BIZCOMMUNITY

Rising inflation, rate hikes could see increased demand for residential rentals

According to TPN Credit Bureau's Residential Rental Monitor, demand for residential rental properties saw some recovery in Q1 of 2022 with the vacancy rate recovering to 8.26%, compared to 13.31% a year earlier. TPN's Market Strength Index, based on the perceptions and experiences of estate agents and landlords, reflects this strengthening, recovering to 52.8%.

Source: Gallo/Getty

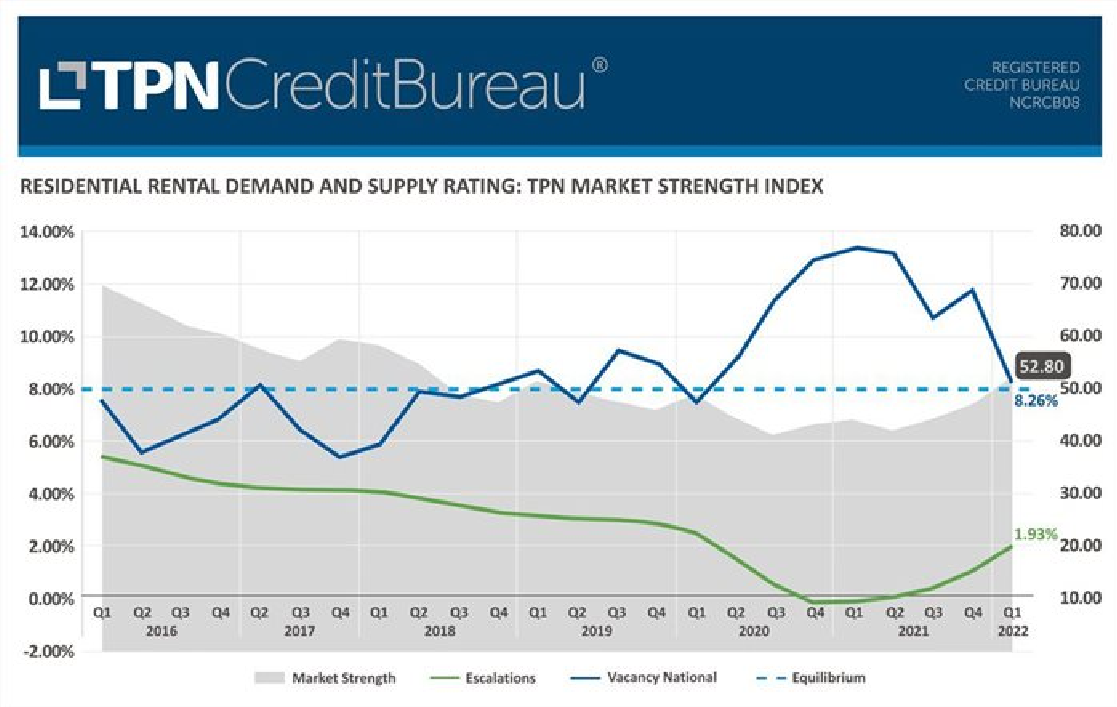
Respondents are asked to rate whether the demand by tenants looking to rent is strong, average or weak and their perceptions of the supply of rental properties. The aggregated data provides a demand and a supply rating while the difference indicates the market strength index. A result of 50 suggests a market in equilibrium.

Increased demand for residential rental stock in the first quarter of the year was the result of low rental escalations which was further supported by slightly improved employment figures. Unemployment figures are a key economic indicator when it comes to residential rental stock. The more people that are employed, the higher the demand for formal rental stock. Weak demand for residential rental stock, on the other hand, pushes vacancy levels to record highs.

6 tips to help first-time landlords navigate the property rental business
6 Jul 2022

Vacancies are expected to decrease further to below 8% by the end of the second quarter as consumers continue to face financial pressure. Rising fuel and food prices combined to push inflation to 5.9% in March 2022. Fuelled by spiking inflation, the South African Reserve Bank (Sarb) has embarked on a series of interest rate increases.

