

Access to housing finance in South Africa: a review of the past five years

Prepared for the FinMark Trust and the Centre
for Affordable Housing Finance in Africa by
Eighty20 Consulting

7 September 2011

Agenda

A brief chronology

What is housing finance

A quick overview of the analysis

Some lessons learned

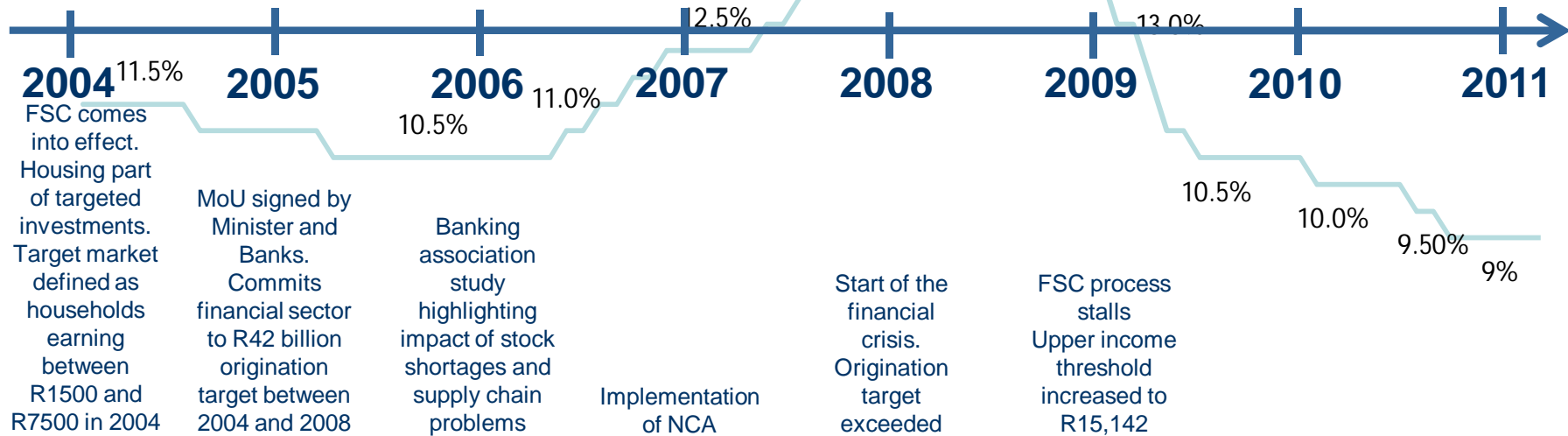
Five papers have been prepared on access to housing finance. In addition new analysis on the performance of FSC mortgages has recently been published



Analysis

June 2005 First paper. Uses FinScope data to explore characteristics of FSC target market	April 2006 Second paper uses FinScope and supply-side data to develop an access frontier for mortgages	August 2007 Third paper Updates mortgage access frontier using FinScope. Includes analysis of access to PBLs and unsecured loans	March 2009 Fourth paper Analysis based on Income and Expenditure Survey. Incorporates sensitivities based on house prices and other key access variables	May 2010 Fifth paper Focuses on performance as well as access. Attempts to get supply-side data to answer key questions	August 2011 Publication of analysis of performance of FSC mortgages using credit bureau data
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Industry



Predominant rate on new mortgage loans

2004
FSC comes into effect. Housing part of targeted investments. Target market defined as households earning between R1500 and R7500 in 2004

2005
MoU signed by Minister and Banks. Commits financial sector to R42 billion origination target between 2004 and 2008

2006
Banking association study highlighting impact of stock shortages and supply chain problems

2007
Implementation of NCA

2008
Start of the financial crisis. Origination target exceeded

2009
FSC process stalls. Upper income threshold increased to R15,142

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It is useful to clarify what we mean by housing finance. Is housing finance for housing, or secured by housing? Do we care what kind of housing?



Housing finance products in South Africa

Mortgage finance

- Can be finance for housing or finance secured by housing (and used for another purpose)
- The value of the residential mortgage book at March 2011 was R769.89 billion (63.58% of all consumer credit)
- There are 1.814 million residential mortgages
- Between 10-13% of households have a mortgage
- Of the 24.759 billion mortgage credit extended in Q1 2011, 92.99% by value (82.43% of accounts) went to borrowers who earn more than R15,000 a month

Fully secured or pension backed loans

- Housing loans guaranteed by pension fund
- No accurate estimates of the size of the market
- Various studies indicate the value of the book could be around R17 billion

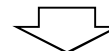
Unsecured housing loans

- No accurate estimates of the size of the market
- Researchers estimate that between 10% and 30% of unsecured loans are used for housing
- According to the NCR as at March 2011 the total value of the unsecured loans book was R80.864 billion (between R8-R24 billion for housing?).
- Of the R16.685 billion granted in Q1 2011, 35.76% by value (20.74% of accounts) went to borrowers who earn more than R15,000 per month

Savings

- No supply-side data on extent of savings for housing
- Can be critical for access to mortgages or to finance incremental housing investment

Facilitate incremental housing investment



Increase / improve stock of housing units

Agenda

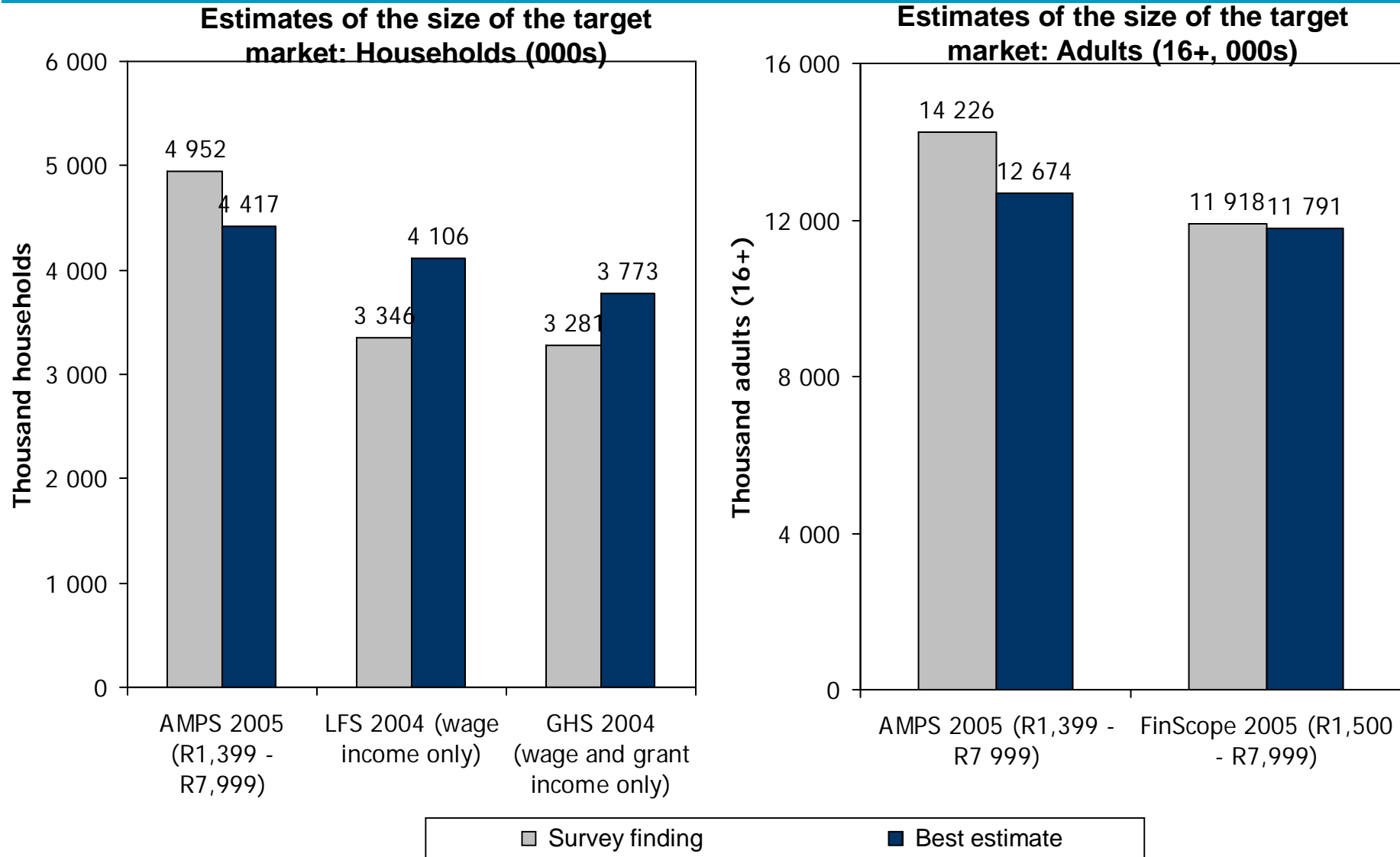
A brief chronology

What is housing finance

A quick overview of the analysis

Some lessons learned

The 2006 report used a range of data sources to size the FSC target market...

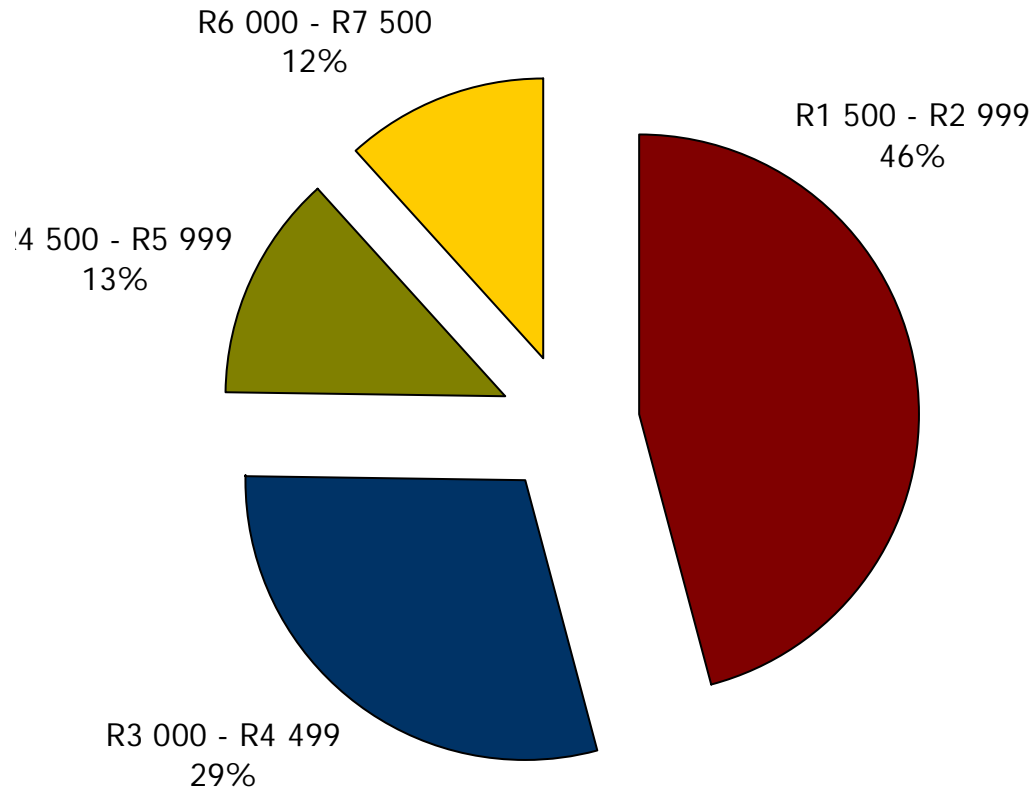


Source: Labour Force Survey September 2004, General Household Survey 2004, All Media and Products Survey 2005, FinScope 2005

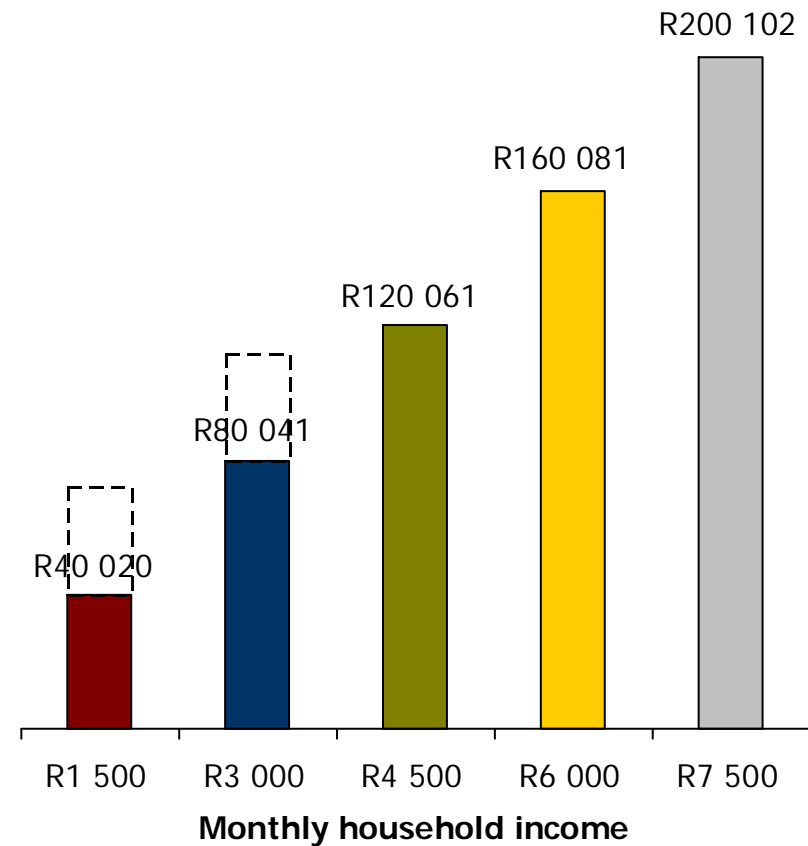
And to characterise it in terms of income and affordability




Distribution of households by monthly household income

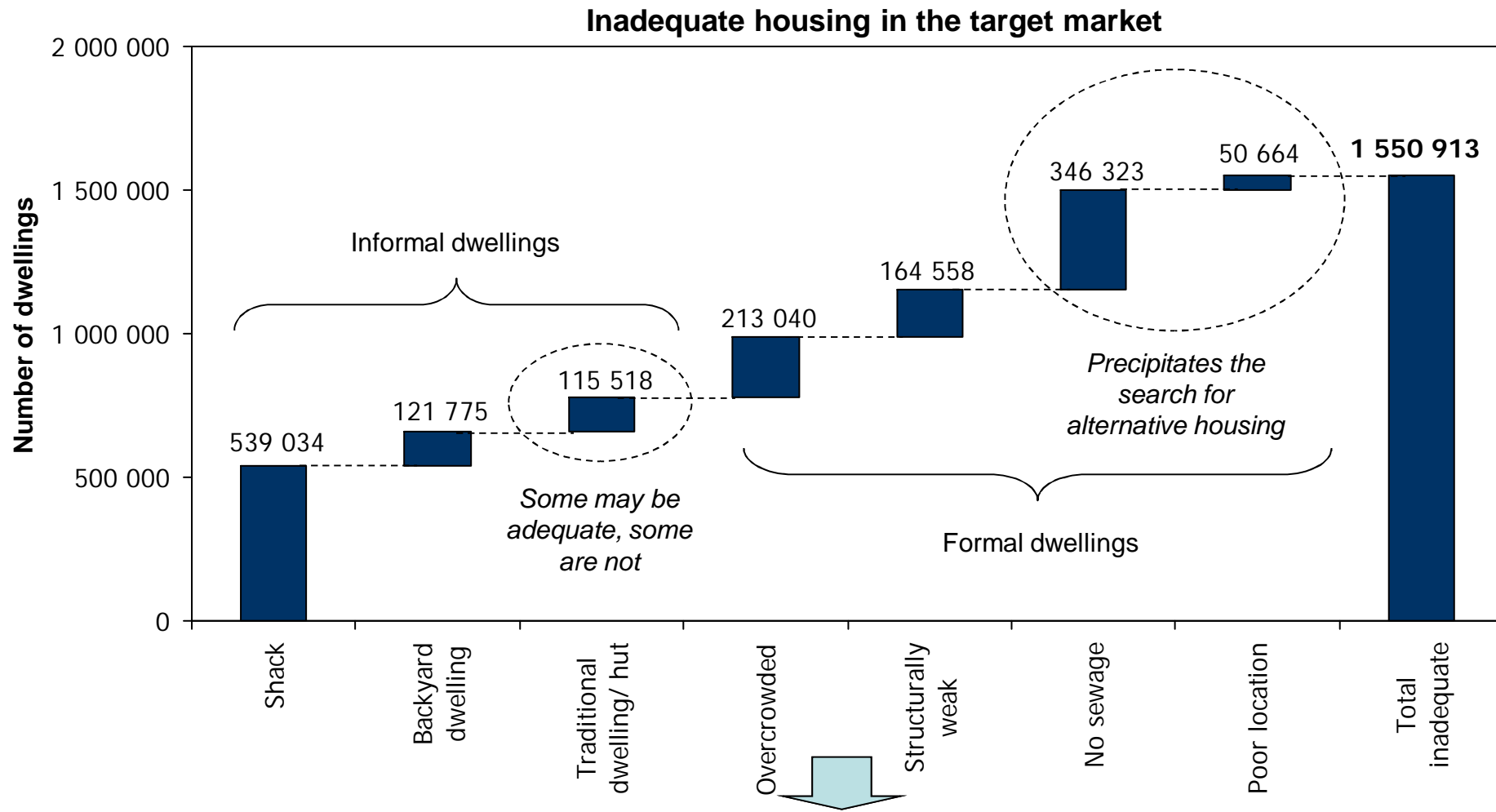


Maximum loan values (12.5%, 20-year loan, installment = 30% of income)



