Q1 2021 shows positive growth in residential building numbers

By John Loos

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Last week's release of Stats SA's March building statistics completed the building picture for the first quarter of 2021. Perhaps some had expected a little more new activity in the pipeline than what the overall numbers suggest, given recently strong home buying. The home buying surge came in response to last year's aggressive interest rate cutting by the South African Reserve Bank (Sarb).

But the overall building activity numbers suggest that the residential development sector may not be set to produce major “fireworks” in 2021.

The number of residential units’ plans passed declined year-on-year by -16.57%. This comes after the negative year-on-year growth rate had been clawing its way back from a -73% year-on-year drop during the “hard lockdown” of the second quarter of 2020 to near 0% by the final quarter of the year.

Residential units completed did go into mild positive year-on-year growth territory to the tune of +9.02% in the first quarter of 2021, but renewed decline in plans passed in the first quarter suggests that we shouldn’t expect strong levels of completions in the near term.

Admittedly, other metrics of new building activity do make the building picture look mildly better than do the growth rates in the total number of units. Square metreage of plans passed was in mildly positive territory due to an increase in the average unit size of these plans.

Also important to emphasise is that the more cyclical part of the market is seeing its building levels respond to an increase in home demand due to interest rate cuts last year. By the “more cyclical part of the market”, we refer to total of number of units excluding the free-standing (or “dwelling houses” as Stats SA calls them) homes smaller than 80m^2. This small free-standing home category represents largely the most affordable end of the market, and is not as strongly influenced by economic and interest rate cycles.

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18.1% year-on-year growth

Excluding this abovementioned category from the totals, first quarter numbers point to an 18.1% year-on-year growth rate in number of units’ plans passed, and a more significant 37.2% increase in the number of units completed in the first quarter of 2021.

This includes an increase in units’ plans passed in the area of “flats and townhouses” to the tune of +14.4% (with units completed a massive +80.4%), and a +25.5% increase in the number of “dwelling houses” larger than 80m^2 (but units completed still -14.5% down).

The decline in the total number of units' plans passed, therefore, was due to a sharp -74.2% drop in the “dwelling houses smaller than 80m^2” category (and -40.9% drop in units completed). This category is largely in the affordable housing side of the market, with an average value on plans passed of R366,000/unit.

The Sarb, when compiling its Composite Leading Indicator, excludes the “dwelling houses less than 80m^2” category, deeming this category to be a less reliable leading business cycle indicator, the other two categories typically more correlated with the business cycle.

Therefore, the more cyclical categories of residential building activity have indeed been responding noticeably to last year’s interest rate cuts and the resultant uptick in home demand.

This shift in the building activity away from the most affordable category towards the two higher valued segments, “flats and townhouses” with an average value at R826,000/unit for plans passed and “dwelling houses larger than 80m^2” at R2.141m/unit, appears driven by market activity which is at its strongest in the “middle segment” of the housing market.

According to the FNB Estate Agent Survey, the agents’ market activity rating by area value band was at its strongest (7.2 on a scale of 1 to 10) in what it classifies as the “middle-income segment”, i.e., where homes are valued on average between R1.6m and R2.6m. By comparison, the most affordable segment, with an average home value below R750,000, recorded a lower 6.51 rating, so market strength appears to taper somewhat towards the more affordable end of the market.

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Long trend of densification set to continue in 2021

The first quarter 2021 data effectively points to the long trend towards greater living density in SA's urban areas continuing, with the flats and townhouses category's plans passed accounting for a 58.2% share of total plans passed, up further from a 42.8% share in 2020.

While the larger "dwelling houses larger than 80m^2" category has also increased its share of plans passed slightly in 2021 to date, we would see this increase as a short-term one at best, unlikely to become a trend in such a financially pressured economy, given their relatively high average value. So densification is more likely to continue, with an increasing share of the smaller flats and townhouses category.

The shift away from the smallest and most affordable of Stats SA's three building categories has translated into an increase in the average size of units' plans passed recently.

