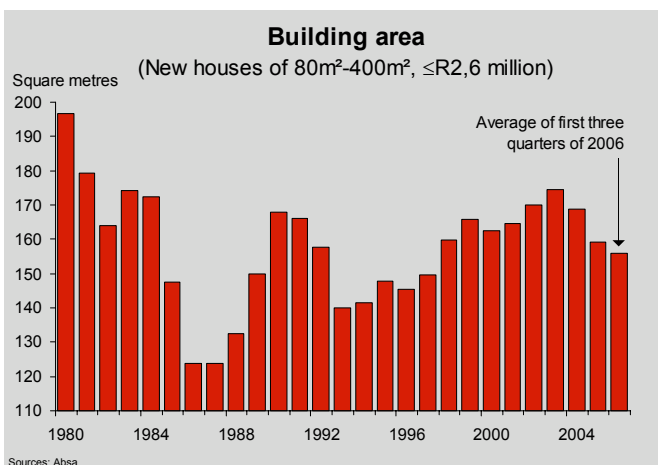
With the residential market in the process of slowing down, and prospects of this trend continuing into 2007, some developers and contractors may leave the sector as a result of tight market conditions, lower levels of activity, tough competition and squeezed margins. This may moderate building cost increases over the next 12 to 18 months.

### Size trends in new housing

According to Absa's calculations, the average building area of newly-built residential properties was on a gradual upward trend between 1993 and 2003. In 1996, after interest rates had been increasing since late 1994, and in 2000, after the high interest rates of 1998/99, the average building area declined only marginally.

Despite the surge in house prices since 2000, which negatively influenced the affordability of housing over this period, the average size of new housing kept increasing until 2003 (see graph on building area, below left). Stand size was probably compromised in an attempt to still afford a decent-sized house (see graph on land area, below).

However, the average size of new housing peaked at 174m<sup>2</sup> in 2003, declining to 169m<sup>2</sup> in 2004, 159m<sup>2</sup> in 2005 and 156m<sup>2</sup> in the first three quarters of 2006. This is probably because the affordability of housing eventually started to have an impact on the average size of newly-built housing.



The average size of stands on which new housing was built has been on a declining trend since the early 1990s. The average land area has dropped from 932m<sup>2</sup> in 1991 to an all-time low of 520m<sup>2</sup> in the first three quarters of 2006 (see graph, p.5). This can be ascribed to suitable vacant land for residential development becoming increasingly scarce, especially in the rapidly growing urban areas of the country.

In the first three quarters of this year, the average land area for new housing was 55,8% of what it was back in 1991 and only 40,8% of the average in 1980 when it was 1 275m<sup>2</sup>. This is an indication of an increase in higher-density residential developments over the years. This trend is expected to continue in future.

### Price trends in new and existing housing

One of the indications of the state of the housing market is the comparison of the average price of new and existing houses, used to determine whether existing houses are overvalued in relation to new houses. The rationale of this analysis is that, once a new house can be built for less than the cost of buying an existing house, the market is set for a downward correction.

In this analysis, the price of a new house includes the construction cost of the buildings, the market value of the stand, as well as VAT and transfer duty. However, in most instances, the price of a new house excludes the cost of landscaping and other improvements such as a pool, paving, lapa, perimeter walls, security systems and carports. The price of an existing house includes that of the buildings, the stand and all improvements to the stand, but excludes transfer duty payable.

There is, however, a belief that comparing the prices of new and existing houses is a meaningless exercise, as the average house in South Africa is a few decades old, and has depreciated over the years through aging.

In contradiction to this belief, many older properties have been renovated, expanded and improved over the years, in many cases more than once. These properties are thus

generally not what they were a number of years ago, and have often appreciated in real value over time as a result.

Moreover, during a boom phase in the residential market, as was experienced over the past few years, the increased construction of new housing (see table on p.3) is expected to lower the average age of the housing stock.

At the peak of the property market boom in the first half of the 1980s, the price difference between new and existing houses had declined to almost zero before the crash of the mid-1980s. Currently the price difference is also very small, after reaching a level of R167 700, or 28,8%, in 2003 before tapering off to only about R12 300, or 1,5%, on average in the first three quarters of 2006 (see graph below). This is the result of the nominal price growth of new houses increasing at a faster pace than that of existing houses during 2002 and 2003.