 Housing subsidy

Source: Labour Force Survey September 2004



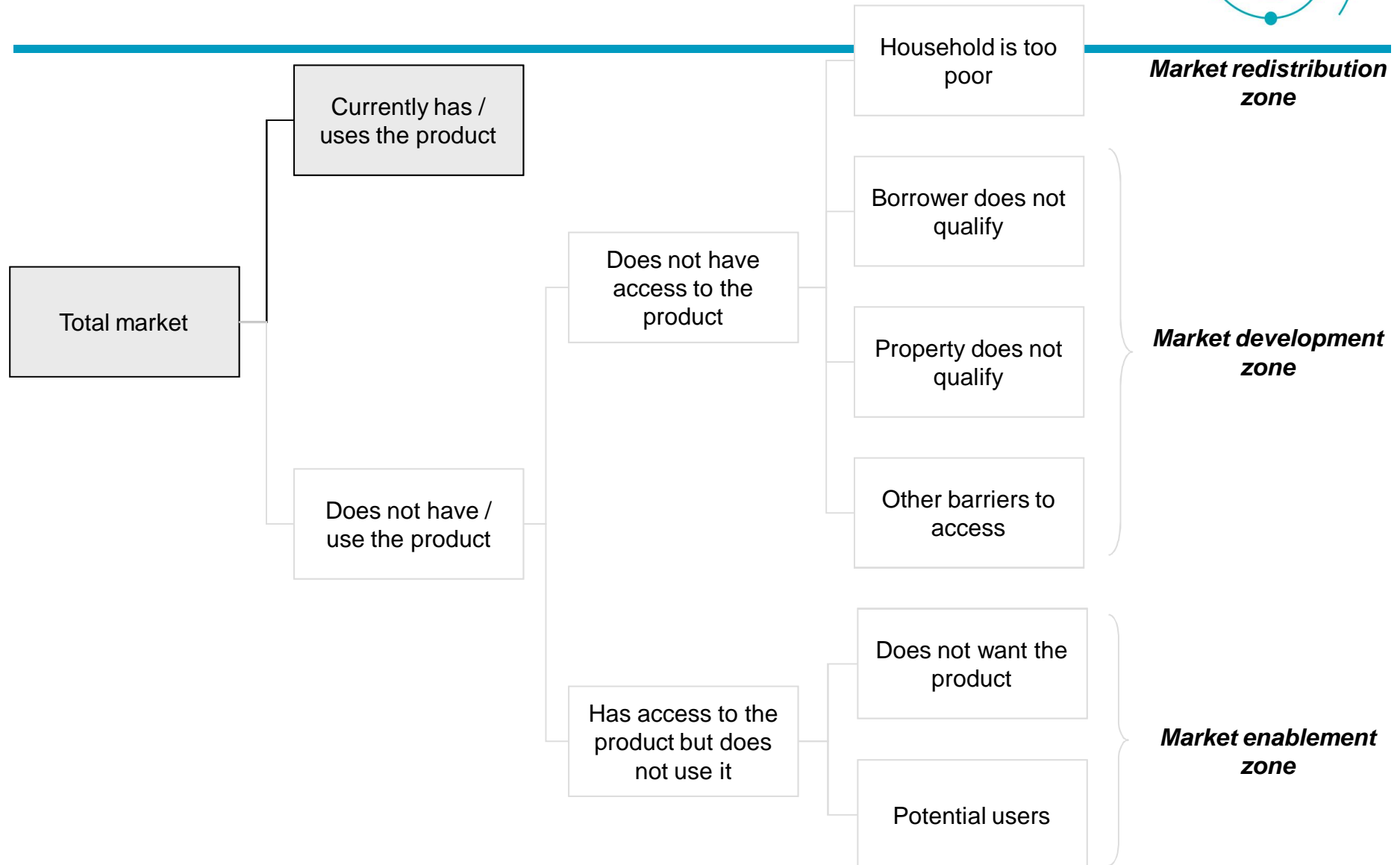
A range of housing finance solutions is required

The research also gathered some supply-side data on the nature of products available. This allowed for the development of an access frontier



	Loan term and size	Interest rate	Deposit and LTV	Qualifying criteria
ABSA (My Home)	<ul style="list-style-type: none"> - Typical term: 20 years, max term: 30 years - Min size: R20 000, max size: Subject to affordability 	<ul style="list-style-type: none"> - Variable rate: Prime linked (lowest rate is prime), based on risk - Convertible adjustable rate: Option of 5 year fixed rate at base rate +2 	<ul style="list-style-type: none"> - No deposit necessary if sufficient collateral is in place (HLGC 5 year collateral insurance or employer guarantee) - Maximum LTV is 110% 	<ul style="list-style-type: none"> - Single or joint regular monthly income of R1 500 – R7 500 - Must repay loan before retirement
FNB (Smart Bond)	<ul style="list-style-type: none"> - Typical term: 20 years, max term: 30 years - Min size: R20 000, max size: R240 000 	<ul style="list-style-type: none"> - Variable rate: Prime linked (will provide loans below prime), based on risk - Convertible adjustable rate: Option of 5 year fixed rate at base rate + 1-1.5 	<ul style="list-style-type: none"> - No deposit necessary if sufficient collateral is in place (HLGC 5 year collateral insurance or employer guarantee) - Maximum LTV is 108% 	<ul style="list-style-type: none"> - Single or joint regular monthly income of R2 500 – R10 000 - Must repay loan before retirement
Nedbank	<ul style="list-style-type: none"> - Subject to affordability 	<ul style="list-style-type: none"> - Variable rate: Prime linked - Convertible adjustable rate: Option of 5 year fixed rate. Pricing depends on risk 	<ul style="list-style-type: none"> - Deposit requirement determined on the merits of each application. Other collateral will be considered - Maximum LTV is 108% 	<ul style="list-style-type: none"> - Single or joint regular monthly income of R5 000+
Standard Bank (Dream start)	<ul style="list-style-type: none"> - Typical term: 20 years - Max term: 30 years - Size subject to affordability 	<ul style="list-style-type: none"> - Variable rate: Prime linked (lowest rate is prime less a quarter), based on risk - Convertible adjustable rate: Option of 2 year fixed rate at base rate + 1 	<ul style="list-style-type: none"> - No deposit necessary if sufficient collateral is in place (HLGC 5 year collateral insurance or employer guarantee) - Maximum LTV is 103% 	<ul style="list-style-type: none"> - Single or joint regular monthly income of R1 500 – R6 000 - One year stable employment - Must repay loan before retirement
Beehive	<ul style="list-style-type: none"> - Term: 12 years - Min size: R20 000, max size: R150 000 	<ul style="list-style-type: none"> - Fixed rate at 17% pa 	<ul style="list-style-type: none"> - No deposit necessary if sufficient collateral is in place (State guarantee or cession of pension fund) 	<ul style="list-style-type: none"> - First time homebuyer - Single or joint regular monthly income of less than R10 000 - Mostly government employees
Green-start	<ul style="list-style-type: none"> - Term: 15 or 20 years (2 products) - Min size: R30 000, max size: R230 000 	<ul style="list-style-type: none"> - Variable rate linked to prime. No fixed rate option 	<ul style="list-style-type: none"> - 10% deposit or collateral in the form of employer guarantee (20%) 	<ul style="list-style-type: none"> - First time homebuyer - Single or joint regular monthly income of R1 750 – R7 500 - Formal employment - Must repay loan before retirement
Mpumalanga Housing Finance	<ul style="list-style-type: none"> - Term: 5 years - Min size: R20 000, max size: R36 000 	<ul style="list-style-type: none"> - Fixed rate at 16% pa 	<ul style="list-style-type: none"> - 5% deposit or collateral in the form of employer guarantee or HLGC collateral insurance 	<ul style="list-style-type: none"> - Single or joint regular monthly income of R1 500 – R3 500 - Must repay loan before retirement - House must be in Mpumalanga

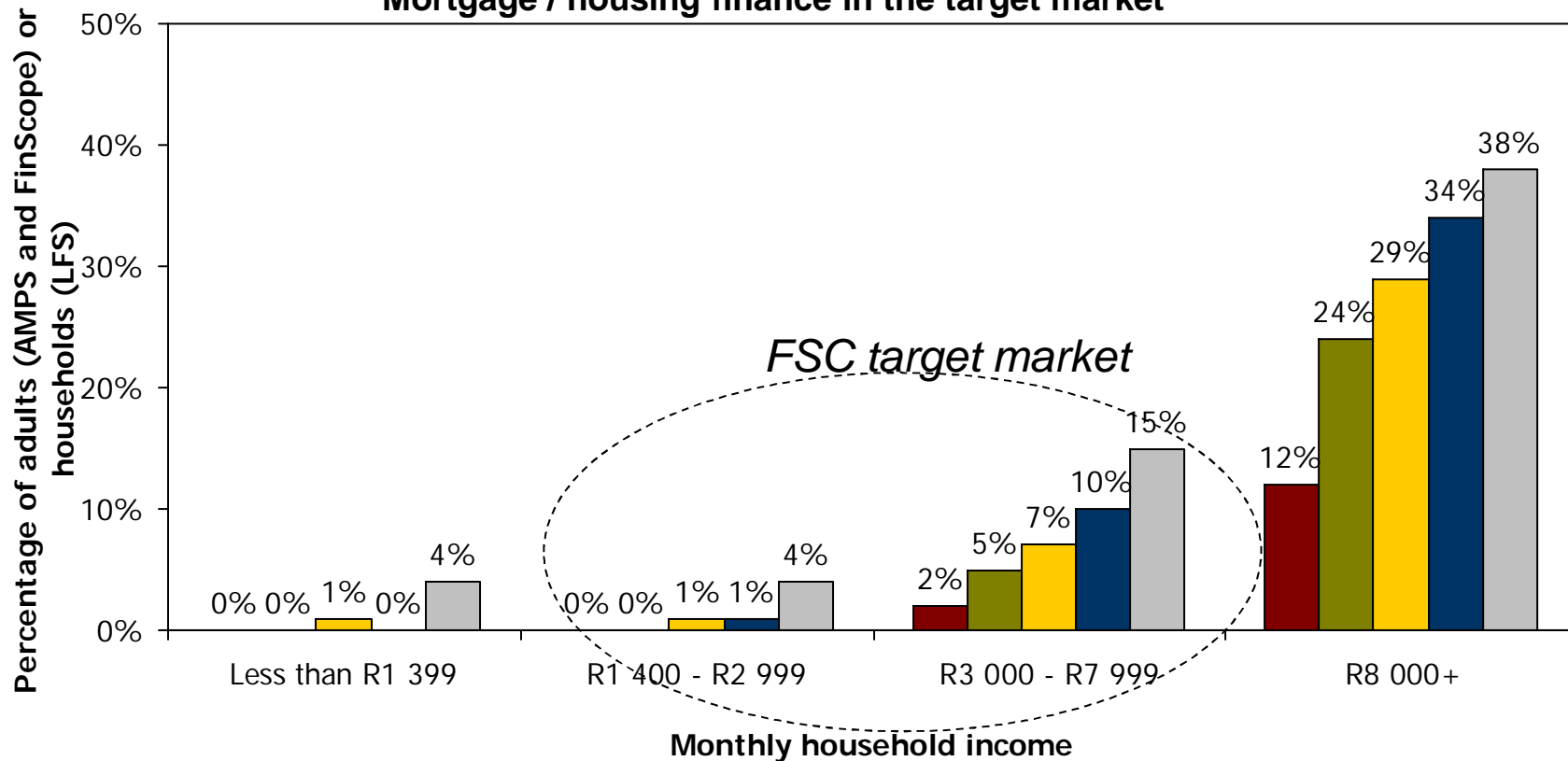
Populating the access frontier



Based on a paper entitled "The Access Frontier as an Approach and Tool in Making Markets Work for the Poor" by David Porteous



Mortgage / housing finance in the target market



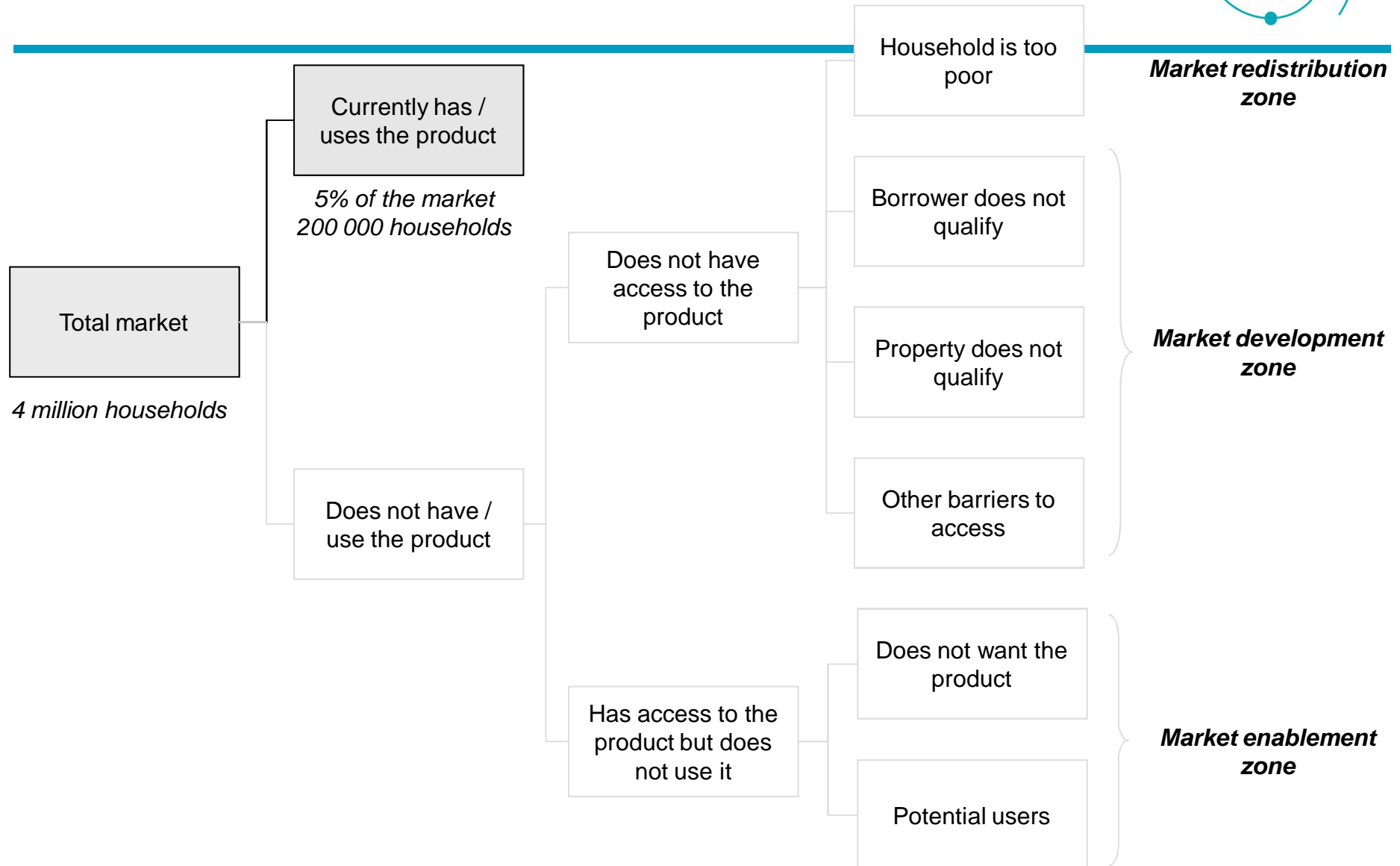
- AMPS - personally have a home loan / mortgage
- FinScope - personally have a home loan / mortgage
- FinScope - household makes bond repayments
- FinScope - Household head has a home loan
- LFS - house owned but not fully paid off