From 118.7m^2/unit as at the first quarter of 2020, the average size of units' building plans passed rose to 148.5m^2 as at the first quarter of 2021, driven by the shift in growth away from the "smaller than 80m^2" free-standing units.

We wouldn't expect this rise to be sustained for much longer, though, because it is in part driven by growth in plans in the larger free-standing homes category, which we believe will be short-lived due to affordability limitations.

While the average value of units completed was still on the decline as at the first quarter of 2021, the average value of units' plans passed had risen by a strong 36.2% year-on-year, also reflective of the shift in building in part away from the most affordable building category.

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Outlook – 2021 residential building market dramatically improved but likely still challenged

We are almost certain to see a massive year-on-year growth surge in building plans passed and completed in the coming months due to the extremely low base created by 2020 hard lockdowns that took place in the second quarter of last year. During that time there was very little activity recorded at all, so year-on-year growth in plans passed and completions during the coming months could reach percentages in the hundreds and possibly even thousands. But these would be meaningless, really, merely reflecting last year's extremely low base effect.

After last year's total decline of -46.7% in the number of residential units completed, we project a very strong positive growth rate of +80% for the entire 2021. However, that would not translate into a strong level of completions by historic standards, being insufficient to bring the number of completions back to pre-Covid-19 2019 levels. This expectation of only "partial recovery" back to pre-Covid-19 levels is based on still-significant underlying weaknesses in the economy and the residential market.

Housing market's underlying "fundamentals" not as strong as would appear

Admittedly, recent home-buying demand has been strong, and the homeowner market appears to have been moving back into demand-supply balance, with some possible shortages of stock in places.

This is perhaps best reflected in the FNB Estate Agent Survey's estimated average time of homes on the market prior to sale, which has shortened from 17 weeks and six days as at mid-2018 to only eight weeks and two days by the first quarter of 2021.

However, this strengthening in the market appears largely to have been led by last year's 300 basis points' worth of interest rate cuts by the SARB, driving the cost of mortgage borrowing down sharply.

All the while, the household sector financial situation actually remains fragile at best. Real household sector disposable income growth had been slowing for some years as the economy stagnated from around 2012, and then took a big knock during the 2020 "lockdown" recession. Its worst quarter of decline was the -15.8% year-on-year drop in the second quarter of 2020, and by the final quarter, it was still showing a decline of -4.8%.

This is a severely pressured environment for the household sector as a whole, with the only thing partly masking the pressure in the housing market being low interest rates.

And where interest rates become less of an influence, i.e., in the rental market, the picture looks significantly weaker than that of the home-buying market. While the percentage of rental tenants in good standing with their landlords regarding rental payments had partly recovered (following Q2 2020 lockdown dip) to 77.61% by the end of 2020, this level was still weak compared to the high of 85.95% reached at a stage of 2014, according to TPN data.

So, not only did departures from the rental to the buying market leave a "hole" in the rental market, but financial pressure amongst tenants has likely also led to a lack of new household formation (young labour force entrants delaying their departure from their parents' home) and an increase in household "shut downs" (tenants ending leases and returning to live with their parents or offspring).

Sharp rise in average estimated residential vacancy rate

The overall result has been a sharp rise in the average estimated residential vacancy rate to 12.91% by the end of 2020, from a far lower 7.47% at the start of 2020 just prior to lockdowns and recession.

Viewing the rental market, therefore, the residential supply situation appears far stronger than in the home-buying market. That's not conducive to strong levels of new development activity.

In addition, an expected lack of further interest rate cutting by the Sarb is likely to lead to some tapering off of home-buying demand in the near term.

Therefore, while the development sector will be looking for development opportunities, especially to repurpose much vacant office space into residential apartments in and around certain major business nodes, such as those in Northern Johannesburg, the scope for such development may prove to be limited in a financially constrained environment, with residential rental vacancies already very significant.

A very strong building completions growth rate in 2021 is thus expected to reflect 2020's low base effect, rather than a move back to strong actual levels of activity.

ABOUT JOHN LOOS

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