



Pension backed loans

October 2011



Agenda

Overview of housing finance

Focus pension backed loans



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 June 2011 was R773.37 billion (63% of all consumer credit)
- There are 1.81 million residential mortgages
- Between 10-14% of households have a mortgage
- Of the 25.449 billion mortgage credit extended in Q2 2011, 93% by value (83% 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 between R5-17 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 June 2011 the total value of the unsecured loans book was R87.98 billion (between R8.7- R26.3 billion for housing?).
- Of the R18.954 billion granted in Q2 2011, 35% by value (20% 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



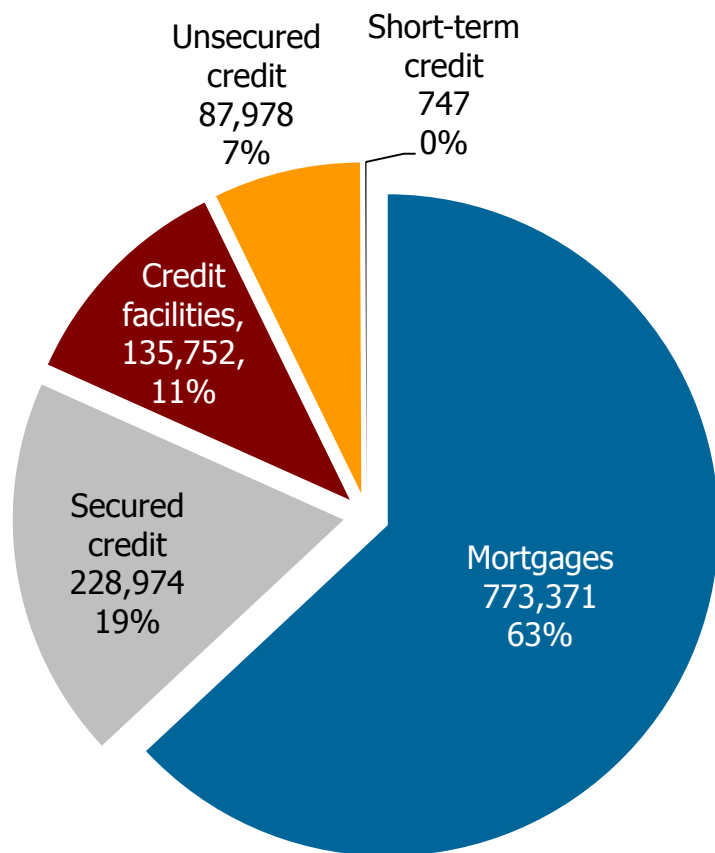
Facilitate incremental housing investment

Increase / improve stock of housing units

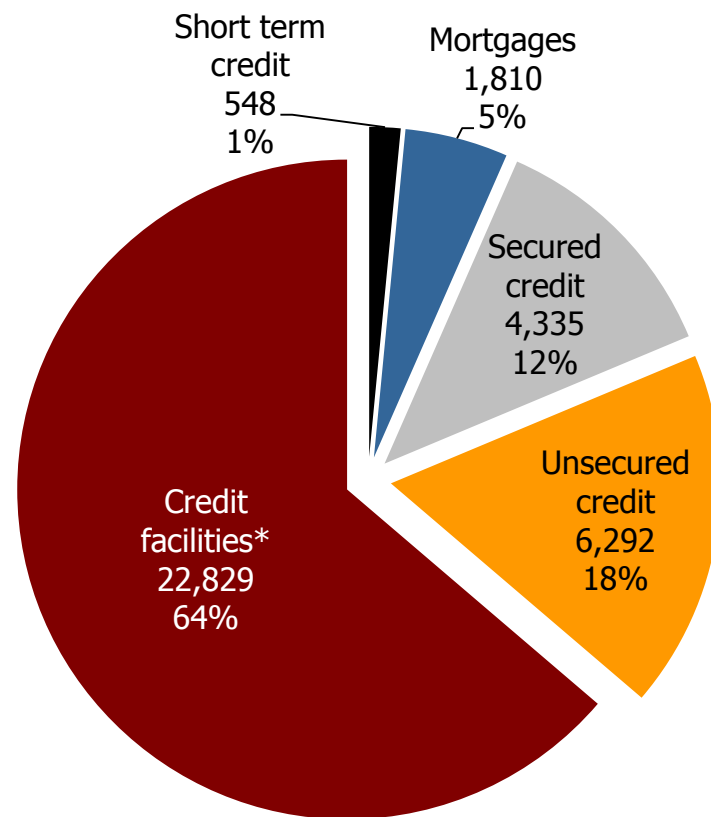


Mortgages account for 63% of all consumer credit by value, but only 5% of the number of active accounts