Best estimate of mortgage penetration in the target market: 5%

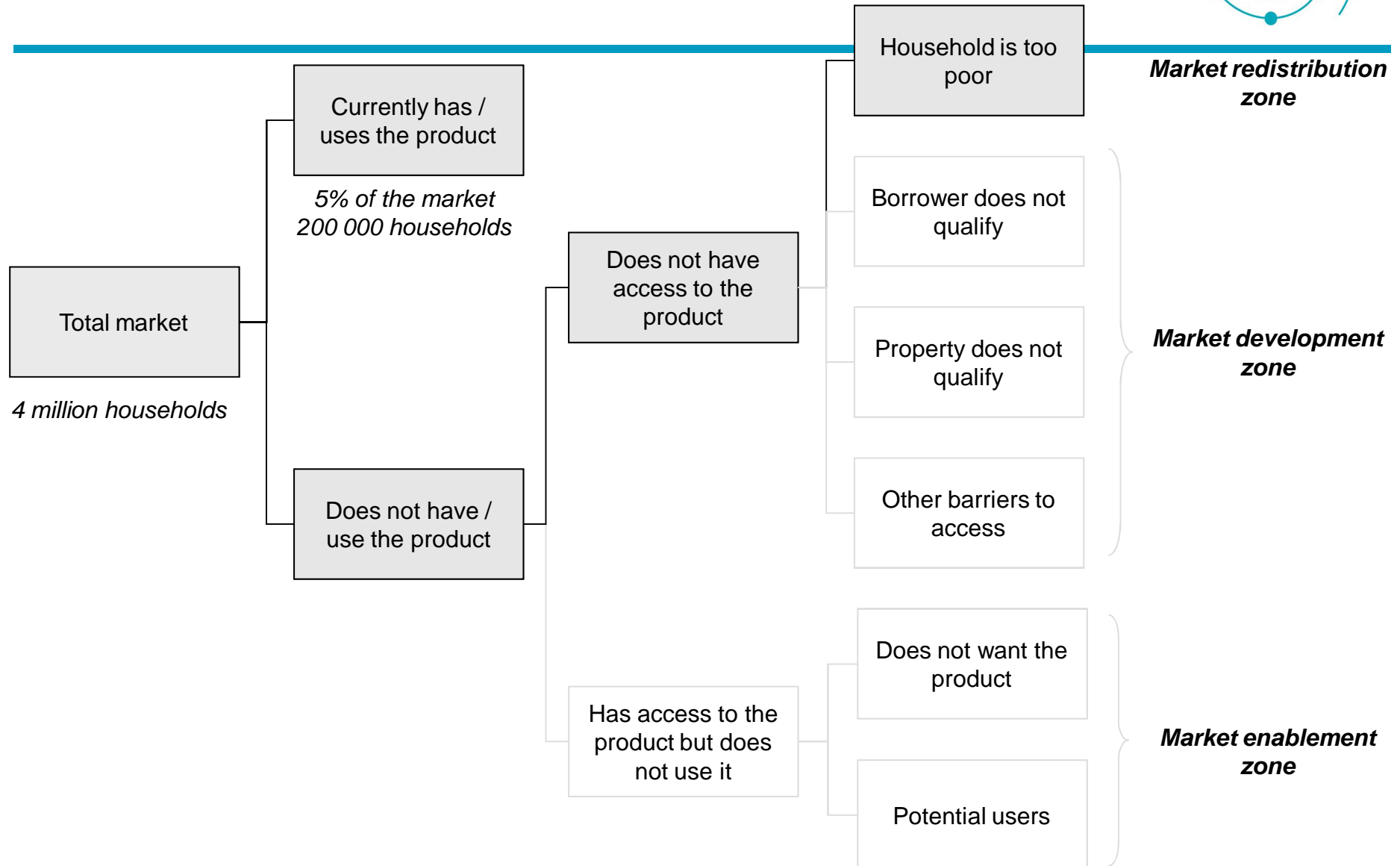
Source: AMPS 2005 RA, LFS 2004, FinScope 2005

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Populating the access frontier

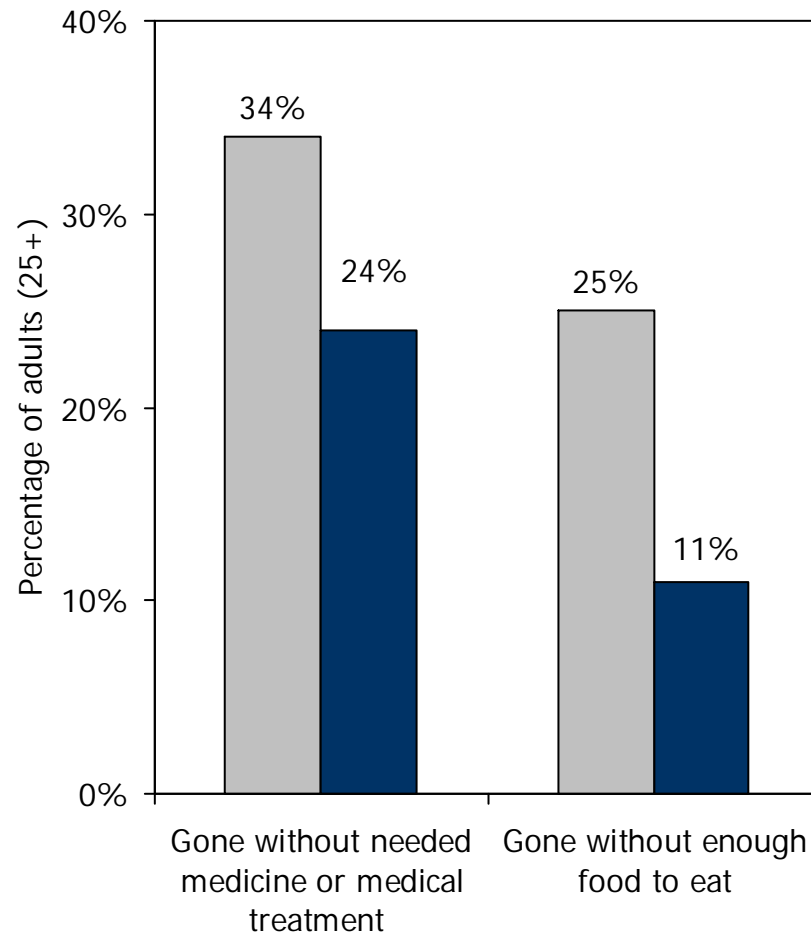


Based on a paper entitled "The Access Frontier as an Approach and Tool in Making Markets Work for the Poor" by David Porteous

Various FinScope proxies were used to identify those in the market redistribution zone



Adults (25+) in households in the target market that have sometimes or often..



Percentage of households in the target market that sometimes, always or often could not satisfy its food needs in past 12 months



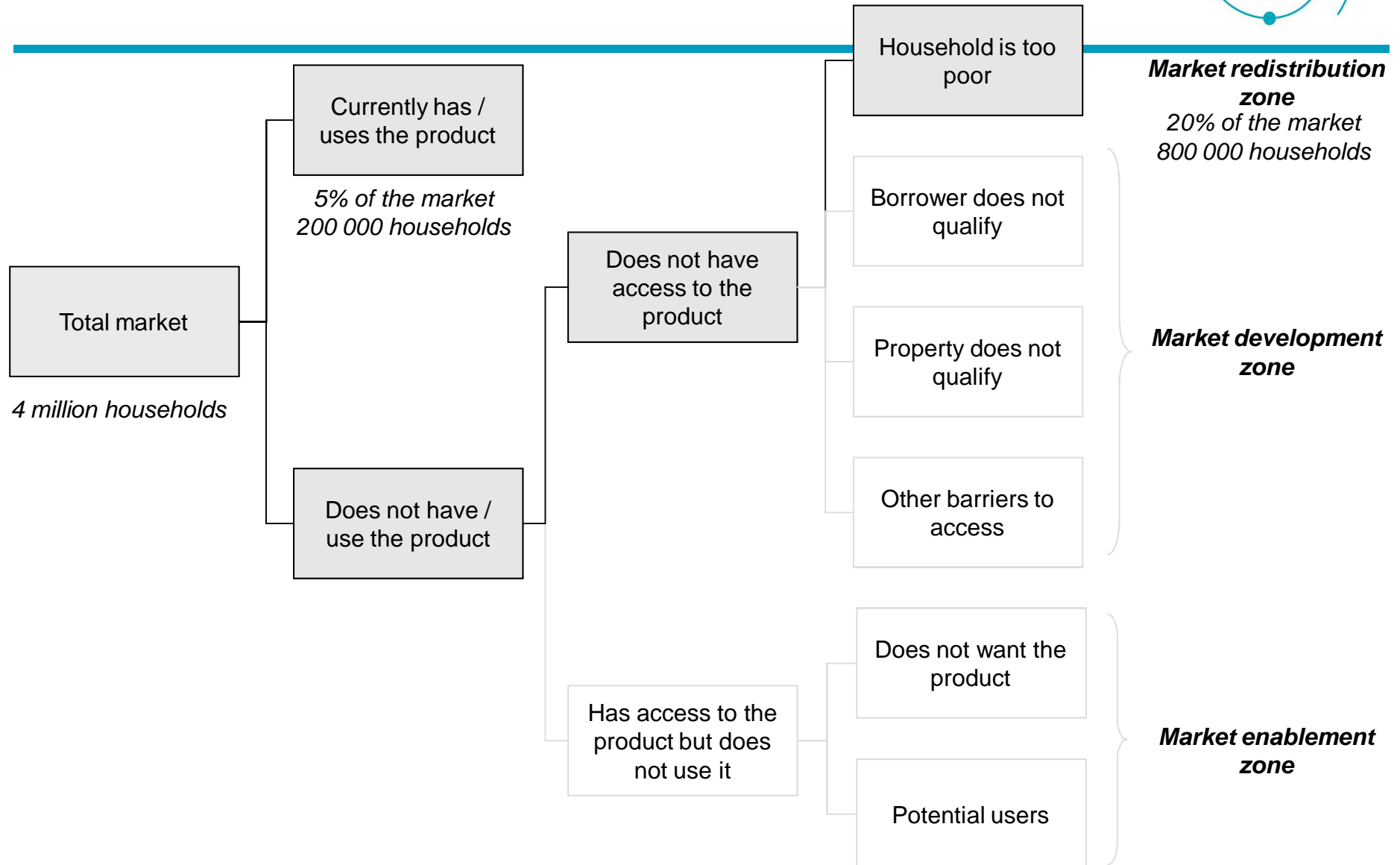
■ Household income: R1 500 - R2 999

■ Household income: R3 000 - R7 499

Source: FinScope 2005, LFS 2004

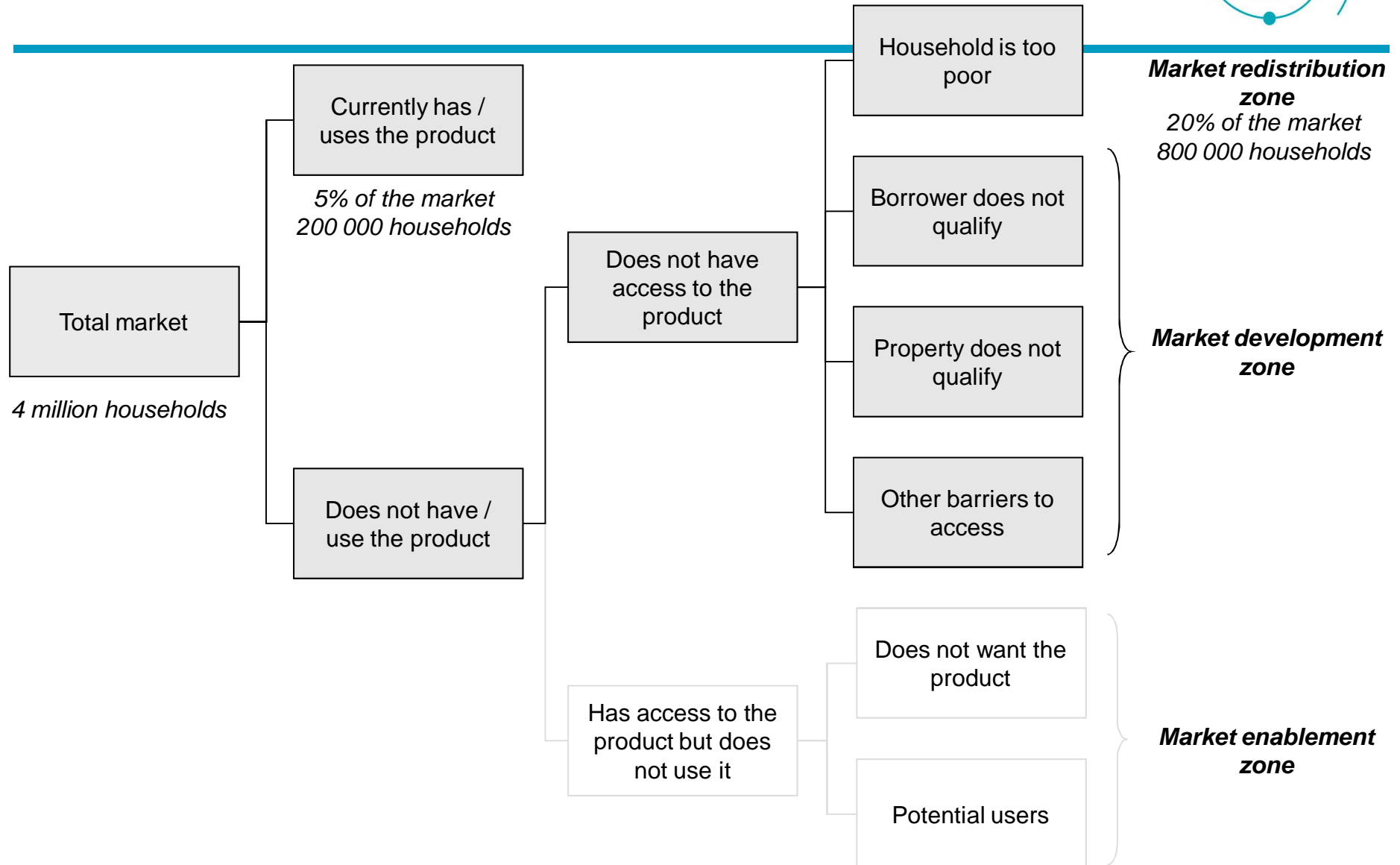
Note: Income category for FinScope is R3 000 – R7 999

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Populating the access frontier

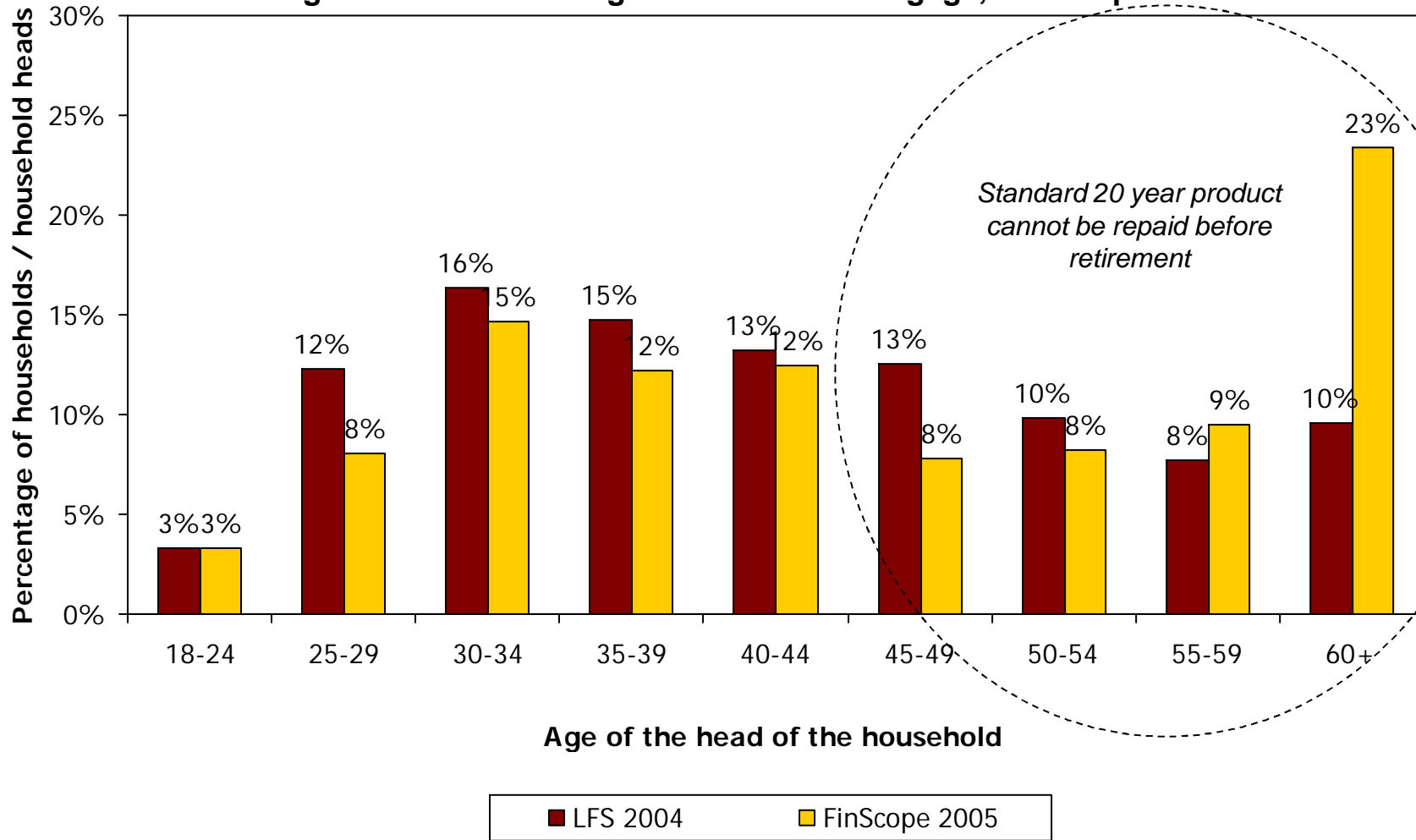


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Between 40 – 50% of those who do not have a mortgage and are not too poor cannot access the standard 20-year mortgage product because they are too old