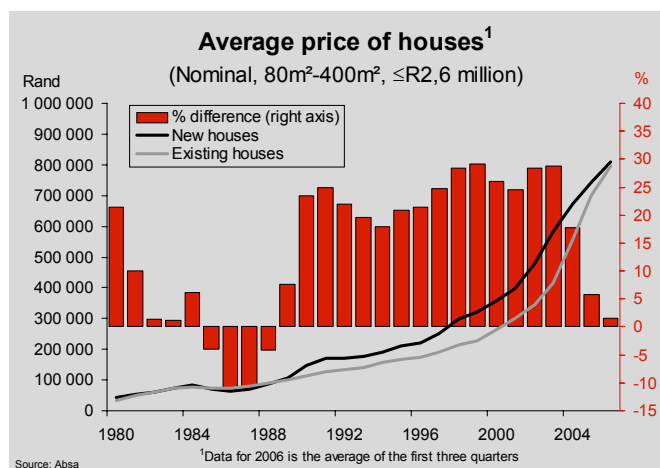
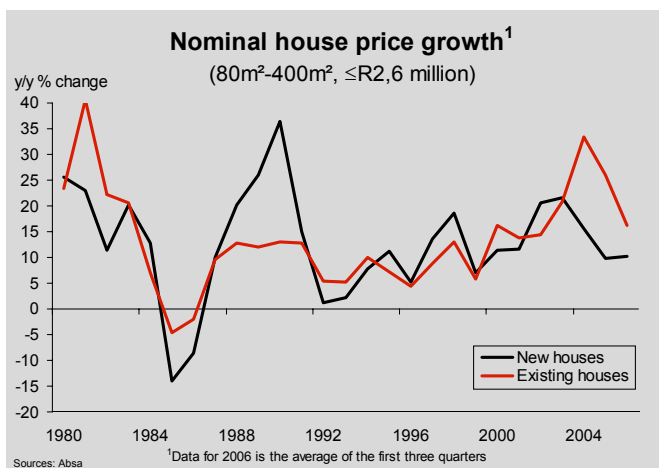
However, the nominal price growth of new houses was much lower than that of existing houses from 2004 up to 2006 (see graph below, left). This caused the price difference between new and existing houses to narrow significantly during this period.

### Conclusion

There are quite a number of advantages and disadvantages to both building a new house and buying an existing house. There are also a wide range of aspects that need to be considered and checked when getting involved in a property transaction.

All of these factors, positive and negative, legal and financial, must be thoroughly investigated and considered, as the acquisition of property is normally a costly and lengthy process.

Various indicators with regard to new and existing housing such as building statistics, building costs, size trends and price developments, point to a strongly performing residential market in recent years. However, it is evident from these indicators that the market for both new and existing housing has cooled off in recent times.



## Residential property market

### Macroeconomic and household sector overview

In the second quarter of 2006, real economic growth accelerated to 4,9% at a seasonally adjusted annualised rate, compared with the 4% recorded in the first quarter of the year. The agricultural sector contracted further at an annualised rate of 33% in the second quarter, with overall economic growth largely driven by sectors such as construction (with growth of 14%), finance, real estate and business services (with growth of 8,6%) and manufacturing (with growth of 6,1%). Excluding the poorly performing agricultural sector, real economic growth came to 5,8% at a seasonally adjusted annualised rate in the second quarter of the year.

The ratio of household debt to disposable income increased further to a historical high of 69,7% in the second quarter of 2006 from 68,6% in the previous quarter. This was the result of sustained high growth in private sector credit extension on the back of low interest rates and strong consumer demand during the quarter. The cost of servicing household debt remained stable at around 7% in the second quarter.

Whereas seasonally adjusted annualised growth in the real disposable income of households increased to 7,6% in the second quarter of the year, the ratio of household net saving to disposable income declined further to -0,2% in the same period. Strong growth in household consumption expenditure of 8% at a seasonally adjusted annualised rate in the second quarter put further strain on household saving.

The following macroeconomic and household sector related developments occurred during the third quarter and in the early stages of the fourth quarter of 2006:

- ▶ Domestic fuel prices were lowered in September and October on the back of lower international oil prices.
- ▶ Headline consumer price inflation increased to its highest level since mid-2003, whereas CPIX inflation (headline CPI inflation, excluding the effect of mortgage interest rates) increased to a level last seen in mid-2004.

- ▶ The Reserve Bank's Monetary Policy Committee hiked the key monetary policy interest rate, the repo rate, by 50 basis points in both August and October. As a result, commercial banks' lending rates (the prime overdraft rate and the mortgage rate) were adjusted upwards by the same magnitude at the same time.
- ▶ Growth in domestic private sector credit extension, especially mortgage advances, remained high.