**Consumer credit: Gross debtors
book Q2 2011**
(R Millions)



**Consumer credit: Gross debtors
book Q2 2011**
(Number of accounts, 000's)



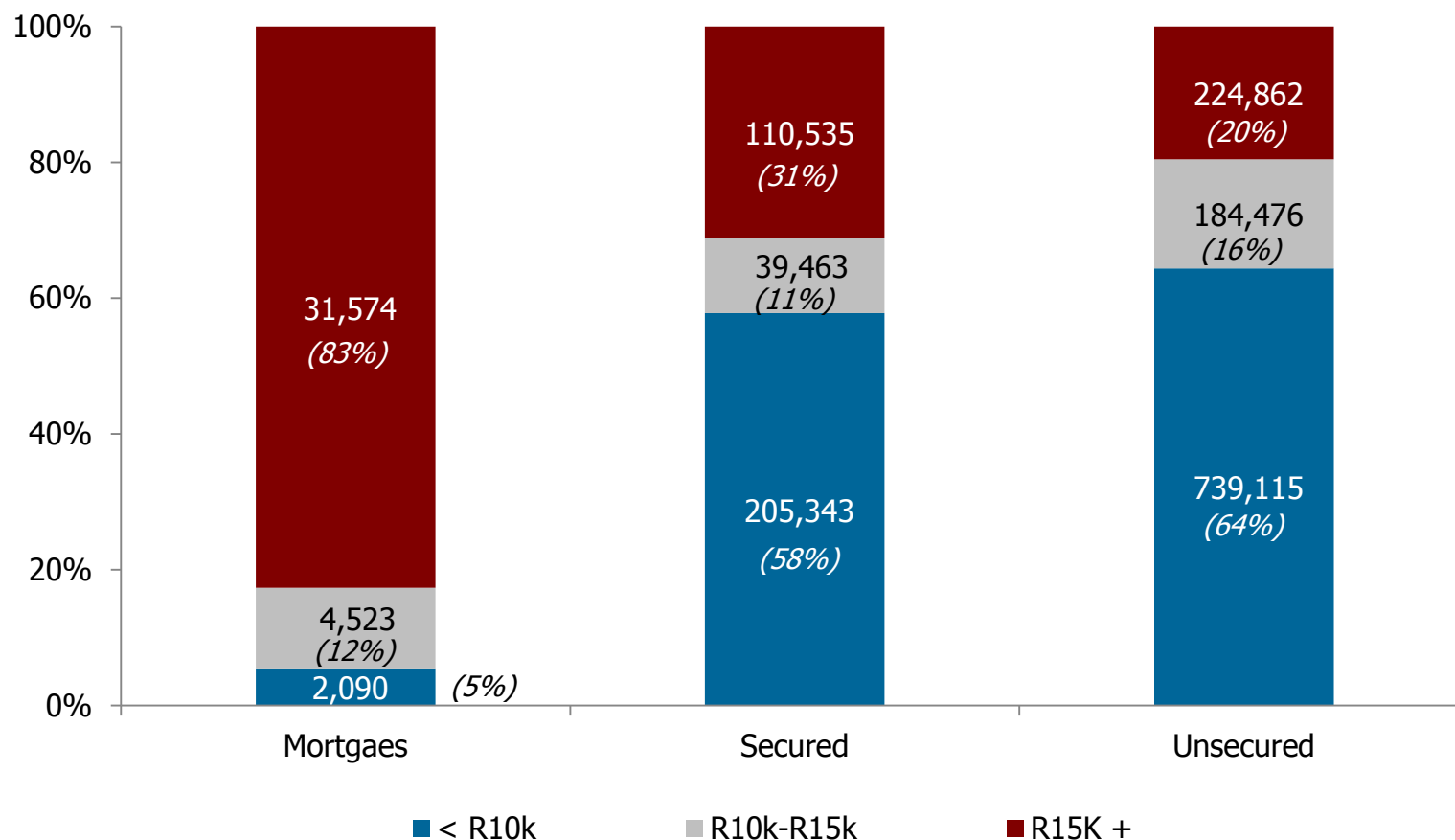
Source: NCR Consumer Credit Market report

*Note: Credit facility includes all credit cards, store cards and overdraft accounts