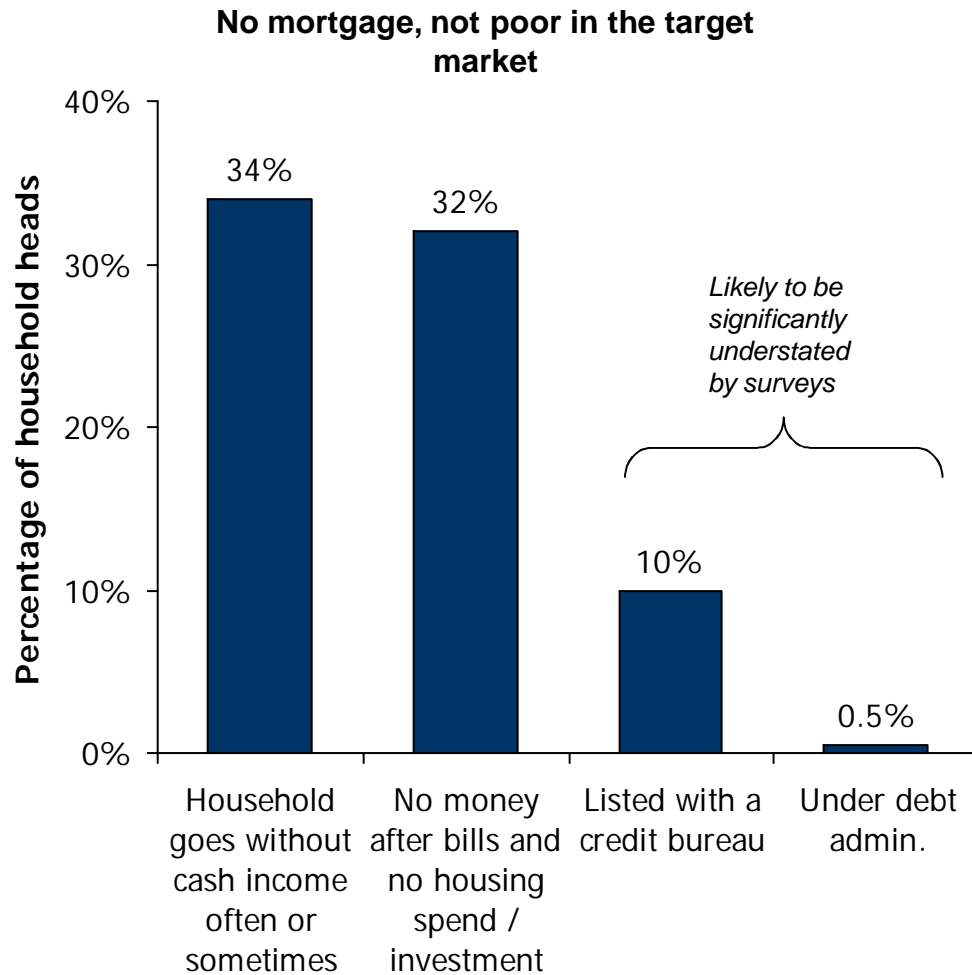
Age distribution in target market: No mortgage, not too poor



Source: LFS 2004, FinScope 2005

Note: Differences between LFS and FinScope arise because the LFS segment includes only wage income, whereas FinScope includes all income sources in the calculation of household income

FinScope data was used to highlight the issue of affordability and credit worthiness at a high level

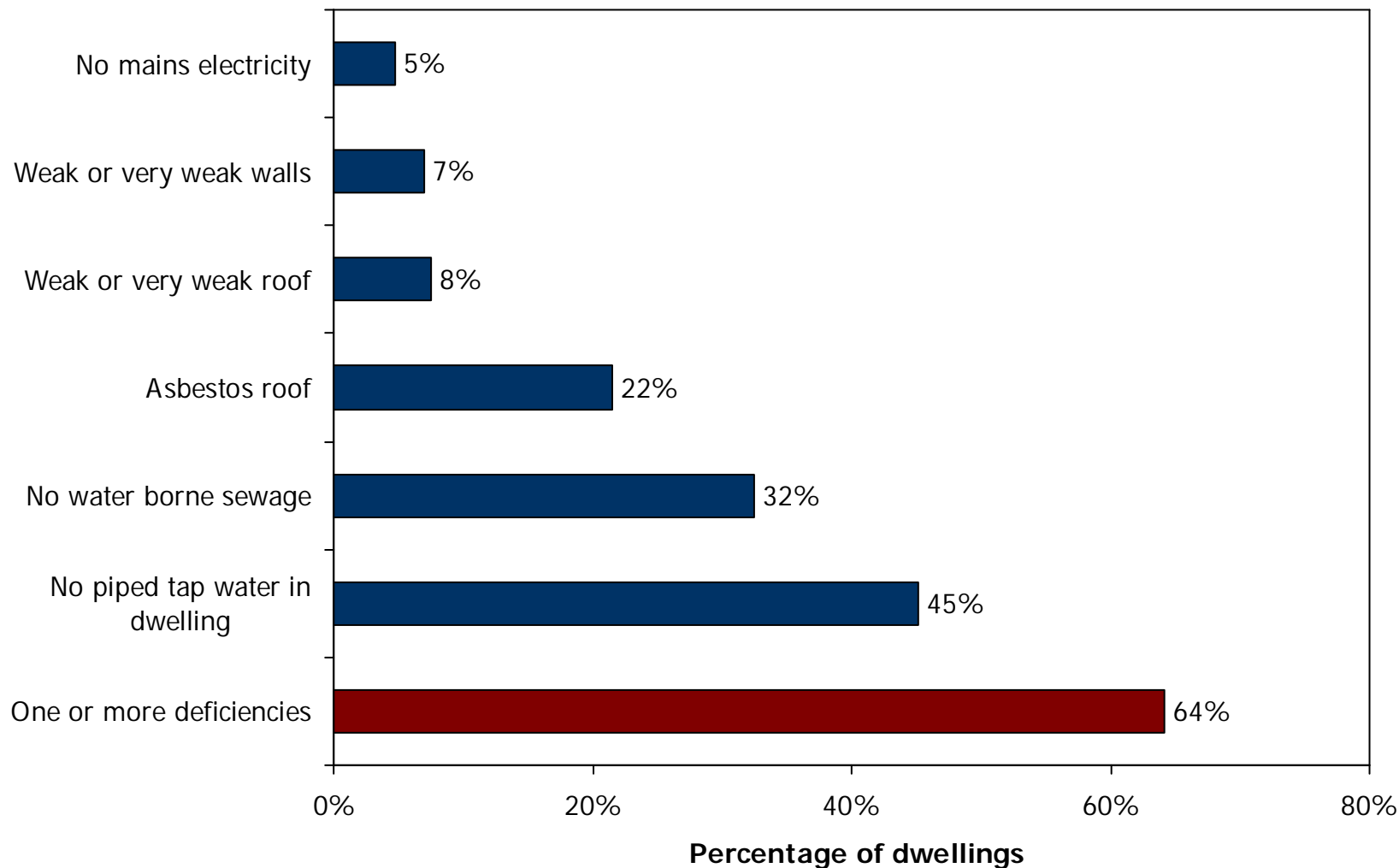


- How many potential borrowers are rejected because of affordability and / or poor credit histories?
- Is there scope for relaxing affordability criteria, particularly in light of the National Credit Bill?

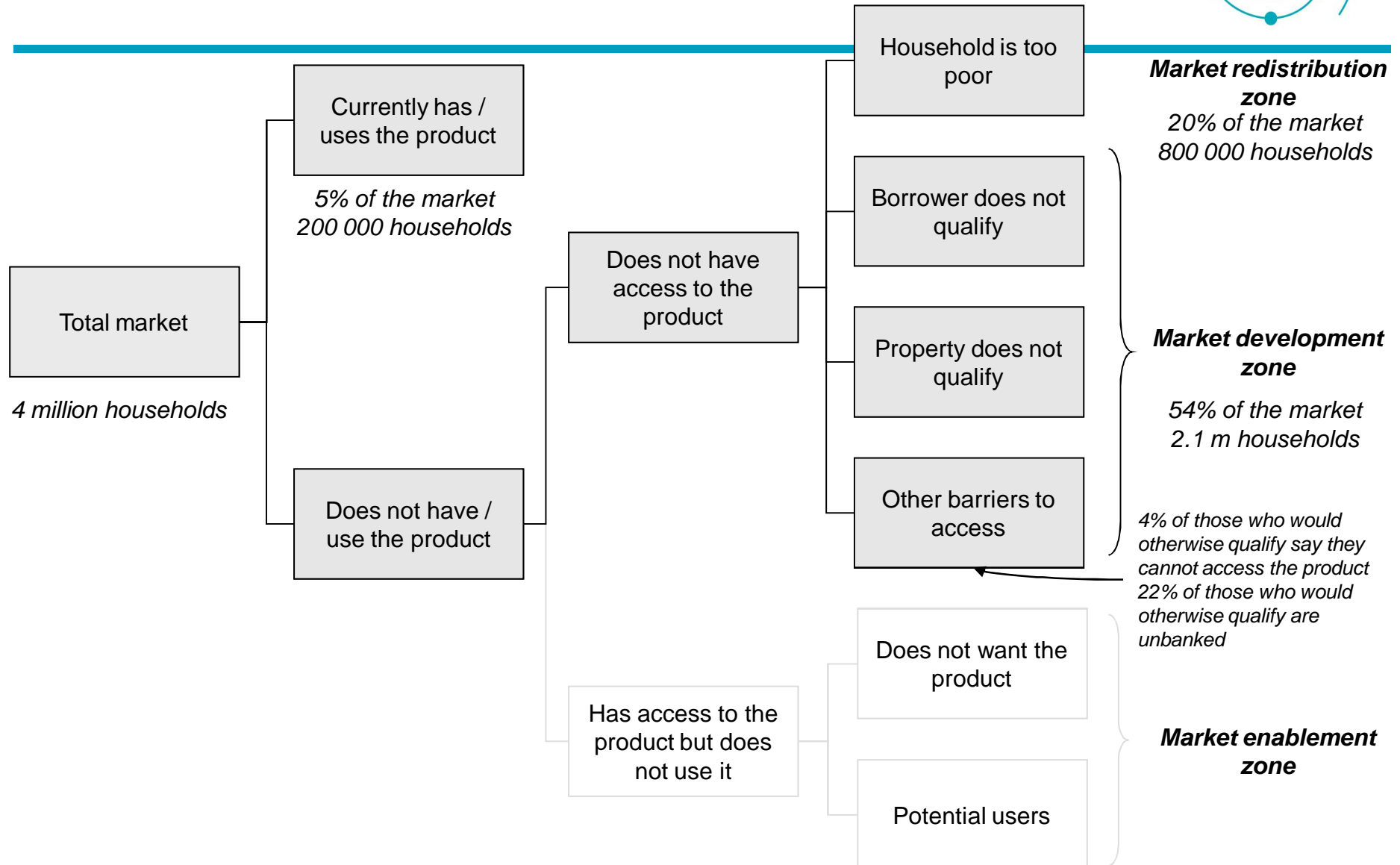
Data from other household surveys was used to explore housing conditions – although this constraint was not explicitly incorporated in the frontier



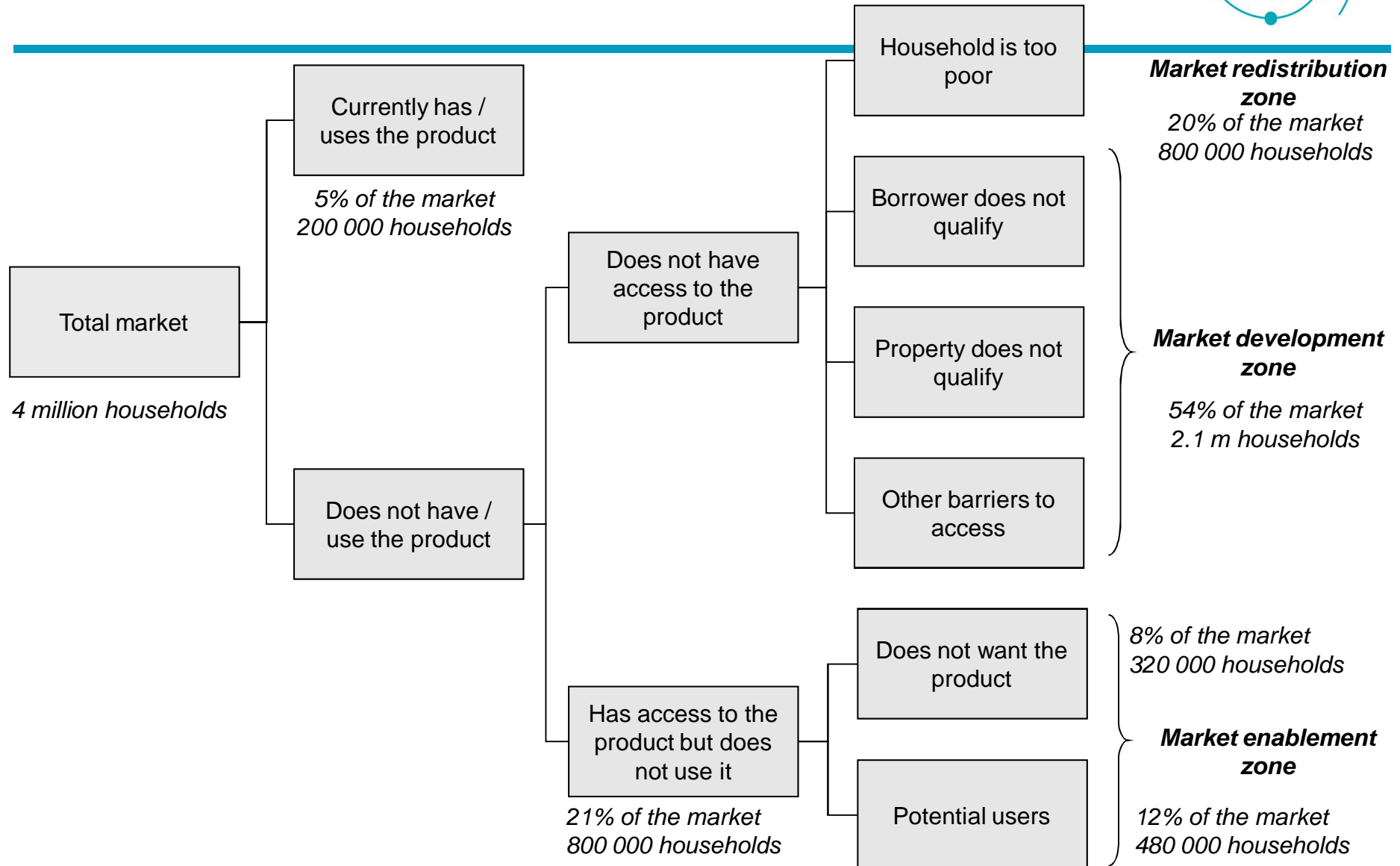
Characteristics of formal, owned houses in the target market



Populating the access frontier

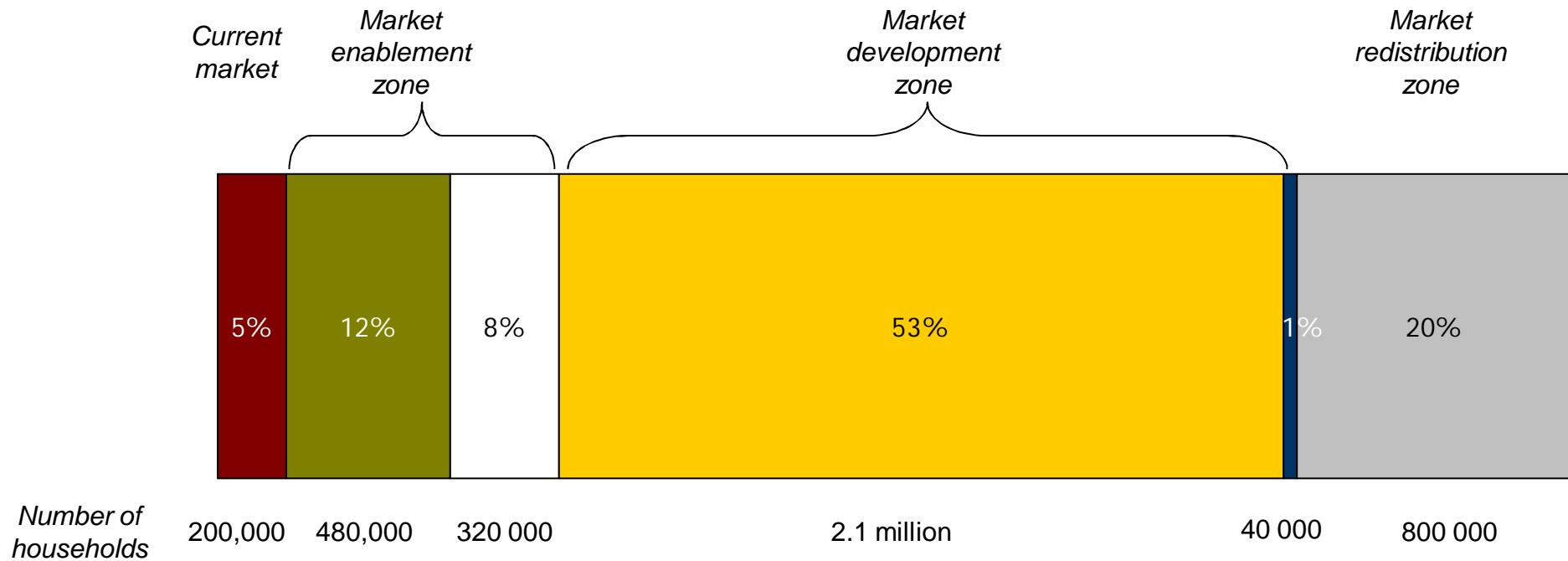


Populating the access frontier



Based on a paper entitled "The Access Frontier as an Approach and Tool in Making Markets Work for the Poor" by David Porteous

The analysis indicated that around 75% of households in the target market did not have access to mortgages



23% single member households
10% live in informal dwellings

- Currently have and use the product
- Have access but do not use
- Do not want a mortgage
- Do not qualify
- Qualify but cannot physically access the product
- Too poor

Note: Totals do not add up to 100% because of rounding

We used the analysis to frame a number of questions



Housing availability

- Is access to mortgages constrained by lack of houses or are there other constraints that would prevent access even if houses were available?
- Data: \pm 480 000 households can access a mortgage, 70 000 affordable mortgages granted each year \Rightarrow Churn is around 15% per annum

Loss limit insurance

- What lender criteria could responsibly be relaxed given the current product profile? How will this be affected by the National Credit Bill?
- Is the LLI primarily about increasing access or about facilitating participation of other FS players in the provision of housing finance principally through securitisation of low-income mortgage loans?
- If the LLI is not principally about access, what is?