### House prices in the third quarter of 2006

#### Affordable housing

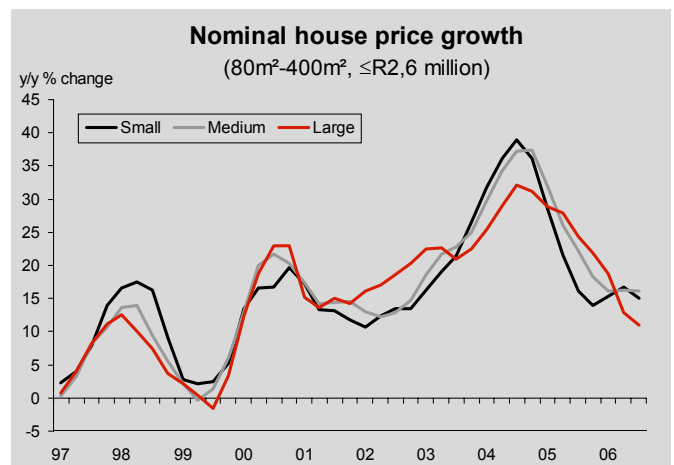
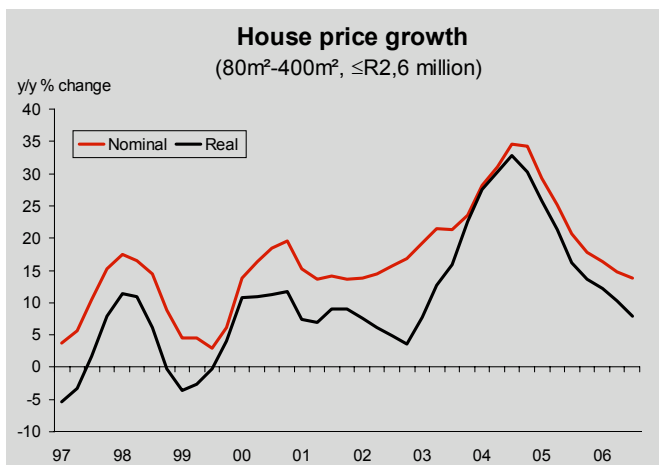
In the third quarter of 2006, nominal house prices in the affordable category increased by only 0,5% year-on-year (y/y) compared with an increase of 6,3% y/y in the preceding quarter. In real terms, house prices in this category declined by 4,7% y/y in the third quarter, whereas real year-on-year growth of 2,2% was recorded in the second quarter.

#### Middle-segment housing

House prices in the middle segment of the market increased by a nominal 13,8% y/y to about R818 300 in the third quarter of 2006 compared with the 14,7% y/y recorded in the second quarter. The 13,8% y/y increase was the lowest nominal growth in any quarter since the first quarter of 2002, when a growth rate of 13,7% was recorded. In real terms, house price growth came to 7,9% y/y in the third quarter (the lowest real growth since the first quarter of 2003) compared with 10,3% in the second quarter of the year.

In the three middle-segment categories, house price growth was as follows in the third quarter of 2006:

- ▶ Small houses (80m<sup>2</sup>-140m<sup>2</sup>): a nominal 15,1% and a real 9,1% higher.
- ▶ Medium houses (141m<sup>2</sup>-220m<sup>2</sup>): a nominal 16,1% and a real 10,8% higher.



- ▶ Large houses (221m<sup>2</sup>-400m<sup>2</sup>): a nominal 11,0% and a real 5,3% higher.

In the category for small houses, year-on-year nominal price growth bottomed at 13,9% in the fourth quarter of 2005 and increased to 15,4% and 16,7% respectively in the first and second quarters of 2006. This could be ascribed to housing, in general, becoming less affordable in recent years, shifting the focus to smaller properties. However, in the third quarter, year-on-year growth in the prices of small houses was down to 15,1%. This might be a reflection of the impact of higher interest rates since June this year.

The year-on-year price growth of medium-sized houses levelled out at just above 16% in the first three quarters of 2006, with the focus probably shifting from larger, more luxurious properties in view of the issue of the affordability of housing in general. During the next few quarters, price growth in the medium-sized segment will be closely watched for any signs of weakening on the back of higher interest rates, such as that with regard to smaller houses in the third quarter.

### Luxury housing

Nominal house prices in this segment of the market increased by an average of 7,6% y/y in the third quarter of 2006, compared with an increase of 8,1% y/y in the second quarter. In real terms, house prices in the luxury category increased by 2,1% y/y in the third quarter of the year, following a real price increase of 3,8% y/y in the second quarter.

The continued low growth in house prices at the upper end of the market since the second quarter of 2005 is related to a strong supply of properties in this market segment during recent years, whereas demand started to taper off in late 2004 because of the high prices caused by strong price growth in 2003 and 2004.

### Regional house prices

On a provincial basis, growth in house prices in the middle

segment of the market remained relatively strong in some provinces in the third quarter of 2006. Nominal house price growth varied from as high as 30,7% y/y in Mpumalanga to only 9,2% y/y in the Western Cape.

In the country's major metropolitan areas, nominal house price growth varied from 21,4% y/y in the central and southern parts of Johannesburg in the third quarter to 9,2% y/y in the Cape Town area.

