

FINMARK TRUST

MAKING FINANCIAL MARKETS WORK FOR THE POOR

P O Box 61674, Marshalltown, 2107 info@finmark.org.za Tel: +27 11 315 9197 Fax: +27 11 645 6896

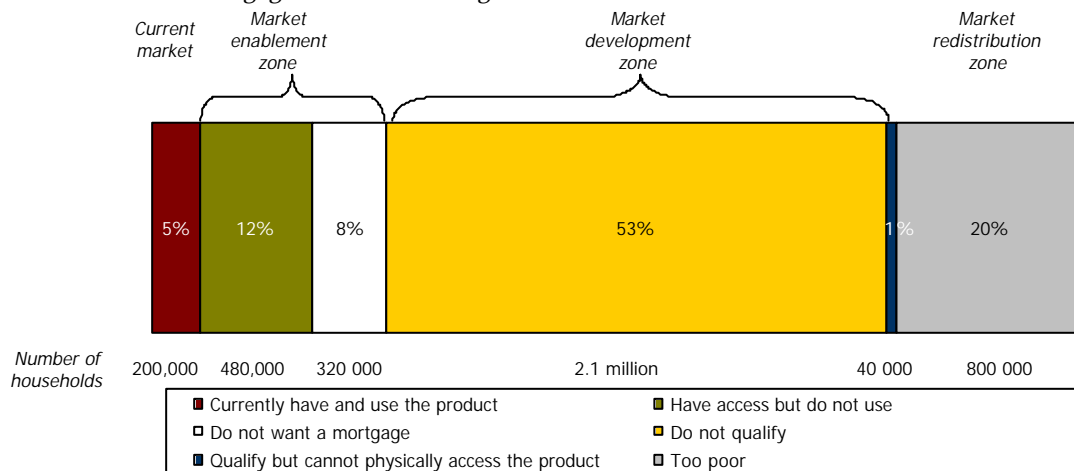
Press release: Charting the housing finance access frontier

As part of the Charter process, the financial sector has committed to providing R42 billion of housing finance to the low income market (households with a monthly income of R1 500 - R7 500), by the end of 2008. Since the publication of the Financial Sector Charter ("FSC") in 2003, three of the country's four largest retail banks have begun actively marketing mortgage products aimed at the FSC target market. While this is a positive development, it is important to assess to what extent these products meaningfully enhance access to housing finance in the low income market.

Access is different from usage. Many more people may have access to a product than those who choose to use it. While usage is usually directly observable, access, in contrast, can be more difficult to gauge. As the banks have already indicated, current housing shortages affordable to the FSC target market are impeding usage of mortgage finance – but do they have access? **A new paper commissioned by the FinMark Trust considers the state of access irrespective of the housing shortage, providing an indication of the nature and magnitude of borrower-related access barriers to current mortgage products in the FSC space.**

The research uses data on target market characteristics together with lender assessment criteria. The analysis shows that banks are currently lending to 5% of the FSC target market. It also shows that 75% of the households in the target market are unable to access the product either because they are too poor (20% of the target market) or because they fail to qualify (due to their age, credit quality or capacity to service mortgage finance). About 20% of the target market has access to bank-provided mortgage products but has not yet obtained the product: many of these appear not to want a mortgage while for others it is likely that housing affordability is the issue.

Access frontier for mortgage finance in the target market



Source: Underlying data based on FinScope™ 2005 using household heads

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

Clearly any shortages of suitably priced, mortgageable housing stock would effectively prevent households who lie in **the market enablement zone** (20% of the target market) from accessing a mortgage. Data on the nature and adequacy of housing in the target market indicates that over 870 000 units are required to

adequately house those in informal dwellings and overcrowded formal dwellings. The shortage relates not only to the delivery of new housing (which is currently limited to less than 20 000 annually), but also to the quality of existing stock. Given current, commonly applied property criteria, over 60% of existing formal, owned houses in the target market are not considered mortgageable by banks.

However, while the stock shortage is significant, it is not clear to what extent it impacts on those within the mortgage **market development zone** (53% of the target market), given their ineligibility for existing mortgage products. The paper explores the detail of this and suggests how it might be overcome.

It is no doubt the case that access to mortgage finance could be enhanced if lenders restructured and optimized the structure and processes associated with existing mortgage products to align more closely with the needs and characteristics of the target market. Improved loan servicing processes, redefined borrower, property or area criteria, loan level product features such as insurance or collateral requirements, as well as portfolio interventions such as guarantees are all mechanisms that could be considered.

The FSC product development process has highlighted the need for a guarantee or “loss-limit insurance”. However, it is not clear to what extent this would result in an increase in access to mortgage finance. Banks are unwilling to disclose data on the percentage of applications that are rejected and the associated reasons for rejection. They have also not disclosed their policies with regard to areas which are deemed to be unsuitable for mortgage finance. It is therefore not possible to determine how many currently rejected loan applications could be accepted if the guarantee were in place, nor how the housing market could be expanded if area restrictions were lifted.

There is also a limit to the extent that mortgage products, even if optimized, can facilitate access to housing finance across the target market. Data on the nature of the housing need and the financial and risk profile of households in the target market highlights the need for a range of housing finance products, most notably, incremental housing loans.

While the banking industry’s emphasis on larger mortgage products is not surprising given the focus on meeting the FSC target and deadlines, smaller, non-mortgage products are at least as important as mortgage loans. Such products could enable the transformation of currently sub-standard units into mortgageable housing stock, facilitating the creation of wealth. They would also provide banks with a lower risk mechanism of engaging in the low income housing finance sector and developing a more robust understanding of the risk profile of the market. While banks may not have the required capabilities to operate effectively in this product space, there may well be opportunities to partner with existing housing lenders who do.

For more information contact Kecia Rust at the FinMark Trust on Kecia@iafrica.com or 083-785-4964, or Illana Melzer at Eighty20 on illana.melzer@eighty20.co.za or 083-271-3764.

To access the paper go to http://www.finmark.org.za/documents/2006/May/AccessHF_report.pdf .

For the presentation, go to http://www.finmark.org.za/forums/Presentations/powerpointfiles/2006/FPres_Hfrontier.pdf

Also, FinMark Trust has launched a new publication: ACCESS housing. Go to http://www.finmark.org.za/documents/2006/April/ACCESShousingNo1_April06.pdf and email tamarah@finmark.org.za to subscribe.