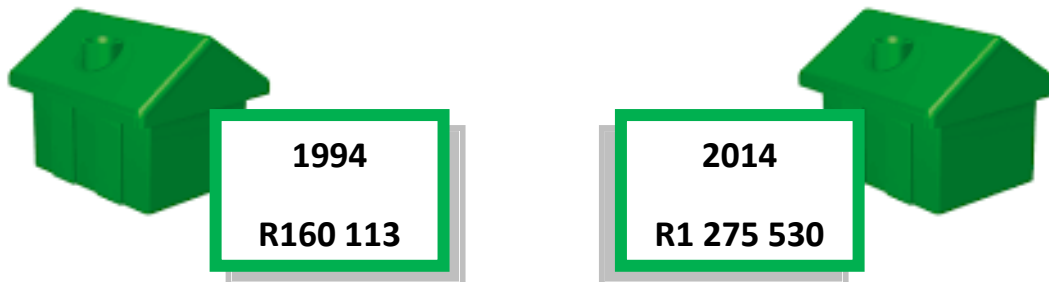


Is the value of property really increasing?

In 1994 the nominal house price was R160 113, in 2014 it was R1 275 530 ...WHAT?

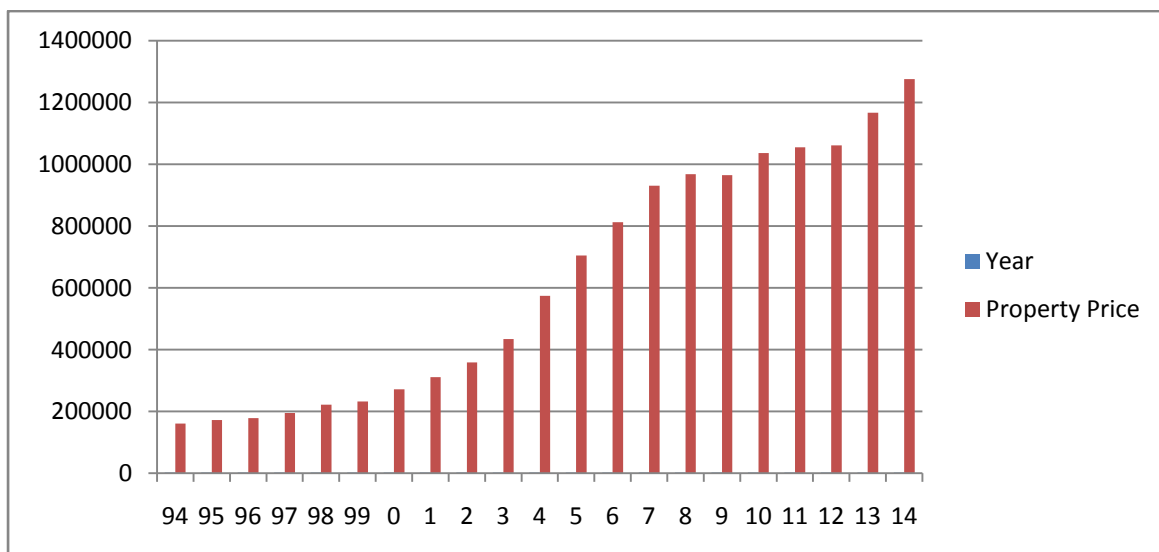


Sellers constantly push for higher prices. Purchasers constantly experience that their affordability of bond down payments are challenged and that it becomes more difficult to enter into the market.

After the so called “correction period” in property prices following 2008, the property market gradually regained momentum, to a present situation where any estate agent will tell you that the market is slow due to a shortage of sellable stock.

Obviously supply and demand dictates prices and because of the higher demand than supply, prices are in an upward cycle. Another factor that determines property prices is building cost, together with the cost of available land. When these are viewed as the components of the final product, the building of a new house is slightly more expensive than buying new at present, but to a very close margin. Though the low supply of sellable stock has an influence on the prices of property, the **cost of building** new doesn't correct the upward price cycle, but rather contribute to it. Other than supply and demand, the “**cost of money**” might therefore be a factor in growing house prices.