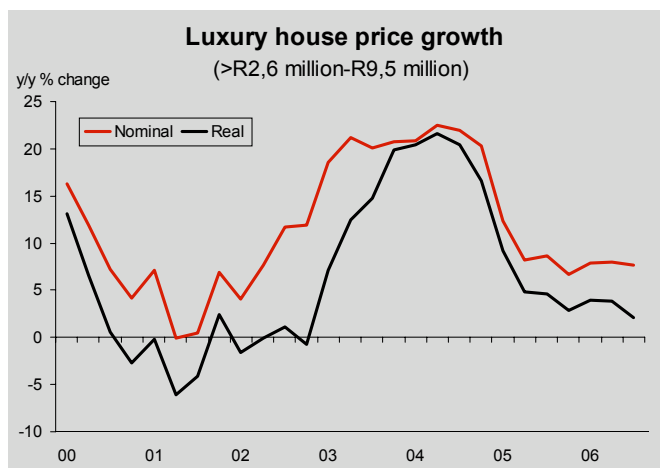
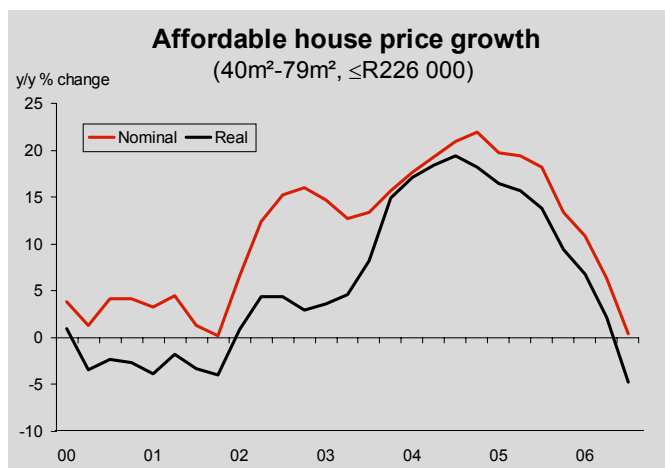
Price growth in the mainly rural regions of Mpumalanga (30,7% y/y), the Northern Cape (29,5% y/y), Limpopo (23,7% y/y) and North West (19,7% y/y) remained strong in the third quarter of the year compared with the country as a whole (13,8% y/y). This can be ascribed to factors such as:

- ▶ the upturn in the property market, which started at a much later stage in these regions than in the big metro areas around the country;
- ▶ the generally low level of house prices in these areas at the start of the upturn;
- ▶ the demand for housing by people wanting to get away from busy urban lifestyles over weekends and during holidays;
- ▶ the demand for housing by people opting to retire and work (e.g. artists) in rural areas; and
- ▶ a limited supply of housing.

### Building costs and new and existing house price trends

The cost of building a new house increased by a nominal 10,3% y/y in the third quarter of 2006, compared with a growth rate of 10,5% y/y in the preceding quarter. This above-inflation increase in building costs is a reflection of the level of activity in the building and construction sector. The demand for building materials and skilled labour has also contributed to this development.

However, the nominal year-on-year growth in building costs continued its downward trend, which commenced in the third quarter of 2004, up until the third quarter of 2006. This can be ascribed to the large number of developers and building contractors active in the property market, which



leads to greater competition. The slowing down of the residential market since late 2004 also played a role.

The average price of a new house increased by a nominal 11,6% y/y to about R832 900 in the third quarter of 2006, which meant an increase of 5,9% y/y in real terms. The average price of an existing house increased by a nominal 14,9% y/y to about R820 200 in the third quarter, which brought the real price increase to 9,0% y/y.

The nominal price difference between new and existing houses was stable at 1,5%, or just more than R12 000, during the first three quarters of 2006. This is the smallest price difference recorded since mid-1989. The price difference between new and existing houses has declined sharply since mid-2003, when it reached an all-time high of R173 200, or 31,2%.

### Land prices

In the third quarter of 2006, nominal residential land prices increased by 17,0% y/y to about R292 300 on average, compared with growth of 18,2% y/y in the second quarter. Real growth in land prices of 11,0% y/y was recorded in the third quarter, compared with 13,56 y/y in the preceding quarter.

The scarcity of suitable and properly serviced land for residential development has been a problem for some time, especially in the rapidly growing urban areas of the country. These conditions are not expected to improve materially and will be reflected in vacant land prices in years to come. Along the coast, the value of residential land with good views has also increased significantly over the past few years. As the supply of and demand for vacant land are, to a large extent, moving in opposite directions in these areas, prices are expected to escalate further in future.

### Mortgage finance

Commercial banks' variable mortgage interest rates increased by 50 basis points in both August and October to reach 12% after the Reserve Bank's Monetary Policy

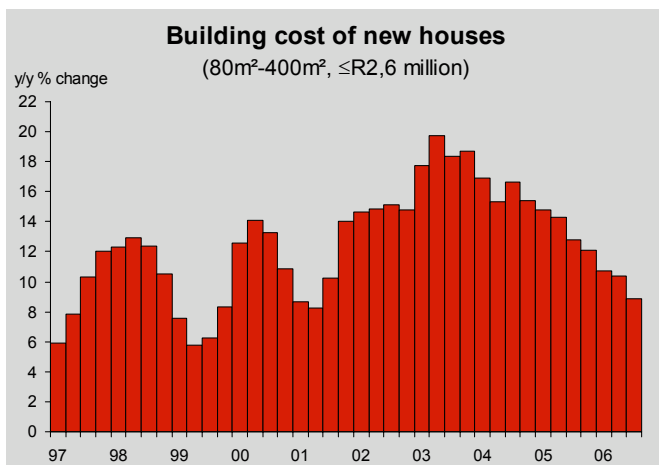
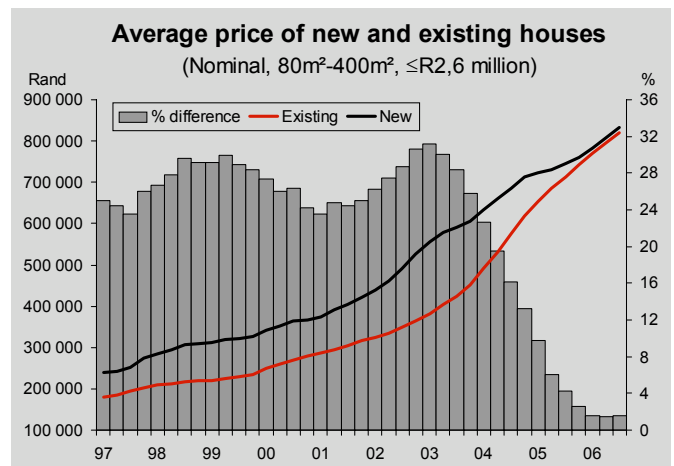
Committee hiked the repo rate to 8,5% at its October meeting. Interest rates have been on an upward trend since June this year.