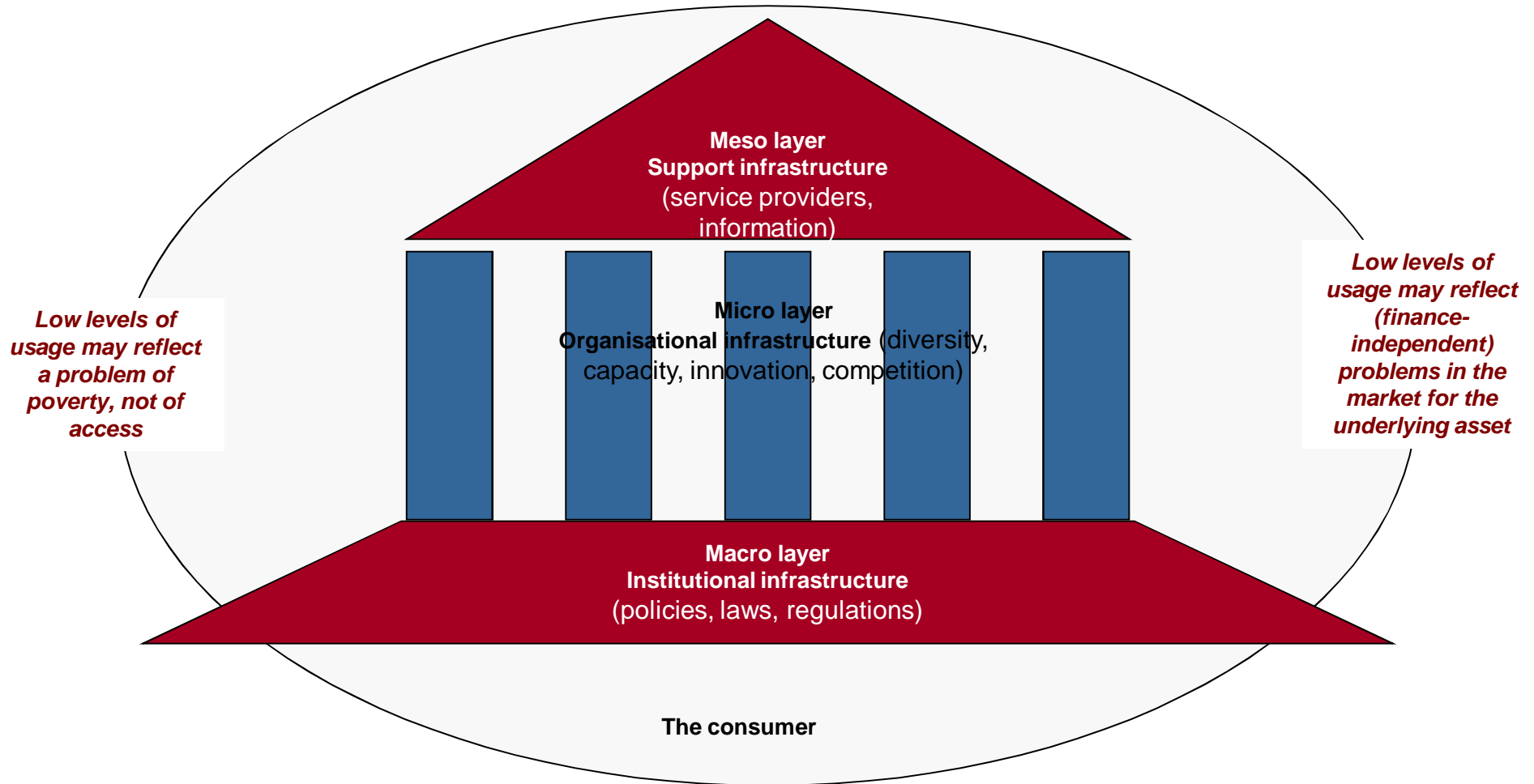
Market needs and bank focus

- Is the focus on the existing mortgage products appropriate given the needs and characteristics of the target market?
- Can banks configure to provide incremental housing loans?
- In what way would bank participation in the provision of incremental housing loans increase access?

Data and disclosure

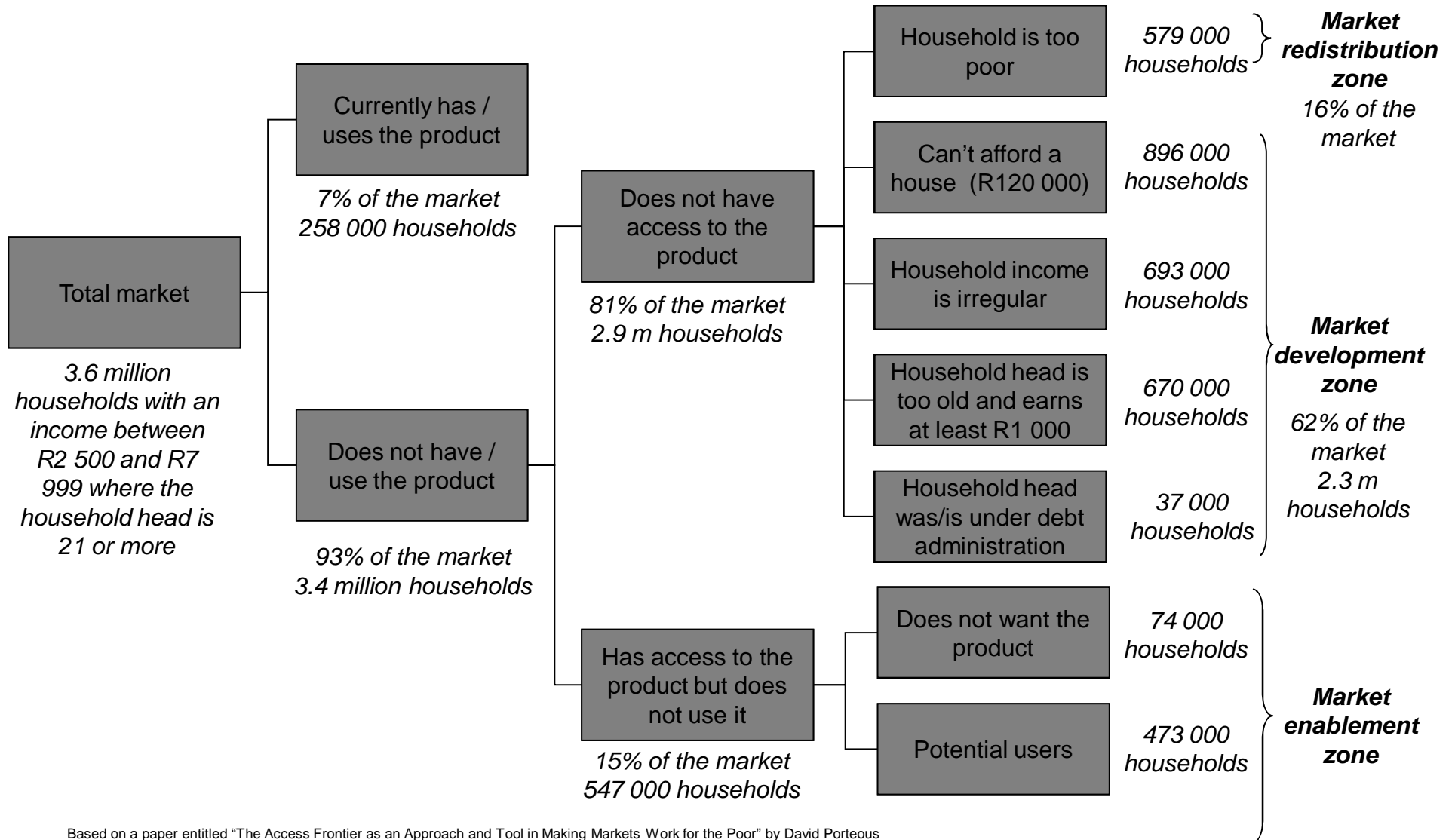
- Why is data on the low-income market so sensitive?
- Need for implementation of HLMDA

The next year we updated the access frontier but explored the difference between problems of access and levels of access



Access problems in credit markets manifest not only in under-utilisation but in over-utilisation

The analysis also explicitly incorporated affordability by assuming a minimum house price



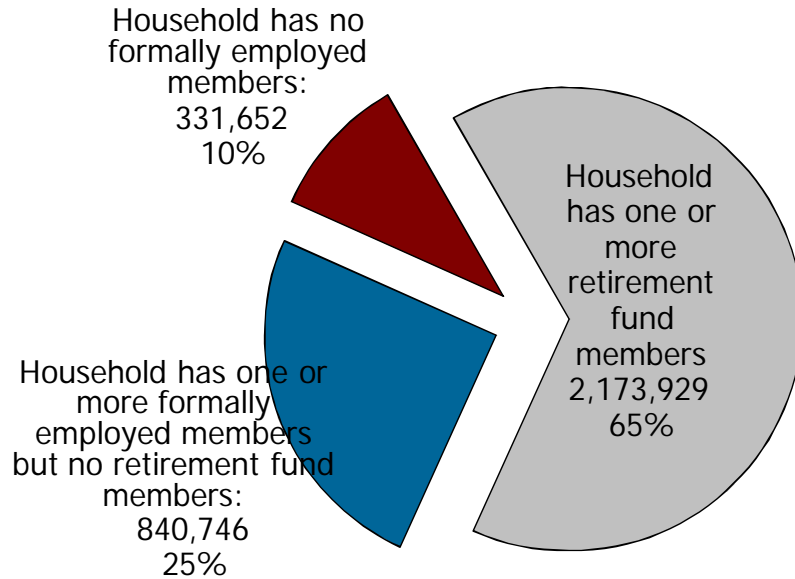
Based on a paper entitled "The Access Frontier as an Approach and Tool in Making Markets Work for the Poor" by David Porteous
 Note: Totals may not add up because of rounding. Source data: FinScope 2006

The analysis also incorporated an access frontier for pension-backed loans



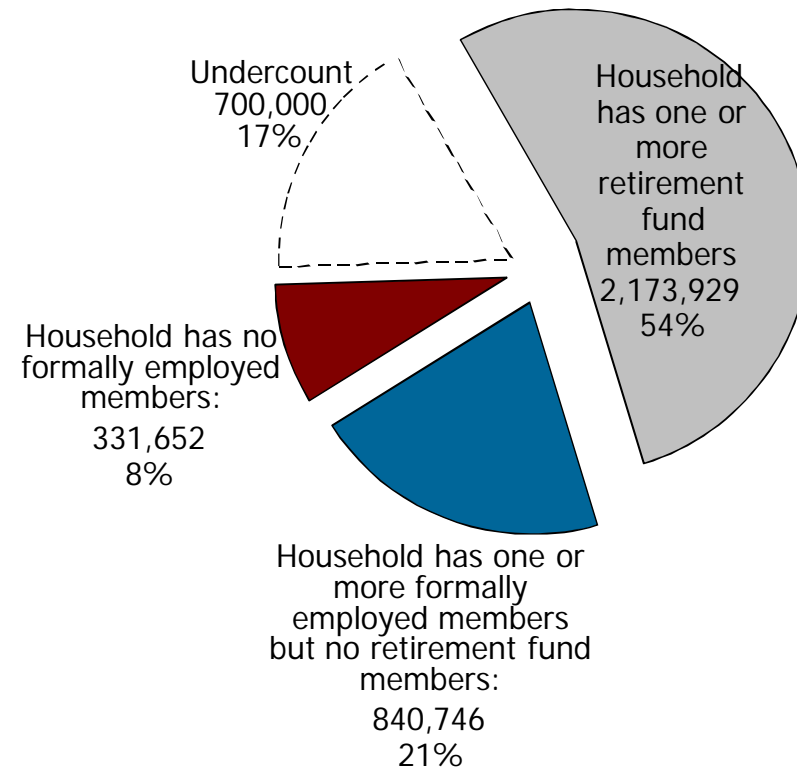
Household level retirement fund membership

(Households with a wage income of R1 500 – R7 500 in 2004)

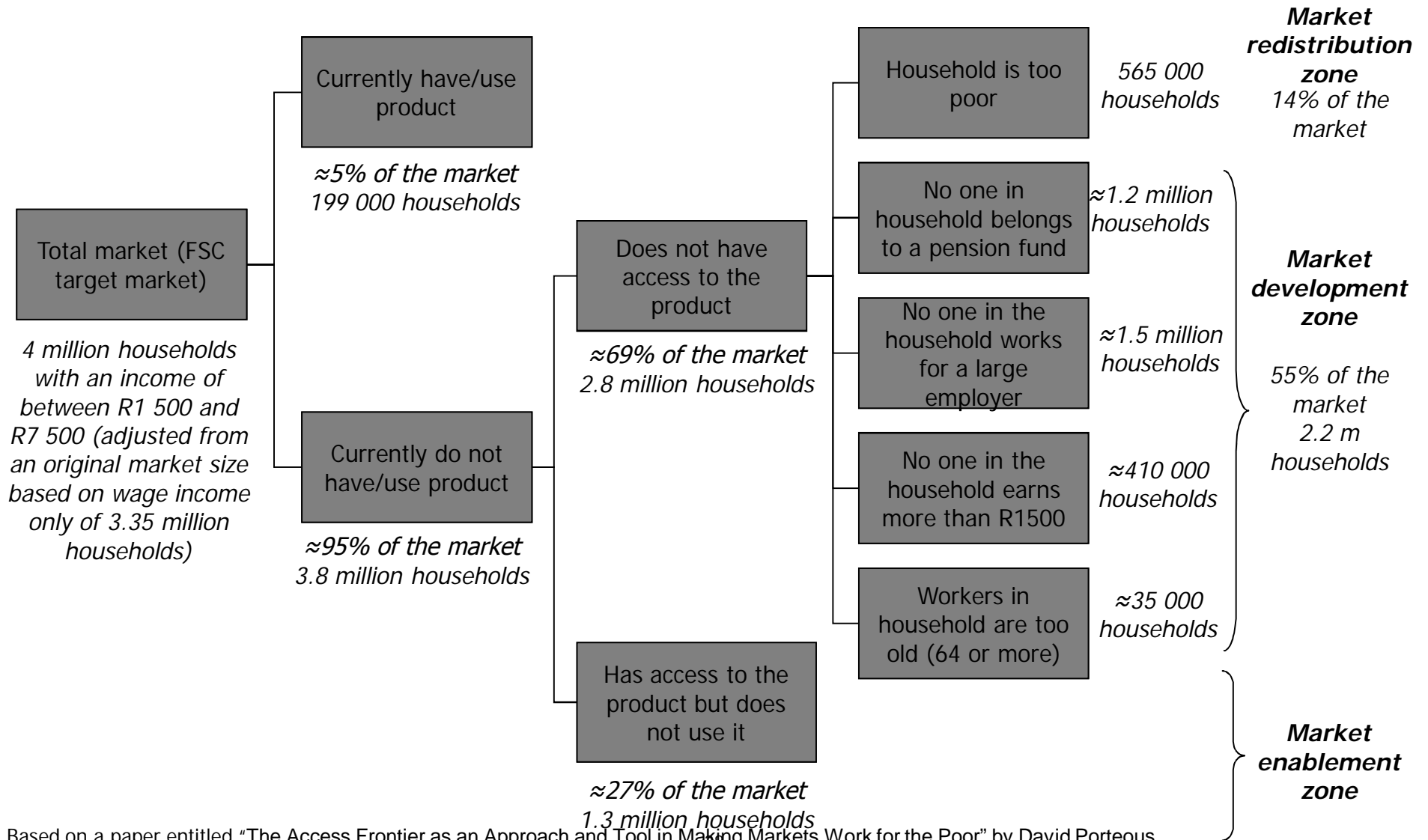


Adjusted household level retirement fund membership

(Households with a total income of R1 500 – R7 500 in 2004)