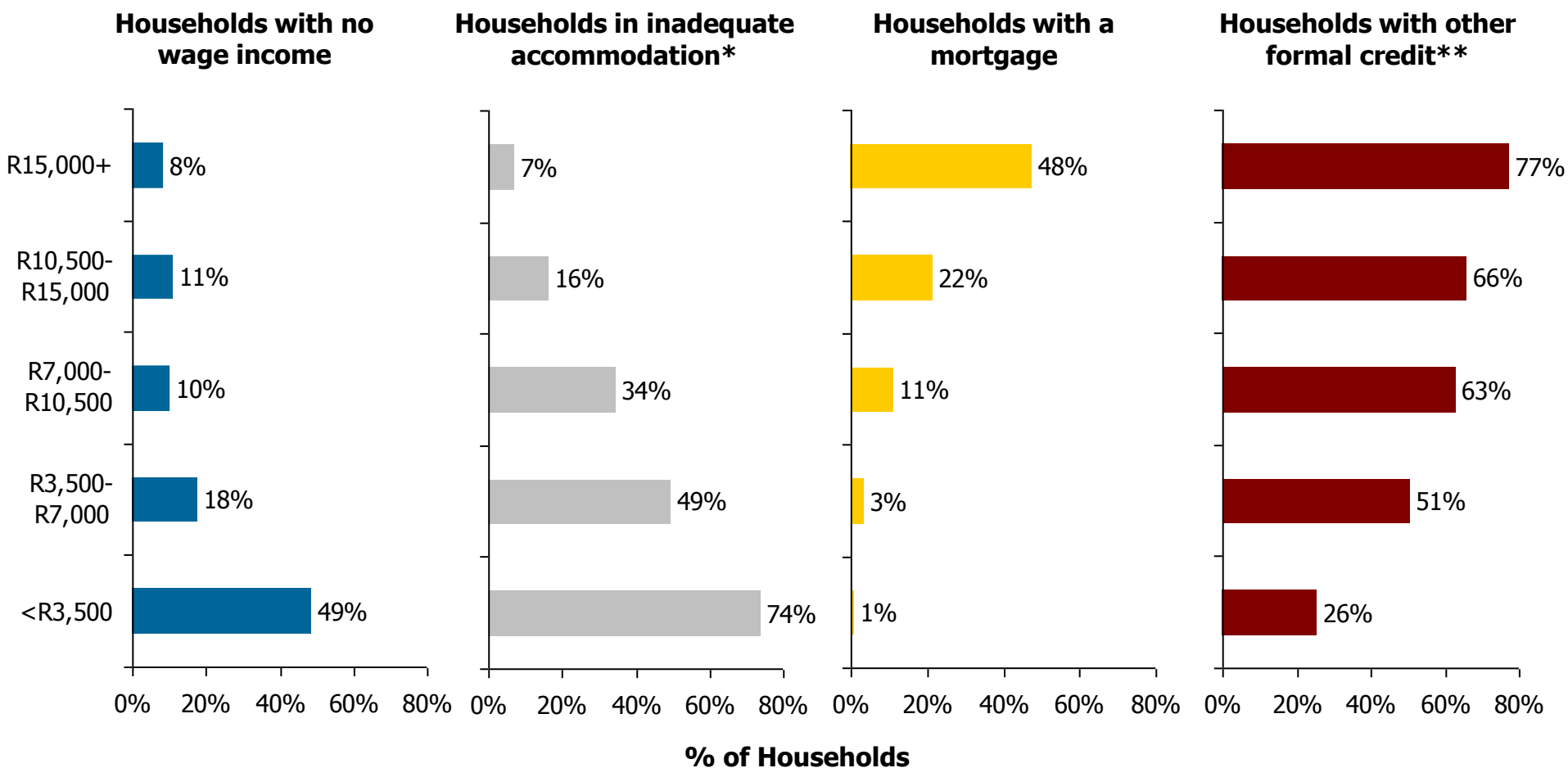
83% of mortgage accounts went to borrowers who earn more than R15 000 per month. Secured and unsecured loans are more popular with lower income individuals

Number of credit agreements 2011 Q2 (Loans granted, R Million)





We can use survey data to explore various household characteristics



Source: IES 2005/6

*Inadequate housing includes: Informal dwellings/shacks and Traditional dwelling/hut/structure made of traditional material, as well as formal dwellings which are over crowded (over 2 people per room) and formal dwellings with inadequate sanitation (no flush toilet in dwelling or on site)

**Formal credit includes: Vehicle finance, credit from retail stores, bank overdraft, other bank loans, and other loans



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Focus pension backed loans



Pension Backed loans

Section 19 (5) of the Pension Funds Act (No. 24 of 1956), permits a retirement fund to grant a direct loan to its members or to furnish a guarantee for a member's loan from a third party (e.g. from a bank or another home loan provider).

The loan must be used for housing related purposes

- To purchase a house
- To buy land and to build a dwelling on it
- To make additions or alterations to, or to maintain or repair an existing dwelling
- To repay a third-party loan which is secured by mortgage bond over a property



Financial assistance is conditional on

- The property actually belonging to the member of the pension fund (or to his or her spouse)
- The house must be occupied by the member (or dependants of the member)
- The retirement fund cannot grant (or secure) a loan for more than one property



Poorer households make less use of mortgage finance. This can be attributed to the fact that lower income households generally cannot afford repayments on the larger mortgage loan but can afford to take up the smaller pension-secured loan (or unsecured loan) to finance their housing requirements



Basic product overview

Value proposition



- Active retirement fund members

- Retirement benefits as collateral for a housing loan to purchase, build or upgrade a home
Retirement funds will either grant loans directly to borrowers or issue guarantees to third party lenders