Based on an average house price of R818 333 in the middle segment of the market in the third quarter of 2006, the monthly repayment on a new mortgage (100% over a 20-year repayment period at a variable mortgage rate averaging 11,3%) amounted to R8 633. In the same quarter of last year, the comparable repayment was R7 180, calculated at an average house price of R719 159 and an average mortgage rate of 10,5% at the time. The difference of R1 453 between these monthly repayments can be ascribed to house prices being 13,8% higher in the past quarter than they were a year ago, whereas the mortgage rate was on average 80 basis points higher than in the third quarter of 2005.

### Affordability of housing

Based on interest rate and house price trends in the third quarter of 2006, the average mortgage repayment and the qualifying gross income levels were 20,2% up on the same quarter last year. In the third quarter of 2005, this growth rate was still at 15,5%.

The house price-to-remuneration ratio tapered off



somewhat in the first quarter of 2006 (the most recently data available for remuneration) from the preceding quarter. This was the net result of house price growth slowing to 16,4% y/y at the time, whereas nominal growth in remuneration was 7,3% in the first quarter of 2006 compared with 4,4% in the fourth quarter of last year.

The mortgage repayment-to-remuneration ratio, which can also be regarded as an indication of the affordability of mortgage debt, also declined slightly in the first quarter of the year. This development in the mortgage repayment-to-remuneration ratio can be ascribed to slower-growing house prices and low interest rates over the past twelve months, whereas growth in remuneration remained relatively strong.

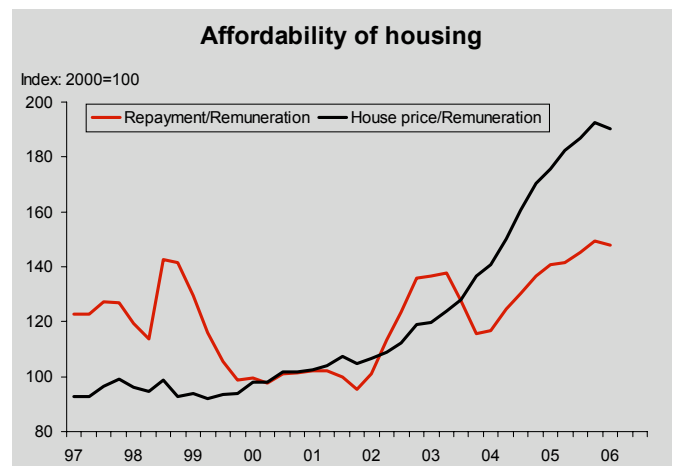
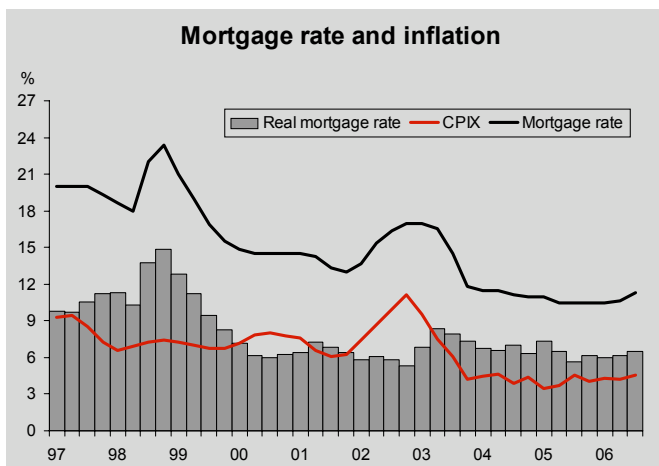
The decline in the abovementioned two ratios from the final quarter of 2005 to the first quarter this year implies that the gap between house price growth and mortgage repayments, on the one hand, and remuneration, on the other, has narrowed. This means that housing was, in effect, slightly more affordable in the first quarter of the year compared with the fourth quarter of last year. Future trends in these two affordability ratios will depend on developments with regard to house prices, interest rates and remuneration.

## Outlook

CPIX inflation increased further in the third quarter of the year on the back of volatile international oil prices, a weaker rand exchange rate, and higher food price inflation. CPIX inflation is projected to rise further to above 6% by year-end. The deficit on the current account of the balance of payments remained above 6% of GDP in the second quarter of 2006, which contributed to the rand depreciating significantly against the major international currencies in recent times. Year-on-year private sector credit extension remained high, with mortgage advances growth at around 30% over the past few months compared with a year ago.