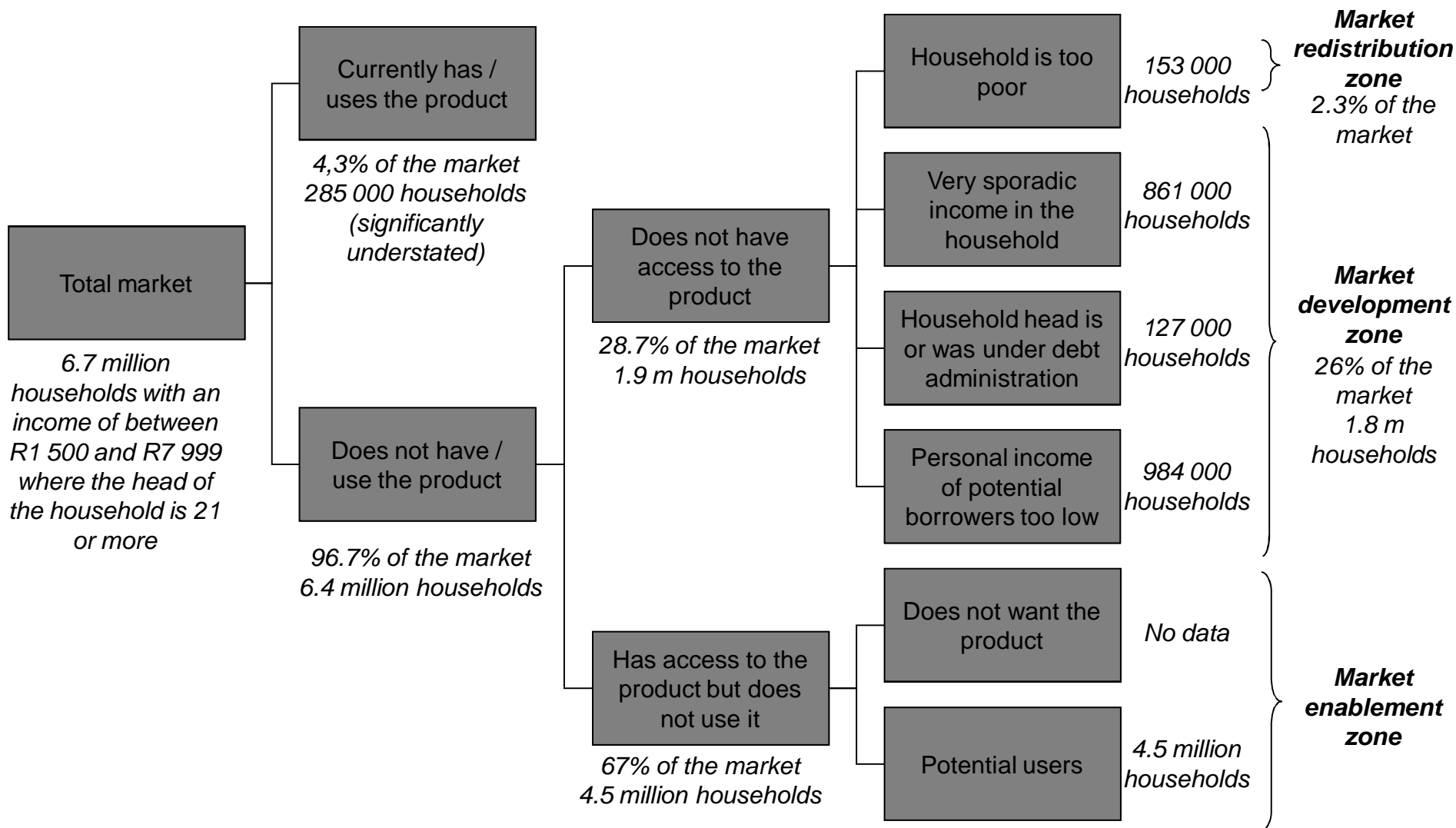


The analysis also incorporated an access frontier for pension-backed loans



Based on a paper entitled "The Access Frontier as an Approach and Tool in Making Markets Work for the Poor" by David Porteous
Source data: LFS Sept 2004

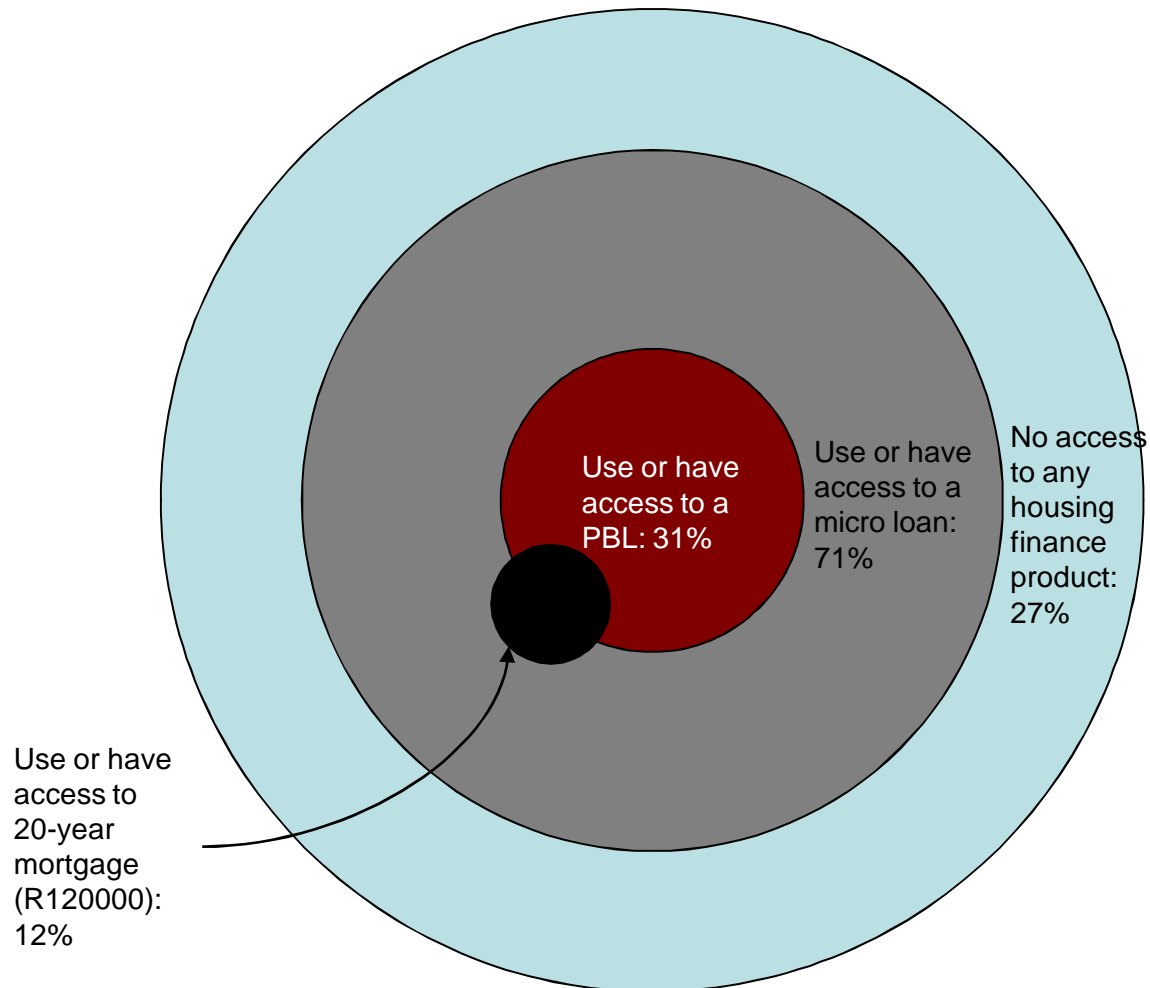
As well as unsecured housing loans



The analysis brought the three credit products together



Estimated level of access to housing finance products in the FSC target market
(Households with an income of R1 500 – R7 999: 6.7 million households)



And took the opportunity to ask another set of questions

New FSC targets

- How will targets be formulated in light of affordability constraints within the target market (NCA, asset price increases, interest rates)?
- How will targets be formulated to limit the bias in favour of larger loans?

Impact of housing subsidies

- What impact do subsidies have on demand for housing finance products?
- What impact does the uncertainty regarding implementation of the FLISP have on product development (both housing and finance)?

Affordability of housing units

- Is there scope to reduce the cost of housing units by increasing density or changing other specifications?
- Given trends in factor costs (and interest rates), what are the implications for access to housing finance for completed units?

Approach to assessing access

- What hypotheses exist with respect to the underlying causes of access problems across the various products?
- What data would be required to test these hypotheses?
- What interventions would be required to alleviate the causes of access problems that do exist?

In 2009 the primary data source for the access analysis was the Income and Expenditure Survey

Own mortgage-able properties



1.8 million households who:

- Say they own their dwellings
- Live in formal dwellings (houses, townhouses or flats) AND
- Live in urban areas

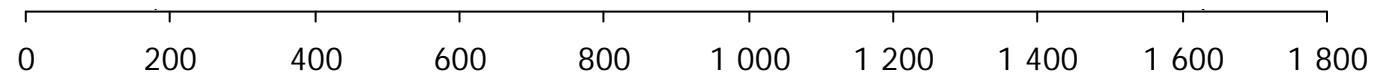
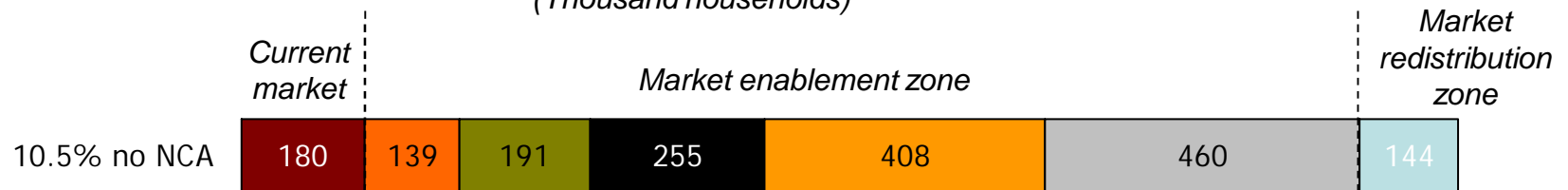


*Use the existing asset to trade up or cash out
The value of the mortgage need not equal the
value of the house*



The analysis incorporated sensitivities relating to house prices and credit market conditions

Access frontier for a bond: Impact of interest rates, NCA and lower LTVs on households who own mortgageable properties
(Thousand households)



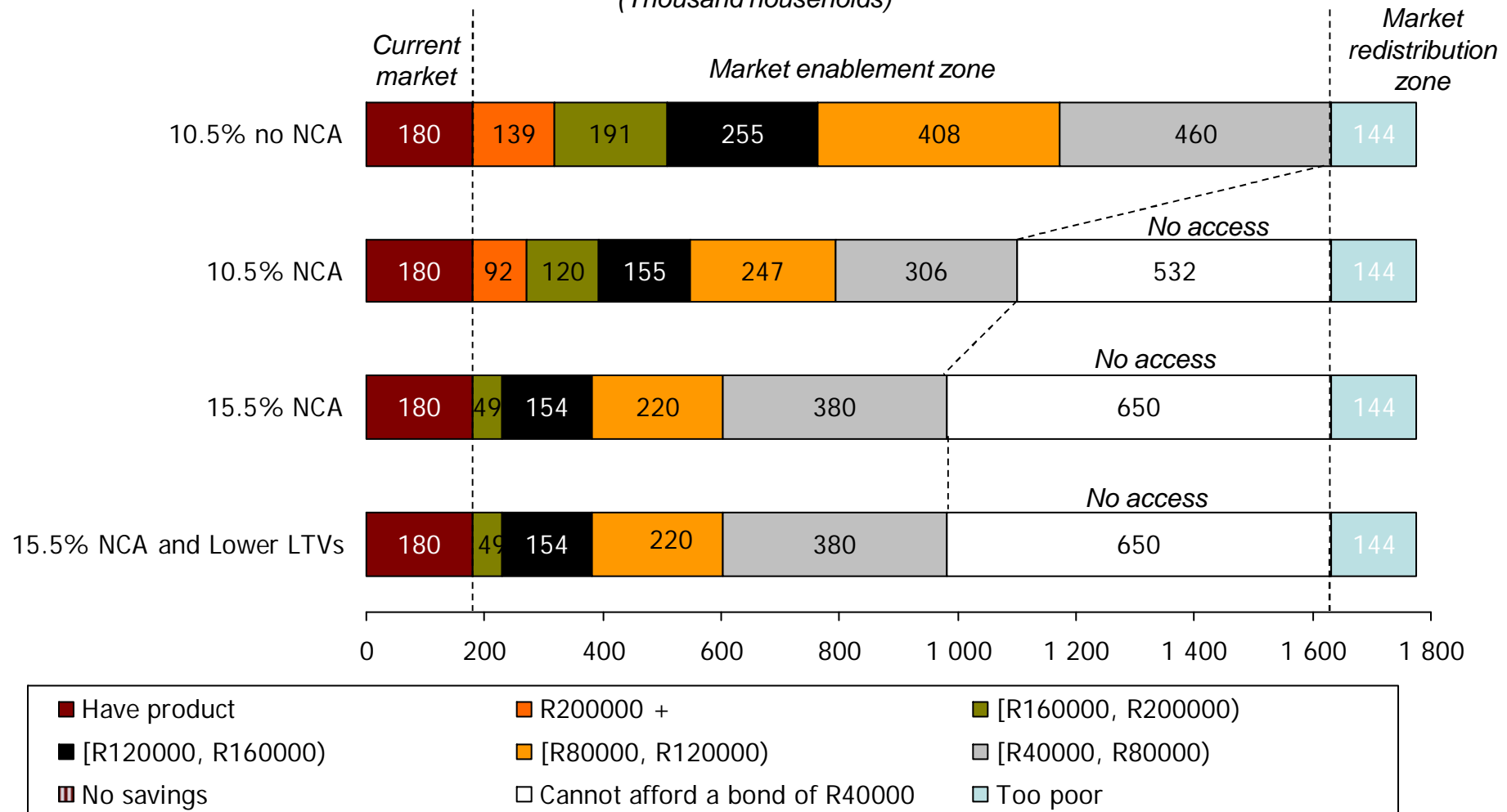
■ Have product	■ R200000 +	■ [R160000, R200000)
■ [R120000, R160000)	■ [R80000, R120000)	■ [R40000, R80000)
■ No savings	□ Cannot afford a bond of R40000	□ Too poor

Source: IES 2005/2006



The analysis incorporated sensitivities relating to house prices and credit market conditions

Access frontier for a bond: Impact of interest rates, NCA and lower LTVs on households who own mortgageable properties
(Thousand households)

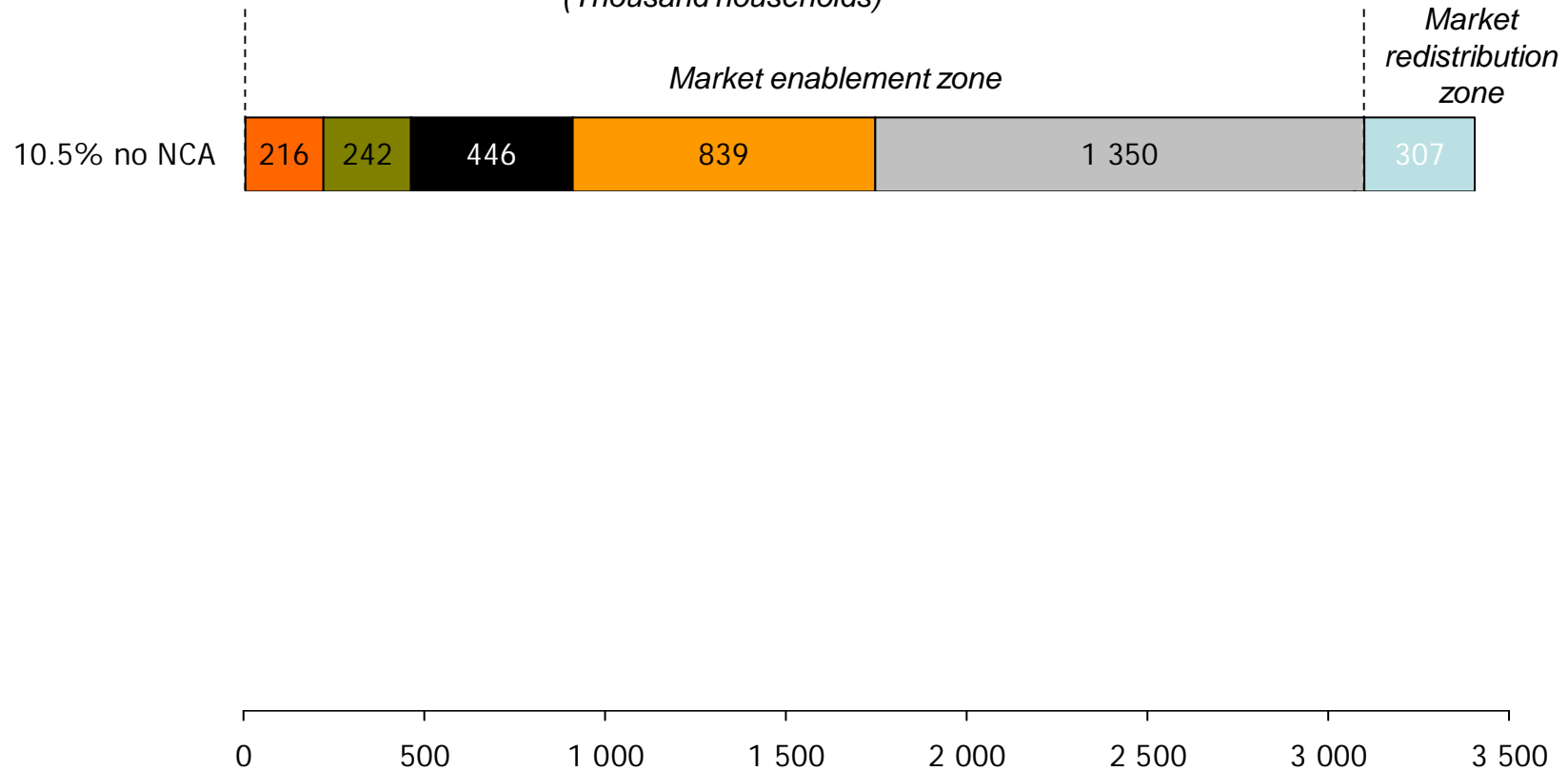


Source: IES 2005/2006



For those who do not own mortgage-able houses the picture is somewhat different. As banks require deposits access for those who are not already homeowners is constrained even further