- ??
- Depends on the provider, but likely to focus on the workplace

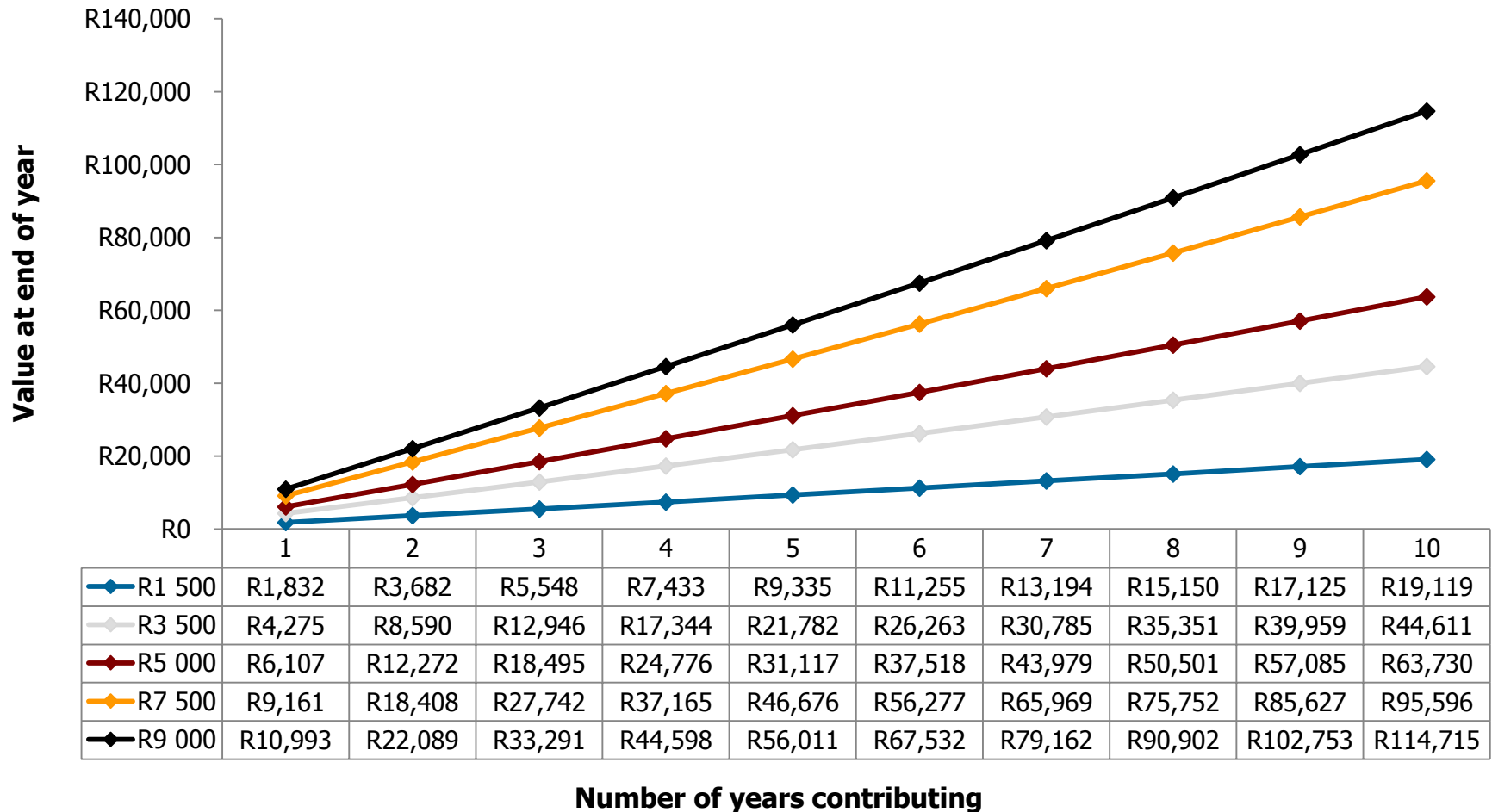
- Through employer/retirement fund

- Instalments typically collected directly off payroll



It is possible to accumulate a meaningfully large amount against which to borrow

Potential value of pension-backed loan (By current income and number of years contributing to fund)



Based on the following assumptions: pension fund grows at 7% pa, personal monthly income grows at 6% pa, tax on withdrawal benefit is 18%, and borrower can borrow 80% of after-tax withdrawal benefit, employer and employee contribute 7.5% each into employees pension fund



PBL's are cheaper than mortgages

Comparison between Mortgage and PBL

Total cost to client

	Mortgage	PBL
Loan amount and term	<ul style="list-style-type: none"> ▪ R50 000 ▪ 10 years 	<ul style="list-style-type: none"> ▪ R50 000 ▪ 10 years
Interest rate	<ul style="list-style-type: none"> ▪ Interest rate: 10% (prime +1) 	<ul style="list-style-type: none"> ▪ Interest rate: 8% (prime -1)
Initial costs	<ul style="list-style-type: none"> ▪ Initiation fee: R1 000 ▪ Bond registration cost: R1 568 ▪ Transfer costs: R3 506 	<ul style="list-style-type: none"> ▪ R250 initiation fee ▪ No bond costs
Monthly fees	<ul style="list-style-type: none"> ▪ R48 monthly admin fee ▪ R5 debit order fee (charged to client by bank) 	<ul style="list-style-type: none"> ▪ R12 monthly admin fee ▪ No transaction cost charged to client (salary deduction)
Cost to client	<ul style="list-style-type: none"> ▪ Instalment: R741.02 ▪ Other costs: R53.00 ▪ Total costs: R794.02 	<ul style="list-style-type: none"> ▪ Instalment: R609.67 ▪ Other costs: R12 ▪ Total costs: R621.67