Against this background, interest rates are forecast to rise further, by 50 basis points at each of the Monetary Policy Committee meetings in December this year, and in February and April next year. This will bring the prime interest rate and the variable mortgage interest rate to 12,5% at year-end and 13,5% by mid-2007.

As a result of these expectations, house prices are projected to increase by 13,7% y/y in nominal terms in 2006, taking into account the price growth of 14,9% on average recorded in the first three quarters of the year. Nominal house price growth of 5,9% is expected for 2007, with prices declining by 1,9% in real terms next year. This will be the first real decline in house prices since 1999.



## Statistics and projections

Average nominal house prices											
	2002 Rand	2003 Rand	2004 Rand	2005 Rand	2005		2006				
					Q3 Rand	Q4 Rand	Q1 Rand	Q2 Rand	Q3		
									Rand	q/q % Δ	y/y % Δ
<b>National</b>											
<b>Middle segment (80m<sup>2</sup>-400m<sup>2</sup>, ≤R2,6m)</b>	357 868	434 536	574 373	705 944	719 159	746 944	772 751	795 560	818 333	2,9	13,8
Small (80m <sup>2</sup> -140m <sup>2</sup> , ≤R2,6m)	255 330	308 860	419 572	501 747	508 593	527 604	551 854	574 974	585 173	1,8	15,1
Medium (141m <sup>2</sup> -220m <sup>2</sup> , ≤R2,6m)	325 921	398 005	536 779	666 496	680 777	705 931	727 305	758 455	790 144	4,2	16,1
Large (221m <sup>2</sup> -400m <sup>2</sup> , ≤R2,6m)	492 784	601 873	779 590	978 826	1 004 686	1 040 728	1 074 069	1 089 688	1 115 338	2,4	11,0
New (80m <sup>2</sup> -400m <sup>2</sup> , ≤R2,6m)	479 598	582 862	673 583	740 129	746 114	761 373	781 657	808 527	832 900	3,0	11,6
Existing (80m <sup>2</sup> -400m <sup>2</sup> , ≤R2,6m)	343 557	415 127	554 137	698 648	714 123	741 970	769 467	796 532	820 227	3,0	14,9
<b>Affordable (40m<sup>2</sup>-79m<sup>2</sup>, ≤R226 000)</b>	89 470	102 568	122 639	144 747	147 846	149 289	151 258	151 362	148 523	-1,9	0,5
<b>Luxury (&gt;R2,6m-R9,5m)</b>	2 157 234	2 601 377	3 150 602	3 422 300	3 469 905	3 536 825	3 574 658	3 619 608	3 735 073	3,2	7,6
<b>Provinces</b>											
<b>Eastern Cape</b>	288 829	361 201	527 440	665 989	678 732	685 989	713 986	753 675	779 215	3,4	14,8
<b>Free State</b>	236 797	287 368	391 921	490 100	501 092	516 535	539 396	556 360	557 858	0,3	11,3
<b>Gauteng</b>	402 624	479 818	613 307	739 438	753 477	772 684	796 619	834 434	866 567	3,9	15,0
<b>KwaZulu-Natal</b>	289 781	407 682	551 730	684 165	698 185	742 732	782 401	796 647	814 179	2,2	16,6
<b>Limpopo</b>	252 378	288 171	375 609	528 093	546 521	592 566	636 590	663 475	672 616	1,4	23,1
<b>Mpumalanga</b>	256 918	304 248	407 270	527 451	535 538	562 080	597 704	653 045	699 748	7,2	30,7
<b>North West</b>	287 953	334 188	426 912	517 190	524 217	551 797	565 596	584 431	627 739	7,4	19,7
<b>Northern Cape</b>	224 280	273 880	370 539	445 270	443 859	460 066	496 095	537 217	574 804	7,0	29,5
<b>Western Cape</b>	404 676	489 661	655 695	839 578	867 220	898 972	923 040	936 193	947 190	1,2	9,2
<b>Metropolitan regions</b>											
<b>PE/Uitenhage (Eastern Cape)</b>	299 166	364 834	539 913	664 695	665 438	659 896	684 737	733 899	789 201	7,5	18,6
<b>Bloemfontein (Free State)</b>	278 135	340 949	482 544	612 204	627 193	639 169	675 104	716 097	743 444	3,8	18,5
<b>Greater Johannesburg (Gauteng)</b>	405 507	482 917	619 957	743 602	758 921	783 803	816 496	854 181	885 914	3,7	16,7
Johannesburg Central & South	378 408	428 905	596 783	698 202	687 300	724 407	759 575	822 383	834 405	1,5	21,4
Johannesburg North & West	507 906	633 418	773 823	942 670	970 204	991 320	1 023 994	1 048 378	1 074 365	2,5	10,7
East Rand	336 595	387 788	503 021	635 717	658 279	681 287	699 794	740 060	771 731	4,3	17,2
<b>Pretoria (Gauteng)</b>	446 328	533 839	664 486	801 522	810 380	825 815	849 015	878 028	907 086	3,3	11,9
<b>Durban/Pinetown (KwaZulu-Natal)</b>	328 710	469 703	623 551	749 787	755 456	802 723	840 842	827 528	845 779	2,2	12,0
<b>Cape Town (Western Cape)</b>	417 082	497 816	662 156	842 366	872 954	910 840	937 294	947 808	952 926	0,5	9,2