The actual growth in the published nominal house prices in South Africa from 1994 until 2014 is illustrated in the graph below:



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Besides bartering, money is involved in all transactions. Let's therefore look at the value of The SA Rand and try to put it in relation to property prices. The 20 year period between 1994 and 2014 seems to be a good statistical period to use. It reflects the first 20 years of the present liberated South Africa. After 20 years, the economy should have settled down into the current government's way of operating, resulting in realistic information to draw conclusions from.

Some interesting questions could be the following:

- ***Can the rise in property prices be due to inflation?
.....Obviously yes, but what is the effect thereof?***

If the published nominal house price of 1994 (R160113) was taken as a starting point and increased annually with the annual average inflation rate, the year on year **result could have** been as follows:

If property values grew with inflation

| Year | Property | Inflation % | Result |
|------|-----------|-------------|-----------|
| 1994 | 160113 | Start | R 160 113 |
| 1995 | R 160 113 | 8.73 | R 174 091 |
| 1996 | R 174 091 | 7.34 | R 186 869 |
| 1997 | R 186 869 | 8.62 | R 202 977 |
| 1998 | R 202 977 | 6.86 | R 216 901 |
| 1999 | R 216 901 | 5.27 | R 228 332 |
| 2000 | R 228 332 | 5.33 | R 240 502 |
| 2001 | R 240 502 | 5.73 | R 254 283 |
| 2002 | R 254 283 | 9.47 | R 278 364 |
| 2003 | R 278 364 | 5.84 | R 294 620 |
| 2004 | R 294 620 | -0.68 | R 292 617 |
| 2005 | R 292 617 | 2.06 | R 298 645 |
| 2006 | R 298 645 | 3.24 | R 308 321 |
| 2007 | R 308 321 | 6.17 | R 327 344 |
| 2008 | R 327 344 | 10.04 | R 360 209 |
| 2009 | R 360 209 | 7.26 | R 386 361 |
| 2010 | R 386 361 | 4.1 | R 402 201 |
| 2011 | R 402 201 | 5.01 | R 422 352 |
| 2012 | R 422 352 | 5.75 | R 446 637 |
| 2013 | R 446 637 | 5.77 | R 472 408 |
| 2014 | R 472 408 | 6.13 | R 501 367 |

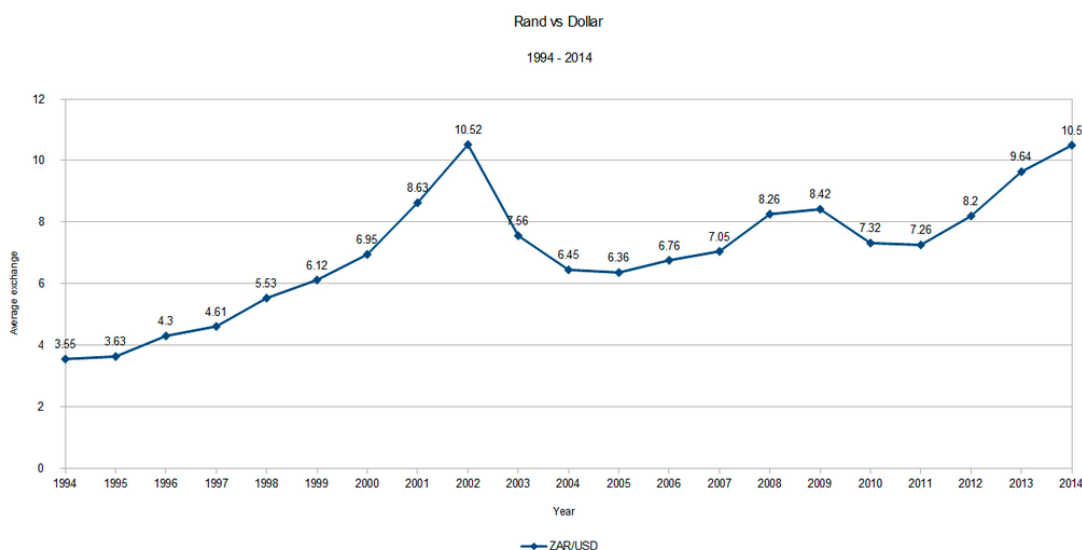
It is quite interesting to note that if house prices were calculated according to the inflation model since 1994, the average house price in South Africa **could have been at the level of R501 367 in 2014**, opposed to the

actual published nominal house price of **R1 275 530**. Fixed property prices are clearly not tracking the inflation model. Therefore, there must be other drivers behind the growth of property values.