Rental escalations in the first quarter of 2022 were at 1.93%. This figure is expected to increase as inflation forces landlords to try and remain abreast of escalating costs. New property investors are competing with higher house price inflation. As such, striking a balance between occupancy and achieving a decent yield is becoming harder to achieve.

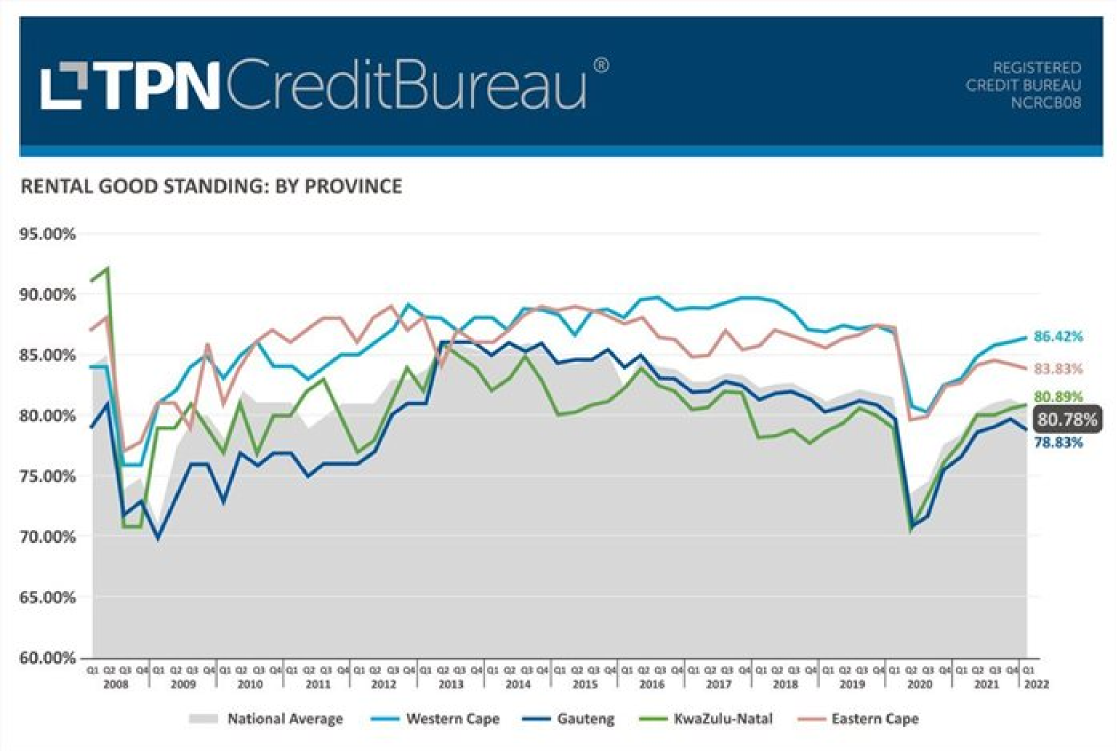


Rental collections likely to be a challenge going forward

Landlords need to be aware that getting rental payments in on time is likely to be a challenge going forward as inflation continues to place consumers under pressure and landlords are forced to escalate rentals.

The financial pressure consumers are under is reflected in the fact that the number of tenants in good standing with their landlords has started to drop. In the first quarter of 2022, the number of tenants in good standing with their landlords dropped from 81.4% in the fourth quarter of 2021 to 80.78% in the first quarter of 2022. A tenant is considered in good standing when they have paid their rental account in full for the month.