House prices are based on the total smoothed purchase price of houses (including all improvements) in respect of which loan applications were approved by Absa Bank. House prices for the provinces and metropolitan regions are smoothed for all houses between 80m<sup>2</sup> and 400m<sup>2</sup>, up to R2,6 million.

Average nominal house prices by middle-segment category in the third quarter 2006									
	Small: 80m <sup>2</sup> – 140m <sup>2</sup>			Medium: 141m <sup>2</sup> – 220m <sup>2</sup>			Large: 221m <sup>2</sup> – 400m <sup>2</sup>		
	Price Rand	q/q % Δ	y/y % Δ	Price Rand	q/q % Δ	y/y % Δ	Price Rand	q/q % Δ	y/y % Δ
<b>National and Provinces</b>									
<b>South Africa</b>	585 173	1,8	15,1	790 144	4,2	16,1	1 115 338	2,4	11,0
<b>Eastern Cape</b>	514 467	-0,5	14,4	774 535	5,5	18,5	1 157 718	10,9	18,8
<b>Free State</b>	403 421	-0,9	15,0	495 185	-3,0	9,1	730 854	8,0	14,1
<b>Gauteng</b>	520 879	1,0	13,0	785 200	4,4	14,3	1 206 015	3,9	13,0
<b>KwaZulu-Natal</b>	580 183	7,2	30,8	842 088	5,4	23,2	1 119 905	1,2	10,3
<b>Mpumalanga</b>	558 275	13,4	27,6	648 426	4,2	24,2	884 733	5,8	23,5
<b>North West</b>	454 381	-1,9	13,1	592 710	10,7	26,0	861 198	7,9	17,4
<b>Northern Cape</b>	493 946	6,3	42,9	545 789	8,7	33,5	721 310	6,2	27,4
<b>Limpopo</b>	464 281	2,7	26,8	687 772	3,4	29,2	894 504	-0,7	18,2
<b>Western Cape</b>	722 571	0,4	11,1	985 029	2,0	11,2	1 362 164	1,5	6,4
<b>Metropolitan regions</b>									
<b>PE/Uitenhage (Eastern Cape)</b>	522 920	3,3	16,6	745 647	6,6	16,9	1 187 557	16,7	17,1
<b>Bloemfontein (Free State)</b>	439 242	1,6	20,0	688 534	-1,7	10,9	1 011 721	5,9	16,3
<b>Greater Johannesburg (Gauteng)</b>	531 032	-0,2	16,0	819 388	4,8	17,6	1 200 074	3,3	11,3
Johannesburg Central & South	440 661	-3,7	14,8	797 855	3,7	24,0	1 217 873	2,7	13,8
Johannesburg North & West	662 933	3,5	9,5	969 317	5,0	12,6	1 418 709	2,1	10,8
East Rand	505 266	-0,4	12,2	728 044	4,1	18,8	994 940	2,5	10,2
<b>Pretoria</b>	529 128	1,1	8,1	834 813	4,1	10,6	1 277 467	3,3	12,8
<b>Durban/Pinetown (KwaZulu-Natal)</b>	439 588	0,8	3,1	921 311	6,5	20,8	1 254 390	1,8	6,5
<b>Cape Town (Western Cape)</b>	728 903	-0,1	9,0	982 789	0,0	8,6	1 472 555	3,4	10,5

House prices are based on the total smoothed purchase price of houses (including all improvements) between 80m<sup>2</sup> and 400m<sup>2</sup>, up to R2,6 million, in respect of which loan applications were approved by Absa Bank.

### Affordability of housing taking into account house price and interest rate trends

Quarter	Nominal house prices <sup>1</sup>		Average mortgage interest rate	Monthly repayment over 20 years (100% mortgage)	Gross monthly qualifying income <sup>2</sup> (100% mortgage)	q/q % change in repayment & income (100% mortgage)	y/y % change in repayment & income (100% mortgage)
	Price	y/y % change					
1q2003	R 400 750	19,2	17,0%	R 5 878	R 19 594	4,9	37,9
2q2003	R 422 505	21,4	16,5%	R 6 037	R 20 124	2,7	29,3
3q2003	R 442 881	21,2	14,5%	R 5 669	R 18 896	-6,1	9,6
4q2003	R 472 010	23,5	11,8%	R 5 142	R 17 141	-9,3	-8,2
1q2004	R 513 620	28,2	11,5%	R 5 477	R 18 258	6,5	-6,8
2q2004	R 554 031	31,1	11,5%	R 5 908	R 19 694	7,9	-2,1
3q2004	R 595 885	34,5	11,2%	R 6 218	R 20 728	5,2	9,7
4q2004	R 633 954	34,3	11,0%	R 6 544	R 21 812	5,2	27,2
1q2005	R 664 144	29,3	11,0%	R 6 855	R 22 850	4,8	25,2
2q2005	R 693 528	25,2	10,6%	R 6 955	R 23 184	1,5	17,7
3q2005	R 719 159	20,7	10,5%	R 7 180	R 23 933	3,2	15,5
4q2005	R 746 944	17,8	10,5%	R 7 457	R 24 858	3,9	14,0
1q2006	R 772 751	16,4	10,5%	R 7 715	R 25 716	3,5	12,5
2q2006	R 795 560	14,7	10,7%	R 8 032	R 26 773	4,1	15,5
3q2006	R 818 333	13,8	11,3%	R 8 633	R 28 777	7,5	20,2