Access frontier for a bond: Impact of interest rates, NCA and lower LTVs on households who do not own mortgageable properties
(Thousand households)



■ Have product	■ R200000 +	■ [R160000, R200000)
■ [R120000, R160000)	■ [R80000, R120000)	■ [R40000, R80000)
■ No savings	□ Cannot afford a bond of R40000	■ Too poor

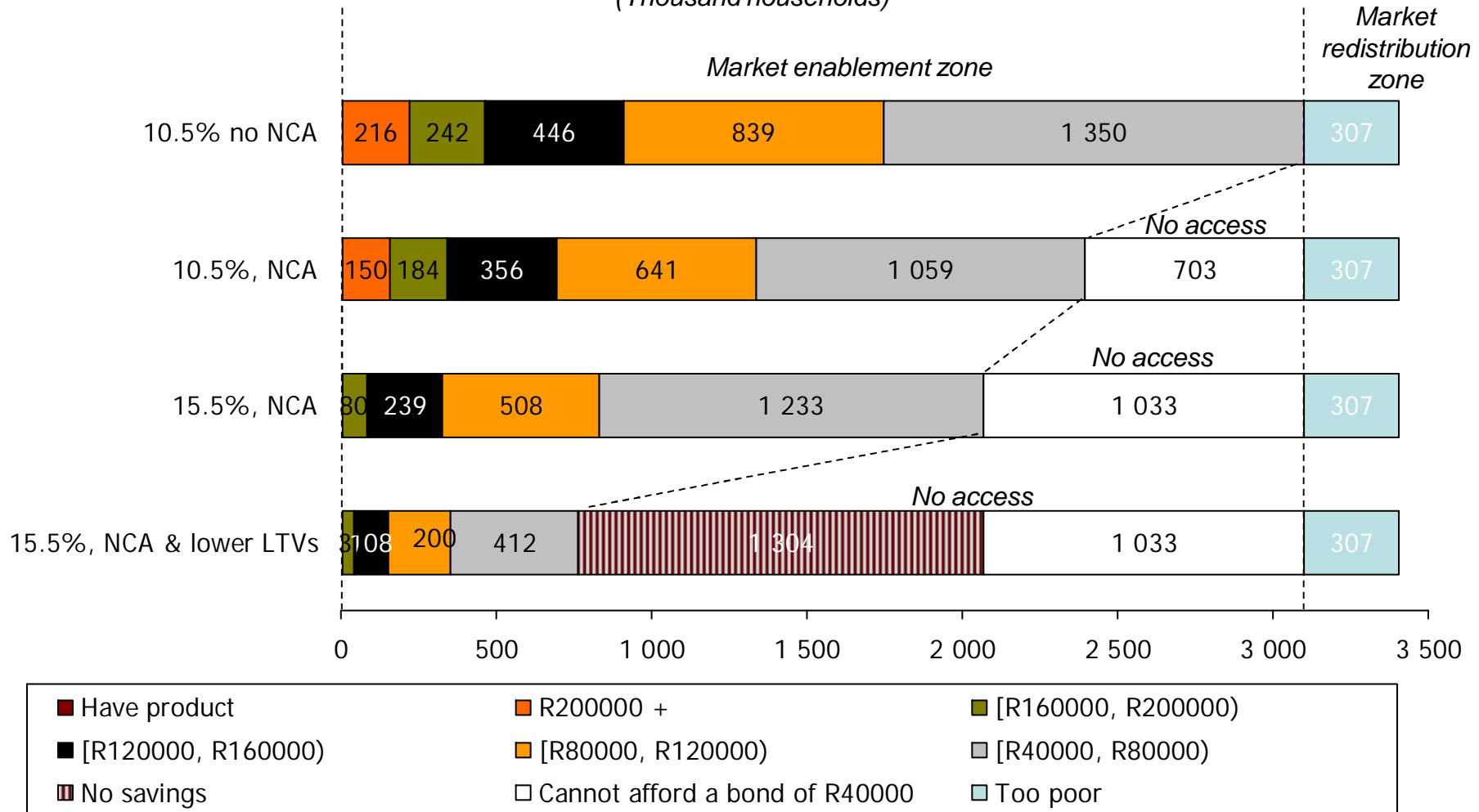
Source: IES 2005/2006



As banks require deposits access for those who are not already homeowners is constrained even further

Access frontier for a bond: Impact of interest rates, NCA and lower LTVs on households who do not own mortgageable properties

(Thousand households)



Source: IES 2005/2006

The analysis can be used to get an estimate for new targets *(Note all amounts are in 2006 Rand terms)*



Own mortgage-able properties



1.8 million households

Trading up

Assumptions:

Average mortgage: R100,000

Average sale price of existing house: R100,000

Churn of 4% p.a. of those who can afford a mortgage of at least R80,000



24 000 households who trade up
R2.4bn per year

Cashing out

Assumptions:

Average mortgage: R80,000

One withdrawal for every five transactions



4 800 households who cash out
R384m per year

Again, the analysis raised more questions than it answered



What are the key lessons?

- Access to finance does not imply an increase in stock
- Affordability constraints partly reflect the inflationary impact of an increase in supply of money in the enablement zone and the impact of subsidies on market perceptions in the redistribution zone. Throwing more end user finance at this market may therefore be counter-productive
- End user targets must be aligned with financing availability further back in the value chain (where the real constraints exist). BASA data indicates around R4bn in developer loans

What impact has the FSC had on access?

- Targets have been exceeded – but recent developments highlight how tenuous some of the gains in access are
- Key achievements must be acknowledged. Critical is the alignment of norms and standards for mortgage-able properties with the available formal stock in the market

What factors still inhibit access?

- Impact of affordability-related constraints has been quantified but what about other constraints that limit participation in formal housing markets? (e.g. informal transactions, informal tenure, etc.)
- What mechanisms can be used to make these limitations matter to households?

So what does this mean for the future?

- How do we maximise learning (and sharing of learning) in a competitive space?
- Shifting the market parameters up to align with affordability constraints will enable banks to meet targets in a market that already functions – so what is the point?

The 2010 analysis focused on performance as well as access, with a shift in focus towards supply-side data



How have FSC loans performed?

- One and a half years after the end of the first phase of the FSC what do we now know about the performance of the 230,000+ mortgages and 570,000+ other housing loans originated as part of the FSC?
- How did mortgage loans perform over the variable interest rate cycle and how does this performance compare with performance in the market as a whole?
- What are the key risks in this market and how do these differ from risks in higher income segments?

What levels of access exist?

- Performance and access are two sides of the same coin. Performance can only be assessed with reference to access
- What are the key access barriers that inhibit borrowers from accessing housing finance?

So what?

- Based on what we know about performance and access in the FSC target market what interventions (if any) are required to support further market development?
- Given the availability of the proposed R1bn guarantee, how best should this facility be applied to support access and performance?

What data do we need?

- In light of the above what data should the industry be accessing and analysing on an on-going basis to assess market performance?
- How should this data be obtained? Who should provide it? Who should have access to it?

In summary, we found little

Access

- There is no data to assess access directly
- There was a noticeable decline in loan origination
- Data strongly suggests a decrease in the proportion of mortgages used to fund the purchase of homes
- There is no data to assess the reason for decline although discussions with developers indicates affordability (too much other credit) and impaired credit histories dominate
- The data for every housing loan application (including unsecured loans) is submitted by banks to the Office of Disclosure annually but no aggregated data is released

Performance

"Despite tough economic conditions, we are pleased to note that the entry level housing market continued to hold its own in terms of arrears as measured against the middle- to upper-income market segments. We believe this underscores both the need to retain banks' prudent origination and collection standards in this market and the willingness by homeowners to service their mortgage obligations....."

....We expect a tougher environment for 2009 because, at the time of finalising this review, all indications were that a number of factors will have a negative impact on the disposable income of people in this market. These include a 500 basis points rise in interest rates over two years, 33% growth in the average price of food, a doubling of fuel prices and sharp increases in both electricity and municipal utilities/rates and taxes. However, given historical successes, our members continue to make progress with this socio-economic imperative in South Africa. - BASA's 2008

Annual Review

Partly in response, FinMark launched the Housing Finance Temperature Gauge which relies on perceptions of lenders and developers



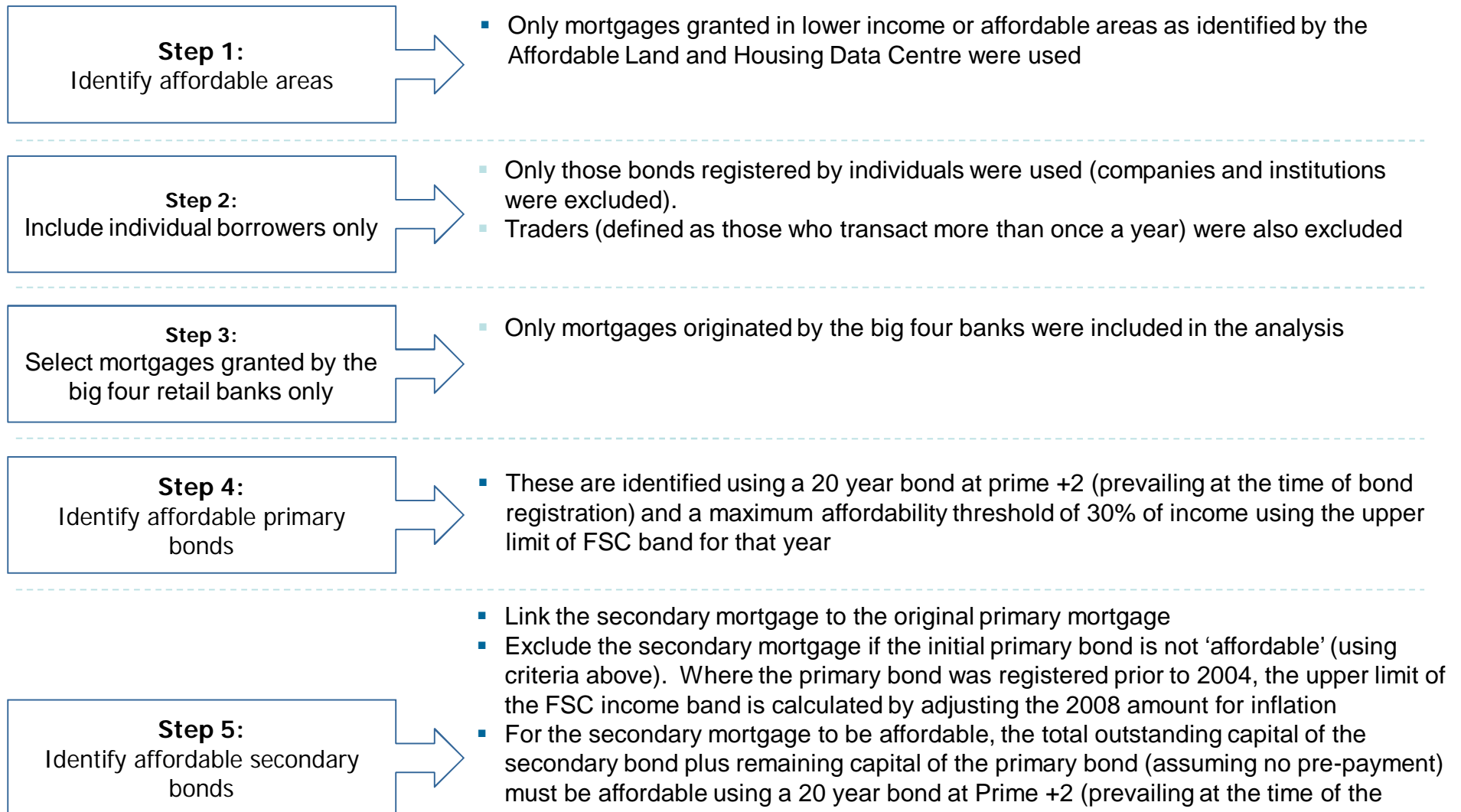
Table 4: Approach towards credit granting criteria Q2 2010 to Q2 2011: Lenders' perspective

Housing finance segment	Much more strict	More strict	The Same	Less strict	Much more relaxed
Incremental Financing	0%	20%	60%	20%	0%
Non-Bank Mortgages	0%	20%	60%	20%	0%
Bank Mortgages < R350 000	0%	60%	0%	40%	0%
Mortgages R350K to R500K	0%	60%	0%	40%	0%
Mortgages >R500K	0%	60%	20%	20%	0%

Table 10: Trend in non-performing loans from Q2 2010 to Q2 2011: Lenders' perspective

Housing finance segment	Arrears increased a lot	Arrears increased a little	The same	Arrears decreased a little	Arrears decreased a lot
Incremental Financing	0%	0%	40%	60%	0%
Non-Bank mortgages	0%	33%	33%	33%	0%
Bank Mortgages < R350 000	0%	0%	0%	80%	20%
Bank Mortgages R350K to R500K	0%	0%	0%	80%	20%
Bank Mortgages >R500K	0%	0%	0%	60%	40%

At the same time, FinMark approached the CPA to obtain access to credit bureau data to assess mortgage performance. A key challenge was identifying FSC mortgages

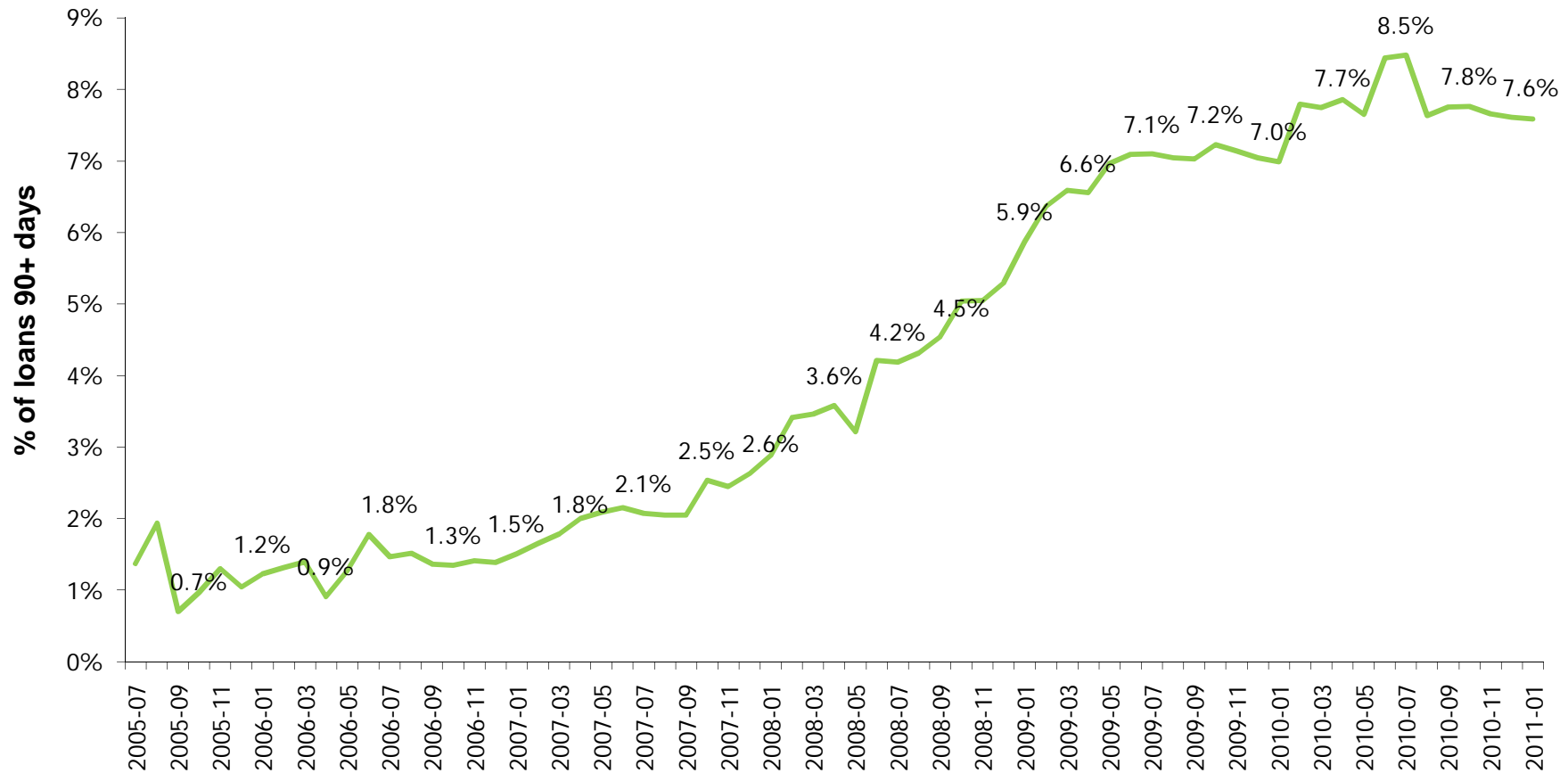


Note: The prime rate, as well as the inflation rate, was obtained from the South African Reserve Bank

The analysis found that 7.6% of FSC mortgages by value were 90 days or more in arrears in January 2011. Performance deteriorated noticeably from very low levels during 2006