PBL's are cheaper than micro loans

Comparison between a PBL and unsecured micro loan

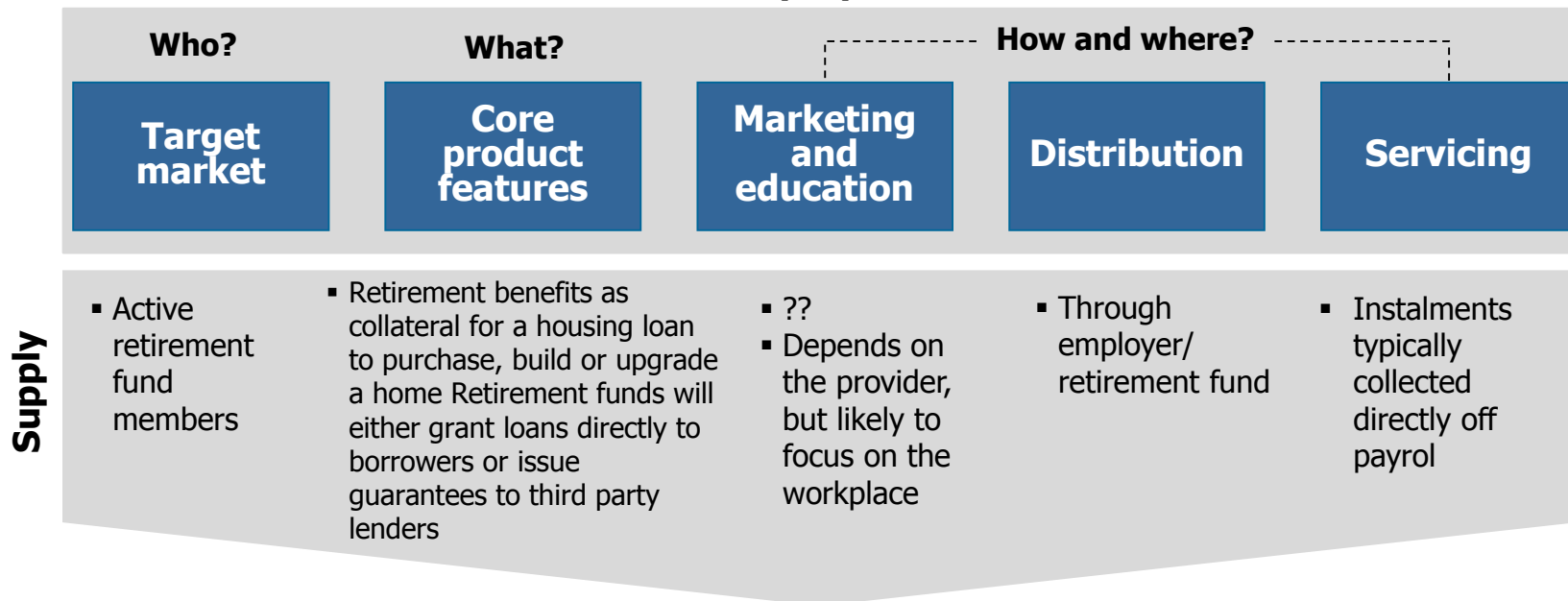
Total cost to client

	PBL (Standard Bank)	Micro loan
Loan amount and term	<ul style="list-style-type: none"> ▪ R10 000 ▪ 36 months 	<ul style="list-style-type: none"> ▪ R10 000 ▪ 36 months
Interest rate	<ul style="list-style-type: none"> ▪ Prime less 1 (8% p.a.) 	<ul style="list-style-type: none"> ▪ 32.1% (repo rate X 2.2) + 20%
Initial costs	<ul style="list-style-type: none"> ▪ R250 initiation fee 	<ul style="list-style-type: none"> ▪ R100 initiation fee
Monthly fees	<ul style="list-style-type: none"> ▪ R12 monthly admin fee ▪ No transaction cost charged to client (salary deduction) 	<ul style="list-style-type: none"> ▪ R? monthly fee ▪ R5.00 debit order cost charged on bank account
Total cost to client	<ul style="list-style-type: none"> ▪ Instalment: R321.20 ▪ Other costs: R12.00 ▪ Total costs: R333.20 	<ul style="list-style-type: none"> ▪ Instalment: R440.46 ▪ Other costs: R5.00 ▪ Total costs: R445.46