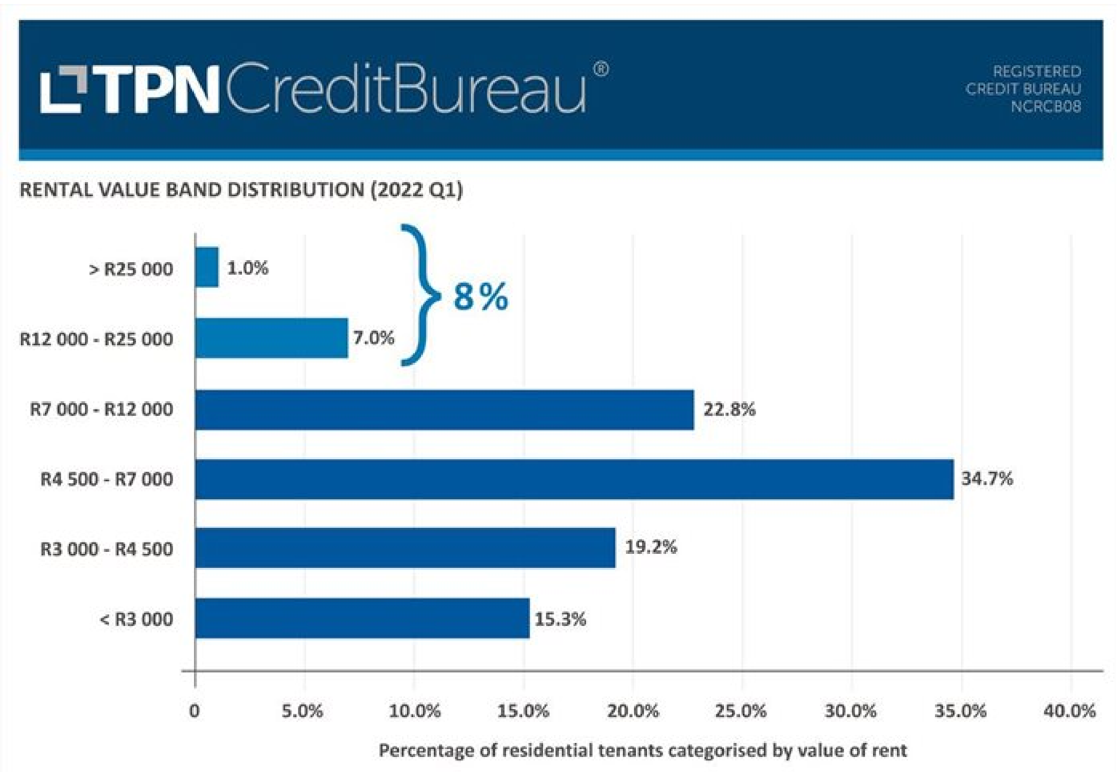
The worst performing category of tenants were those paying less than R3,000 per month with only 68.10% of tenants in good standing. The only rental price brackets which have continued to improve on the number of tenants in good standing are those paying R12,000 a month or more. Inflation is removing financial buffers, impacting the ability of tenants to pay their rental on time, including those tenants in higher rental brackets. Close to 70% of the rental market pays R7,000 or less per month, while 22% pays between R7,000 and R12,000 per month. This means that only 8% of the rental market is improving their good standing.



Rising interest rates could increase demand for residential rental property

Although rising interest rates are not encouraging for consumers – particularly those with high levels of debt – they may be just what the rental market requires right now to improve demand. Given that interest rates - currently at 8.25% - are expected to increase in the foreseeable future, landlords can be cautiously optimistic that demand for rentals may improve as consumers delay property purchase decisions.