A question that is seldom considered in property circles can be the following;

- ***Does the devaluation of the Rand in relation to other currencies play a role in property prices in South Africa?***

The SA Rand devaluated from R3.55 in 1994 to R10.50 against the UD Dollar in 2014 (Year averages).



The devaluation of the SA Rand should not be confused with inflation. Though it is not inflation, it is one of the drivers of inflation. It does however have a further accelerating effect on the net result in what could be bought with money, not only abroad, but also locally in South Africa. The reason behind this statement is because South Africa is mostly an exporter of agricultural products and raw materials, but an importer of consumer goods. Furthermore, the trade balance also had a negative result in 2014 as indicated in the table below:

| 2014 | | |
|------------------|------------------|-------------------|
| Exports | Imports | Trade Balance |
| R 78 459 877 276 | R 94 726 728 261 | R -16 266 850 985 |
| R 82 970 469 356 | R 82 015 710 084 | R 954 759 272 |
| R 79 606 638 834 | R 91 288 281 772 | R -11 681 642 938 |
| R 77 883 041 489 | R 90 318 896 849 | R -12 435 855 360 |
| R 77 767 609 753 | R 84 766 947 583 | R -6 999 337 830 |
| R 80 541 729 367 | R 80 483 383 623 | R 58 345 744 |
| R 85 529 706 091 | R 92 283 569 052 | R -6 753 862 961 |
| R 76 944 913 596 | R 93 758 208 750 | R -16 813 295 154 |

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| | | |
|--------------------------|----------------------------|--------------------------|
| R 90 107 581 486 | R 93 687 169 206 | R -3 579 587 720 |
| R 88 453 030 000 | R 110 263 962 216 | R -21 810 932 216 |
| R 84 069 206 756 | R 89 421 506 722 | R -5 352 299 966 |
| R 87 351 641 940 | R 80 592 418 713 | R 6 759 223 227 |
| R 989 685 445 944 | R 1 083 606 782 831 | R -93 921 336 887 |

This indicates a deficit on the trade balance in 2014 of close to 10%

The SA Rand accelerated its devaluation trend in 2015 and by the 2nd October 2015, its value was R13.90. Compared to the 2014 average of R10.50, the devaluation of the SA Rand was 32% during the first nine months of 2015. (Source: SA Reserve Bank)

| Exchange rates | | |
|----------------|---------|------------|
| R/\$ | 13.9086 | 2015-10-02 |
| R/€ | 21.0848 | 2015-10-02 |
| R/£ | 15.5311 | 2015-10-02 |

Conclusion:

...FACTS:

- > South Africa is an importer of consumer goods.
- > South Africa had a negative trade balance of close to 10% in 2014.
- > The SA Rand is in a constant cycle of devaluation with an accelerated rate of 32% during the first nine months of 2015.
- > Cash Assets/Markets in South Africa are losing value at an alarming rate!!

If an illustration is made with the actual nominal house price in 1994 as starting point and then **adjusting the value annually** with the value **adjustment ratio** of the **SA Rand : US Dollar**, the results are as indicated in the table below:

| Year | Start Value | Value adjustment | Result |
|------|-------------|------------------|-----------|
| 1994 | 160 113 | Start | R 160 113 |
| 1995 | 160 113 | 2.25% | R 163 721 |
| 1996 | 163 721 | 18.46% | R 193 940 |
| 1997 | 193 940 | 7.21% | R 207 921 |
| 1998 | 207 921 | 19.96% | R 249 415 |
| 1999 | 249 415 | 10.67% | R 276 026 |
| 2000 | 276 026 | 13.56% | R 313 461 |
| 2001 | 313 461 | 24.17% | R 389 232 |
| 2002 | 389 232 | 21.90% | R 474 476 |
| 2003 | 474 476 | -28.14% | R 340 973 |
| 2004 | 340 973 | -14.68% | R 290 910 |
| 2005 | 290 910 | -1.40% | R 286 850 |
| 2006 | 286 850 | 6.29% | R 304 891 |
| 2007 | 304 891 | 4.29% | R 317 971 |