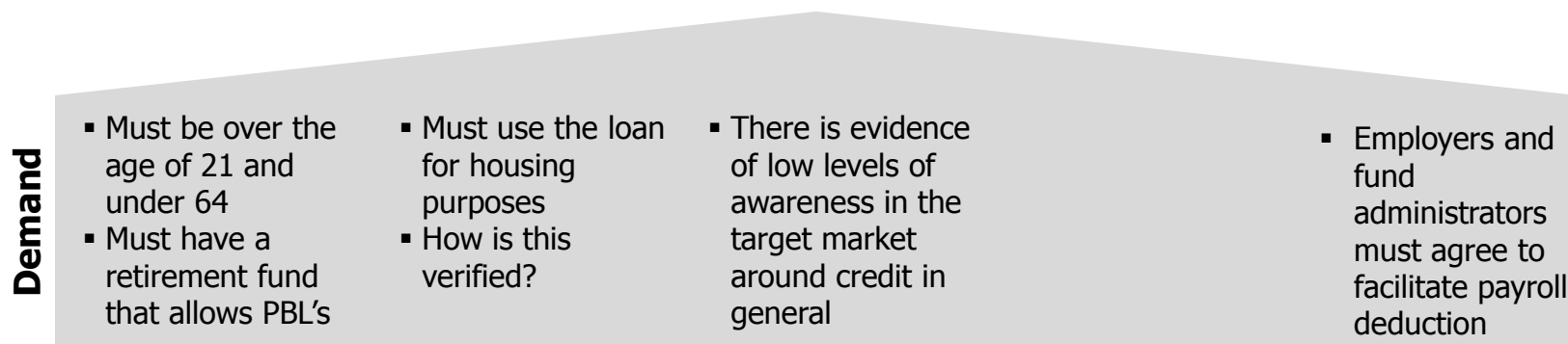
Access is not the same as usage – there may be more people who have access to a product than the number who choose to use the product. Conceptually access is the point of intersection between supply and demand