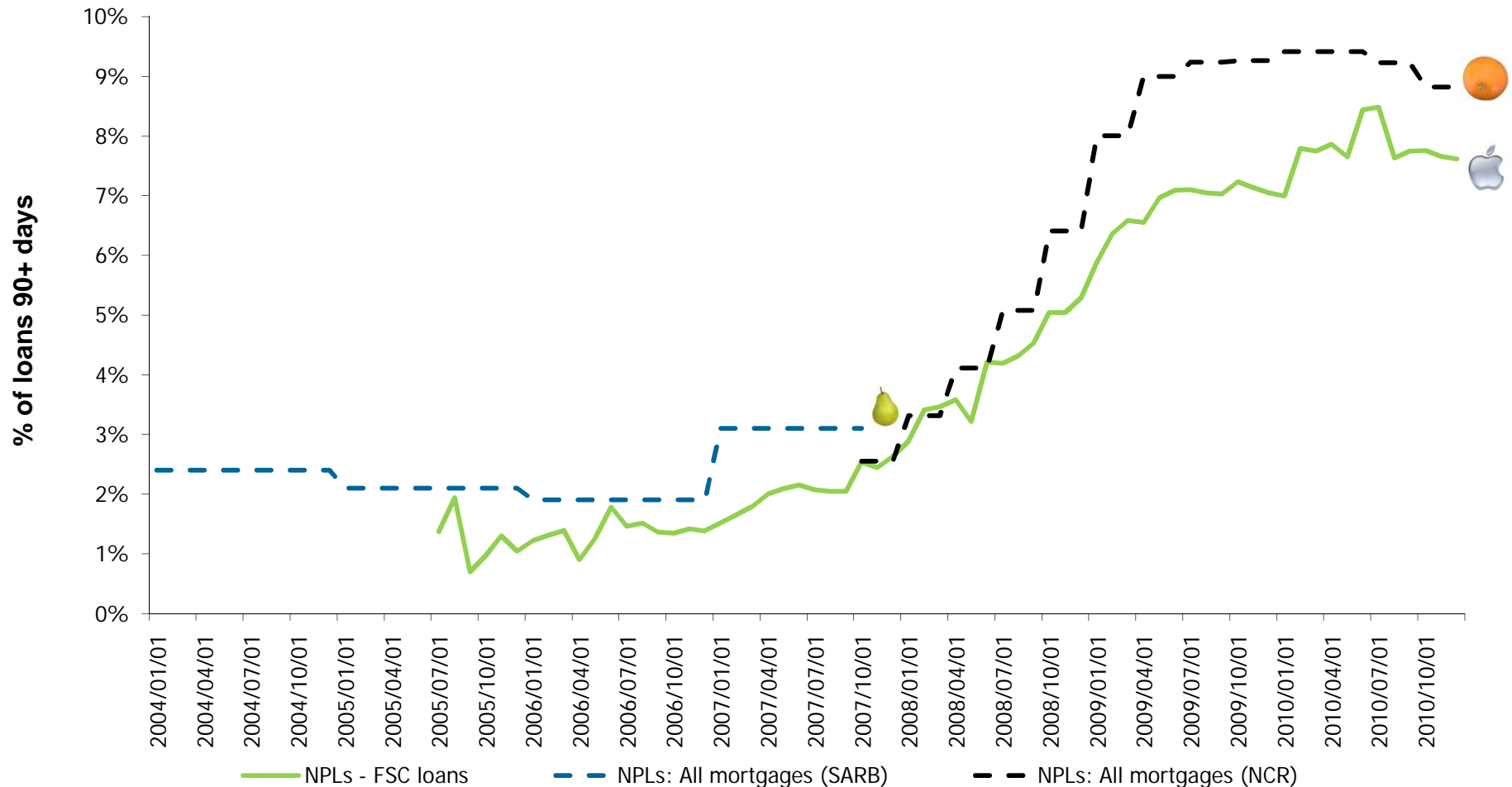
Performance of FSC loans: NPL by calendar date



FSC loans appear to have performed slightly better than mortgages as a whole as reported by regulators. Ideally the analysis should be conducted on the same data source using the same methodology over the same origination window



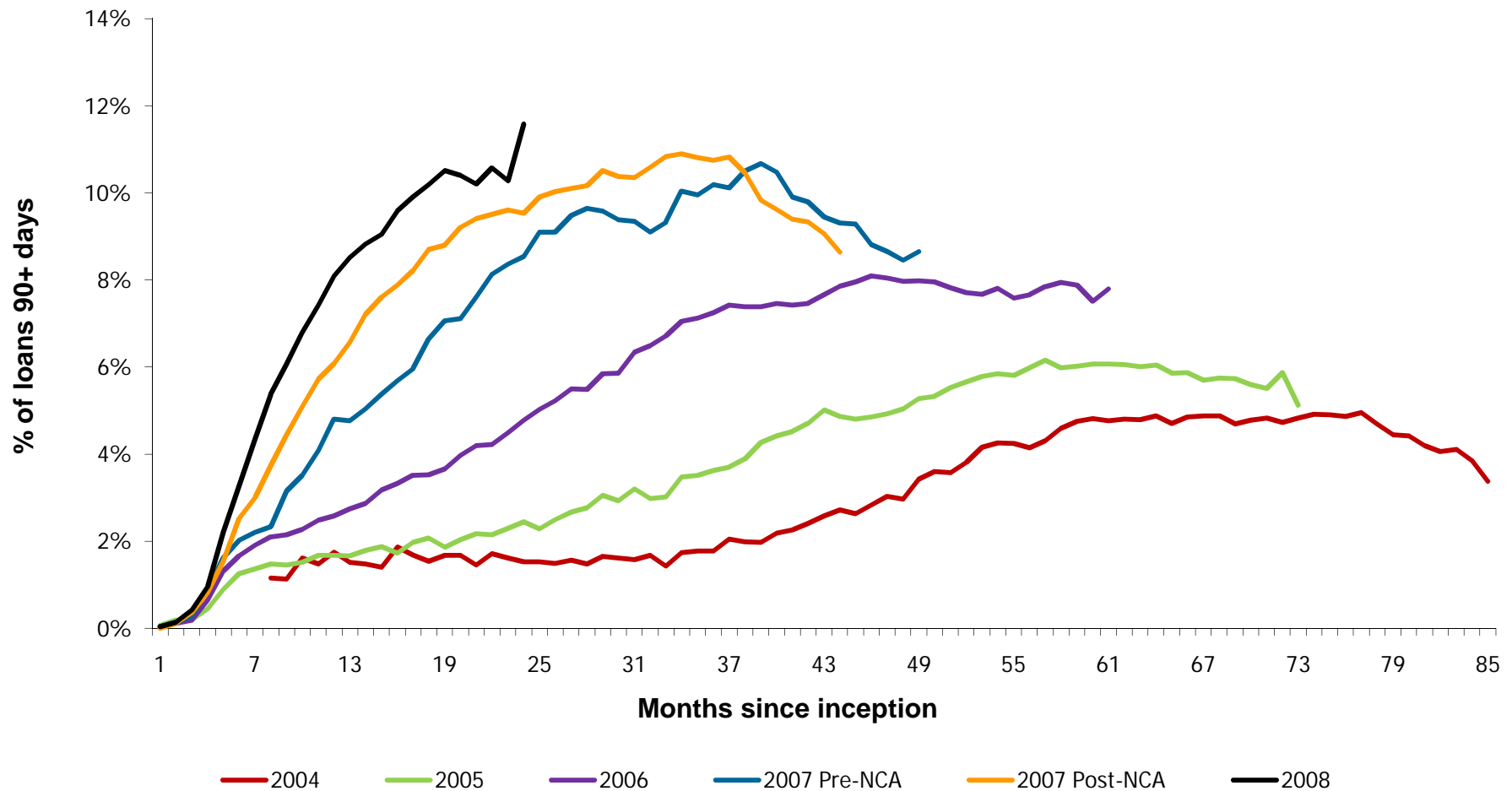
NPLs: FSC mortgages compared to all mortgages



A vintage analysis highlights how this is impacted upon by the date of origination. The pattern across years is noticeably different

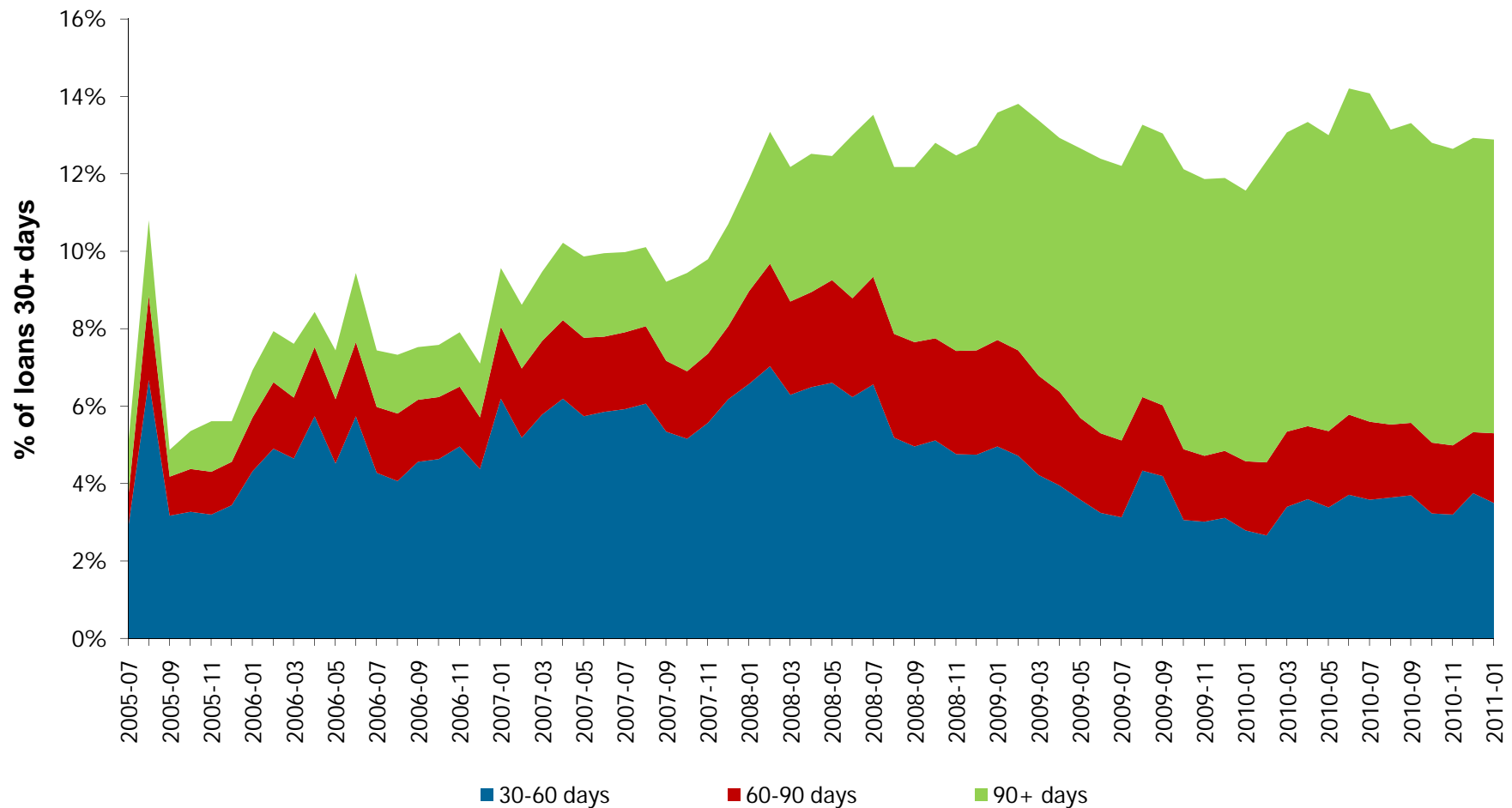


Vintage analysis: NPL by months since inception

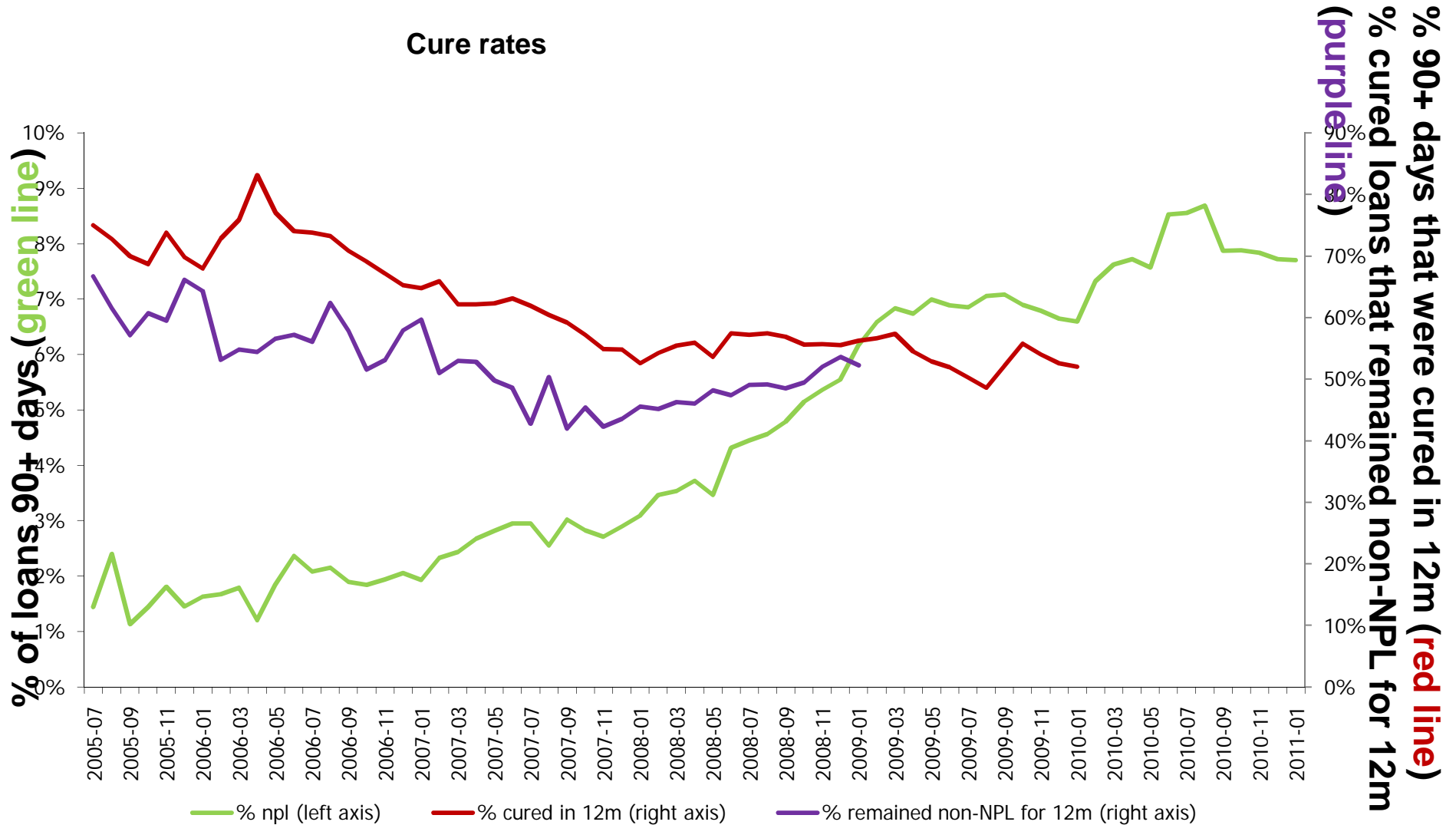


An aging analysis indicates that performance is likely to improve

Aging analysis over time (cumulative)



The analysis explored the likelihood of defaulting loans becoming 'cured'. Cure rates declined steadily as did the proportion of cured loans that remained cured for 12 months

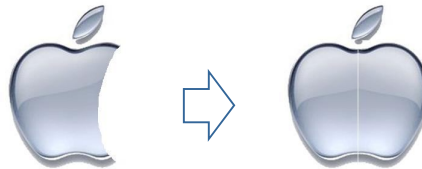


FinMark Trust's CAHF aims to conduct the analysis quarterly and to augment it continuously



Comparing apples with apples

- Performance must be benchmarked
- To do this we need to do a like-for-like comparison against other segments of the market
- The next round of analysis will be based on:
 - A matched cohort
 - Across the market
 - Calculated the same way



Understanding risk more fully

- The analysis has focused on the risk of default and has explored this across loan, property and customer-based various dimensions
- This can be extended to include:
 - LTV (where applicable)
 - Mortgage type (purchase / equity withdrawal)

What else?

repeat buyer.....

- Other data (for example on debt counselling) can be incorporated into the analysis
- But there is more to risk than default alone
- We need to explore loss given default too



Bringing in some colour

- How does performance of other credit products relate to mortgage performance? (i.e. are there leading indicators of default?)
- How does borrowing behaviour change when borrowers get mortgages?
-

Agenda

A brief chronology

What is housing finance

A quick overview of the analysis

Some lessons learned

Some key lessons



1. Sometimes asking the right questions is more important than getting the right answers

More than providing a 100% accurate picture of the market, an analysis of access helps to frame the right questions

2. Data is never perfect

Use a range of data sources to triangulate. Sometimes the perfect is the enemy of the good

3. FinScope is about perceptions

When it comes to access, sometimes, reality is in the mind of the customer

4. Access is all about customers

The analysis helps to put the customer squarely at the centre of deliberations

5. Analysis is not a once off

It is an on-going quest for best available data and analysis to ground a conversation



Thank you



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