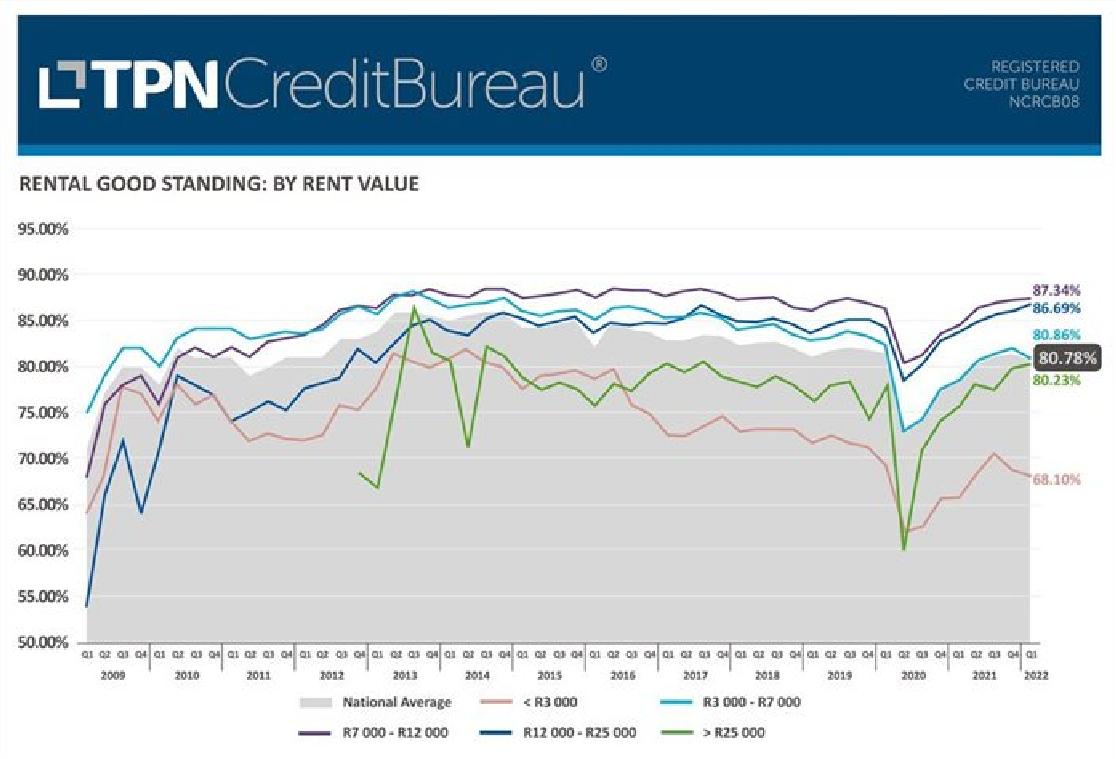
Increased demand, however, may not necessarily translate into improved escalations. Lower interest rates created a theoretical bubble during the pandemic as new buyers entered the market motivated by cheaper debt costs. This resulted in property inflation peaking at 5.1% according to FNB's House Price Index, the highest since 2016. Although property inflation peaked, escalations, on the other hand, went the other way and is only now falling into sync with property inflation.



Even with improved rental escalations, rental property yields for sectional title properties remained flat at 10.1% while the yield on full title properties dropped from 7.1% to 7% in the first quarter of 2022.

Rental properties between R7,000 and R12,000 had the lowest vacancy levels in the first quarter, followed by those priced between R12,000 and R25,000. The highest vacancies recorded are those in the R3,000 to R7,000 category.

TPN data reveals that the number of residential tenants classified as squatting – defined as having not paid three consecutive months of rental and continue to occupy the property in the fourth month - has seen a progressive increase in the last decade. Although the trend is cause for concern for landlords, the total number of tenants classified as squatting remains small when compared to the number of tenants who do meet their rental obligations. In reality, less than 5 out 10,000 tenants end up classified as 'squatters'. However, the pandemic has resulted in some tenants abusing the system to their advantage, creating fear and uncertainty with the property investment market.



Poor consumer confidence and a possible recession

Consumer pressure increased in the second quarter of 2022 and is likely to continue worsening in the third quarter in tandem with a worsening economic outlook which includes rising food and fuel prices and higher inflation. Poor consumer confidence is reflected in the FNB/BER Consumer Confidence Index which sank to -25 in the second quarter from -13 in the first quarter of 2022. The only time in recent history that it has been lower was at the start of the Covid-19 pandemic. This doesn't bode well for economic growth or job creation.

Of particular concern is that the confidence levels of high-income households – classified as those earning more than R20,000 per month – deteriorated to -30 in the second quarter. The FNB/BER Consumer Confidence Index was conducted prior to Eskom announcing Stage 6 load shedding which will dent both consumer and business confidence even further.

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14 Jul 2022

South Africa may well be heading for a technical recession, the term used to describe two consecutive quarters of negative economic growth. While it’s very clear that consumers will be under strain in the coming months, ironically, this could see increased demand for residential rental property.