Value proposition

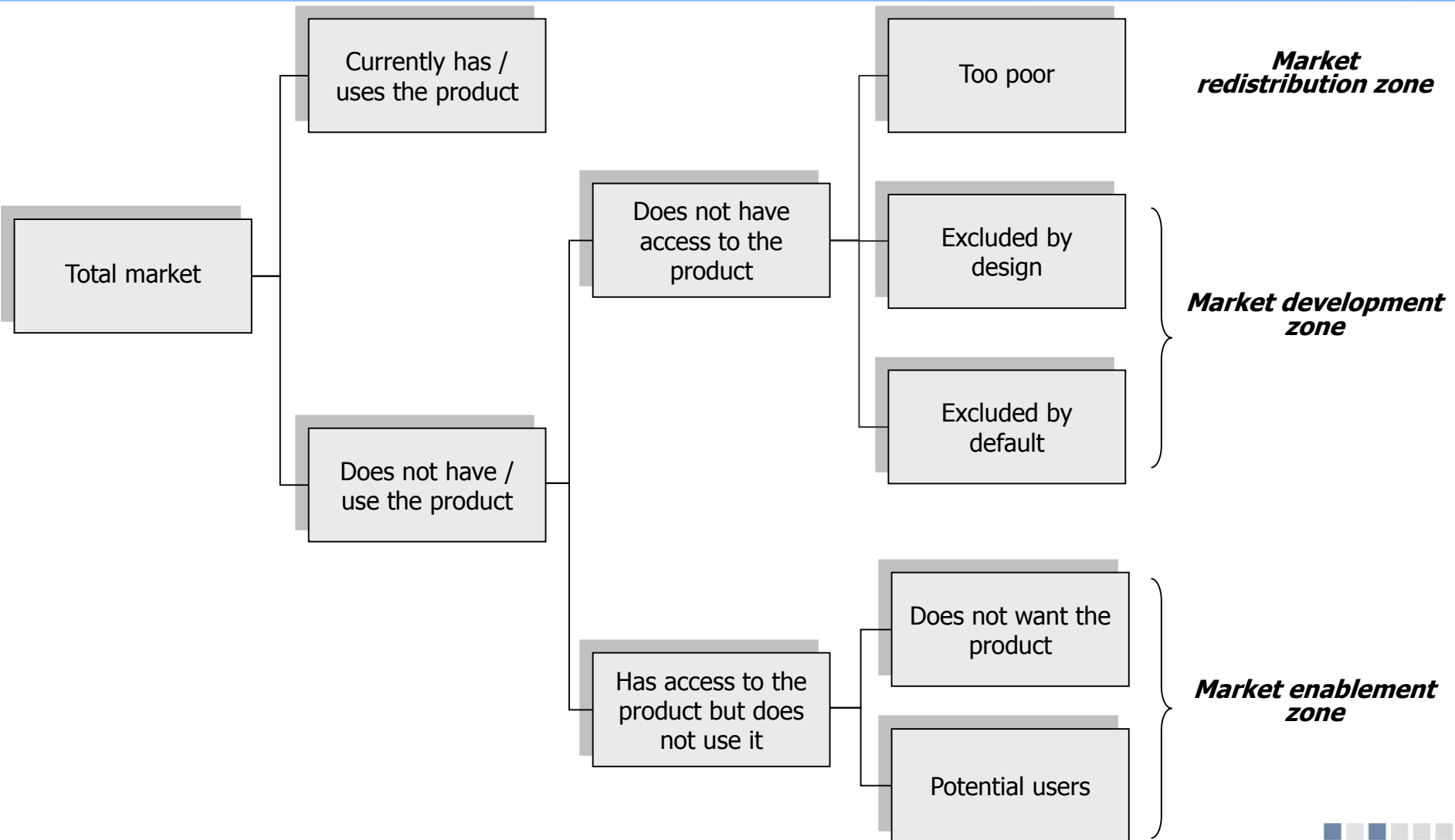


Access



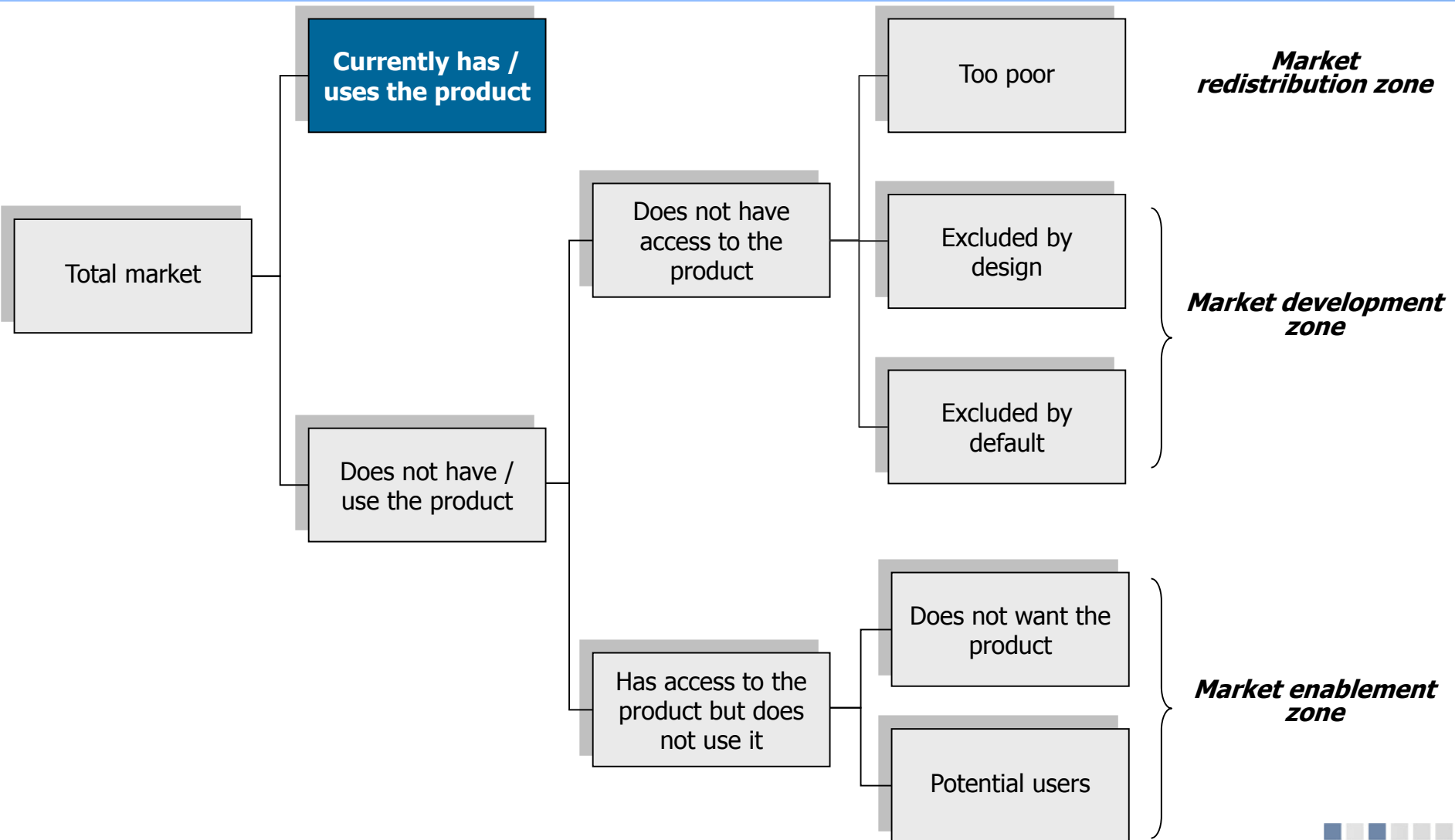


Given supply and demand-side data the Access Frontier Methodology developed by David Porteous enables an identification and quantification of access barriers. It segments those who do not yet use a product into various market zones