| | | | |
|------|---------|---------|-----------|
| 2008 | 317 971 | 17.16% | R 372 545 |
| 2009 | 372 545 | 1.94% | R 379 761 |
| 2010 | 379 761 | -13.06% | R 330 148 |
| 2011 | 330 148 | -0.82% | R 327 442 |
| 2012 | 327 442 | 12.95% | R 369 838 |
| 2013 | 369 838 | 16.34% | R 430 275 |
| 2014 | 430 275 | 10.06% | R 473 574 |

The **currency based calculation** of house prices since 1994 results in an value of R473574, opposed to the **actual** published nominal house price of **R1 275 530**. As per the previous illustration with the inflation model, it is therefore clear that the increase in house prices could not be directly put into relation to the devaluation of the currency. Fixed property prices are clearly not tracking the inflation model and also not the devaluation of money model. It outperforms both and by a huge margin!

As stated before, the devaluation of the SA Rand is a driver of inflation and therefore supposed to be factored into inflation. If one look at the two previous calculations models where firstly inflation and secondly the devaluation of the SA Rand were used to calculate the effect that it could have on house prices, the temptation arises to add both inflation and the devaluation of the SA Rand on top of each other and see if the result thereof comes close to the nominal house price of R1 275 530 in 2014.

| Year | Illustrative Result | Real Nominal house prices |
|------|---------------------|---------------------------|
| 1994 | R 160 113 | 160113 |
| 1995 | R 178 014 | 172276 |
| 1996 | R 226 349 | 178486 |
| 1997 | R 263 585 | 194435 |
| 1998 | R 337 878 | 221284 |
| 1999 | R 393 632 | 232127 |
| 2000 | R 470 843 | 271863 |
| 2001 | R 618 159 | 310685 |
| 2002 | R 824 897 | 358132 |
| 2003 | R 627 416 | 433969 |
| 2004 | R 531 656 | 573869 |
| 2005 | R 535 037 | 704205 |
| 2006 | R 587 112 | 812028 |
| 2007 | R 650 078 | 930116 |
| 2008 | R 838 121 | 968303 |
| 2009 | R 916 382 | 964835 |
| 2010 | R 829 328 | 1036428 |
| 2011 | R 863 739 | 1054448 |
| 2012 | R 1 031 668 | 1061226 |
| 2013 | R 1 269 513 | 1166840 |
| 2014 | R 1 482 915 | 1275530 |

The result of this exercise comes to a calculated vale of R1 482 915 opposed to the real nominal house price of R1 275 530 in 2014. Though it is not spot on, it comes closer than any one of the previous exercises. This proves that the full effect of the devaluation of the rand is not factored into inflation as far as property prices are concerned.

Final Conclusion:

- Property values increased by 696% during 20 years (ending 2014)
- The official South African published inflation rate is not even closely comparable to “property inflation”
- The SA Rand is losing value at an alarming rate. It devaluated by 195% in 20 years (ending 2014)
- Cash assets in South Africa compared to the US Dollar, is worth 32% less at start October 2015 than in 2014
- Fixed property as a tangible asset showed significant growth during the past 20 years.

Something to be considered is the future of the SA Rand. With all due respect, what could the future expectation of the Rand be? Think of it, in relation to the US Dollar, the same One Rand that you held in your hand during 1994 was worth 34 Cents in 2014, and even scarier, 25.5 Cents today (2nd October 2015).

Investors, who understand the eroding effect of inflation and devaluation of money, **will not keep their investments in cash or cash assets**. They will either move to equity (stock market), but because of the volatility in the markets, **fixed property remains a stable, tangible favour of investors**.

Investment property has two money producing streams.

- The one is **capital growth** which clearly outperformed both inflation and the devaluation of the SA Rand by a far margin during the past 20 years,
- and the other is rental **income**, which normally increases in line with inflation (avoidance of the eroding effect of inflation on income).

When these two streams are combined with positive gearing (using the bank’s money) the growth of property investments are very hard to match.

2nd October 2015

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