<sup>1</sup> Smoothed purchase price of houses in the 80m<sup>2</sup>-400m<sup>2</sup> size category (including all improvements), valued at R2,6 million or less, in respect of which loan applications were approved by Absa.

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

#### Monthly mortgage repayment (rand, calculated over a period of 20 years)

Mortgage amount	Repayment at different mortgage rates				
	10,5%	11,0%	11,5%	12,0%	12,5%
100 000	998	1 032	1 066	1 101	1 136
200 000	1 997	2 064	2 133	2 202	2 272
300 000	2 995	3 097	3 199	3 303	3 408
400 000	3 994	4 129	4 266	4 404	4 545
500 000	4 992	5 161	5 332	5 505	5 681
600 000	5 990	6 193	6 399	6 607	6 817
700 000	6 989	7 225	7 465	7 708	7 953
800 000	7 987	8 258	8 531	8 809	9 089
900 000	8 985	9 290	9 598	9 910	10 225
1 000 000	9 984	10 322	10 664	11 011	11 361
1 500 000	14 976	15 483	15 996	16 516	17 042
2 000 000	19 968	20 644	21 329	22 022	22 723

#### Mortgage amount at fixed monthly repayment (rand, calculated over a period of 20 years)

Mortgage repayment	Mortgage amount at different mortgage rates				
	10,5%	11,0%	11,5%	12,0%	12,5%
1 000	100 162	96 882	93 771	90 819	88 017
2 000	200 325	193 763	187 542	181 639	176 035
3 000	300 487	290 645	281 313	272 458	264 052
4 000	400 649	387 526	375 083	363 278	352 069
5 000	500 811	484 408	468 854	454 097	440 086
6 000	600 974	581 289	562 625	544 916	528 104
7 000	701 136	678 171	656 396	635 736	616 121
8 000	801 298	775 052	750 167	726 555	704 138
9 000	901 460	871 934	843 938	817 375	792 156
10 000	1 001 623	968 815	937 708	908 194	880 173
15 000	1 502 434	1 453 223	1 406 563	1 362 291	1 320 259
20 000	2 003 245	1 937 631	1 875 417	1 816 388	1 760 346

#### Transfer duty on property in 2006/07

Value of property	Transfer duty payable
R0-R500 000	0%
R500 001-R1 000 000	5% on the value above R500 000
R1 000 001 and above	R25 000 plus 8% on the value above R1 000 000

Source: National Treasury

#### Key variables and projections Annual averages

		2000	2001	2002	2003	2004	2005	2006	2007
\$/R exchange rate	Rand per US\$	6,94	8,60	10,52	7,56	6,45	6,36	6,84	7,57
CPI headline inflation rate	%	5,3	5,7	9,2	5,9	1,4	3,4	5,1	8,0
CPIX inflation rate	%	7,7	6,6	9,3	6,8	4,3	3,9	5,0	7,7
Mortgage interest rate	%	14,5	13,8	15,8	15,0	11,3	10,6	11,2	13,3
Household disposable income	Real % Δ	4,0	3,2	3,0	4,0	5,7	6,6	6,5	5,4
Final consumption by households	Real % Δ	4,1	3,5	3,2	3,5	6,5	6,9	6,8	5,3
Household saving to disposable income	%	1,2	0,9	0,7	1,2	0,5	0,2	-0,2	-0,1
Private sector credit extension (end of period)	Nominal % Δ	8,7	14,5	4,7	12,1	19,2	20,5	18,7	13,1
Mortgage advances (end of period)	Nominal % Δ	12,0	15,3	10,8	16,5	24,5	28,6	23,8	14,1
Household debt to disposable income	%	53,3	52,6	50,3	51,8	55,9	62,4	70,4	70,9
Gross domestic product	Real % Δ	4,2	2,7	3,7	3,0	4,5	4,9	4,2	4,3
House prices (80m <sup>2</sup> -400m <sup>2</sup> , ≤R2,6m)	Nominal % Δ	17,1	14,2	15,2	21,4	32,2	22,9	13,7	5,9
House prices (80m <sup>2</sup> -400m <sup>2</sup> , ≤R2,6m)	Real % Δ	11,2	8,0	5,6	14,7	30,4	18,9	8,2	-1,9