

Affordability will be the leading driver of real estate trends in 2023

Price sensitivity will be the main driver for landlords and property managers jockeying to attract and retain tenants in 2023. In fact, this defining trend will only compound and deepen in importance in future years as tenant income growth remains weak, unemployment levels remain staggeringly high, interest rates creep upwards, and inflation - particularly utility and municipal expenses - outpace rental escalations.



Michelle Dickens, deputy CEO, and Johette Smuts, head of data analytics, at PayProp

Michelle Dickens, deputy CEO of PayProp, suggests that, “Savvy landlords and property managers can add real value by future-proofing their investments. For example, investment in infrastructure such as alternative energy and smart energy utilisation will enable cost savings in utility costs and other property expenses.”

Trend 1: Rent escalation and inflation mismatch impacts affordability

Pre-pandemic, the South African tenant endured rental escalations of 3.5 to 4.5% – similar to inflation at the time.

The ensuing pandemic period had a dramatic effect on rental escalation, which disconcertingly turned negative (-0.3% YoY in November 2020). Meanwhile, inflation (Consumer Price Index or CPI) bottomed out at 2.1% in May 2020.

Inflation is currently soaring again at 7.6%, but landlords are being left behind with rental escalation achieving a mere 3.1% in August 2022 and dropping lower to 2.6% in September 2022.

Landlords are feeling the pressure with the combined effects of low rental escalation, but property expenses (such as levies and municipal charges) increasing at higher-than-inflation rates, and most notably now, increasing interest rates.



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Trend 2: Rising interest rates worsen debt-to-income ratio and drive down rental escalation

The second trend which will impact the real estate market in 2023 is rising interest rates. Tenant affordability will come under pressure as tenant's debt obligations to their credit providers will notch up with each interest rate hike.

And as interest rates spike, there's downward pressure on rental escalation at the same time.

Johette Smuts, PayProp head of data analytics, notes that, "Tenants who downscale are becoming more common, as reported in the *PayProp State of the Rental Industry Survey*, in which one in three tenants reported moving to more affordable homes."

Importantly, tenants' debt-to-income ratio hovered between 42-48% pre-pandemic. The low interest rate cycle of 2020 and 2021 helped curb this, giving tenants the chance to save on interest-related repayments. Tenants' debt-to-income ratio accordingly fell to 37% during this time.

But as inflation started to rise in mid-2021 and interest rates did the same in November 2021, so too did the tenant debt-to-income ratio, which breached 48% by the beginning of 2022.

"This reinforced the overarching trend of affordability being the real driver behind the real estate market in 2023," says Dickens.



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How energy efficiency can help alleviate the affordability crunch

Now more than ever, energy efficiency and alternative energy are key considerations for both tenants and landlords, Dickens continues.

"Property managers are at the coal face of managing monthly meter readings, readings between occupants, as well as collection and disbursements of the flow of money between utility providers, tenants and owners," she says. "Accordingly, they have a fiduciary responsibility to ensure accuracy and transparency of the reconciliation of money between the parties."

The role of proptech: scale and efficiency

Dickens says proptech and fintech are fundamental to real estate sustainability through efficiency.

“One area of this is energy efficiency. Proptech, which integrates with smart meters to facilitate data analysis, seamlessly provides tenants and landlords with the intelligence to inform their own energy utilisation, which enables tenants to better budget on monthly utility costs. Landlords benefit through monitoring for excessive or zero consumption as a result of a breach of the smart meter.”

"Proptech drives efficiencies for property managers, enabling them to operate at a higher scale and grow their businesses, as well as reduce costs in an environment where affordability is the leading driver of real estate in 2023," concludes Dickens.

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