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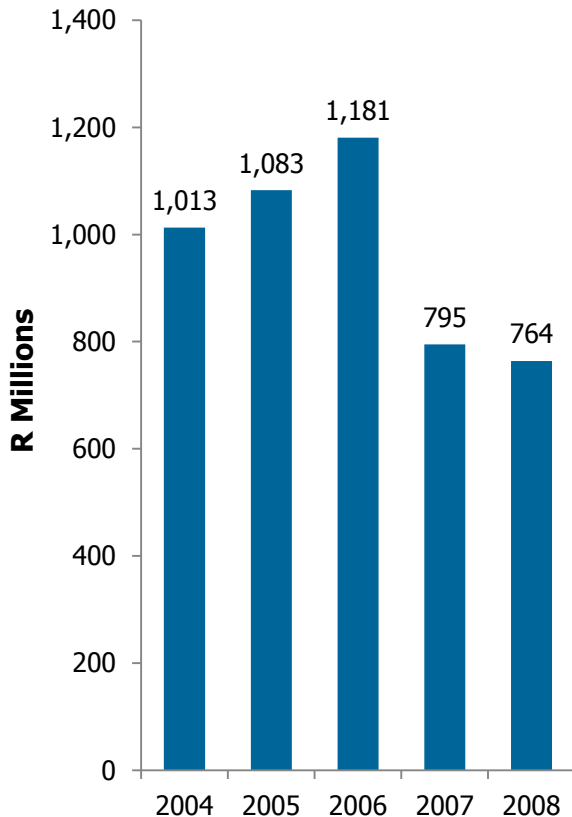




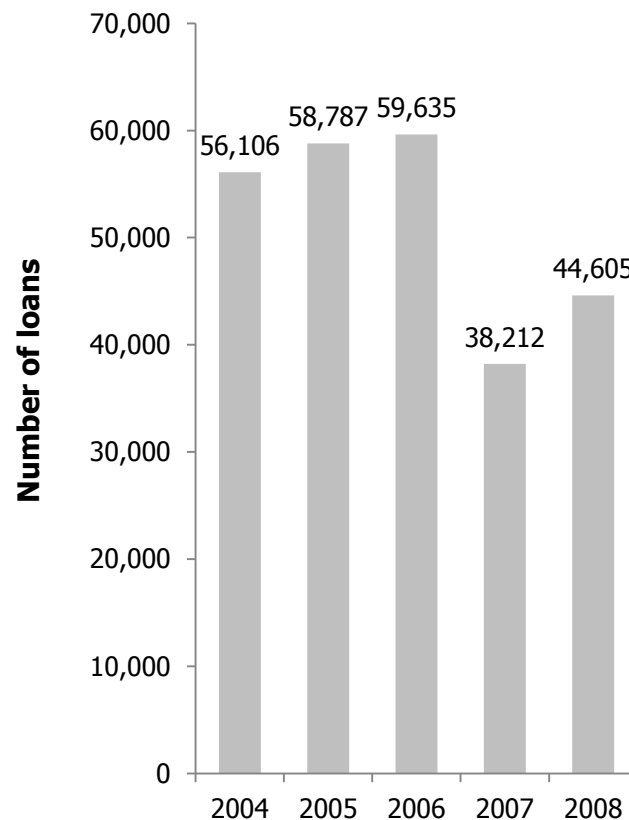
BASA published some data for pension-backed loans granted to the FSC target market by the big four banks between 2004 and 2008. The impact of the NCA is clearly visible

FSC PBL Origination: 2004 – 2008

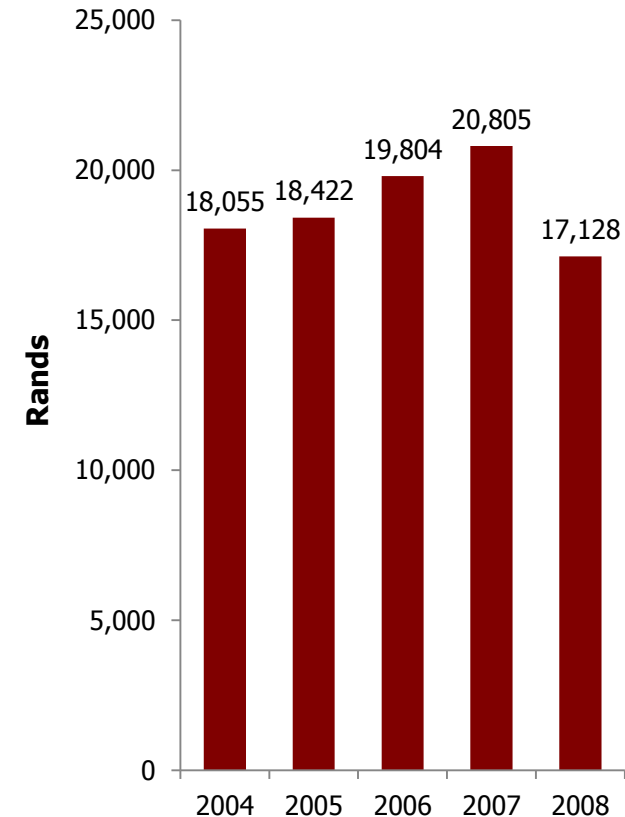
Rand value



Number of loans



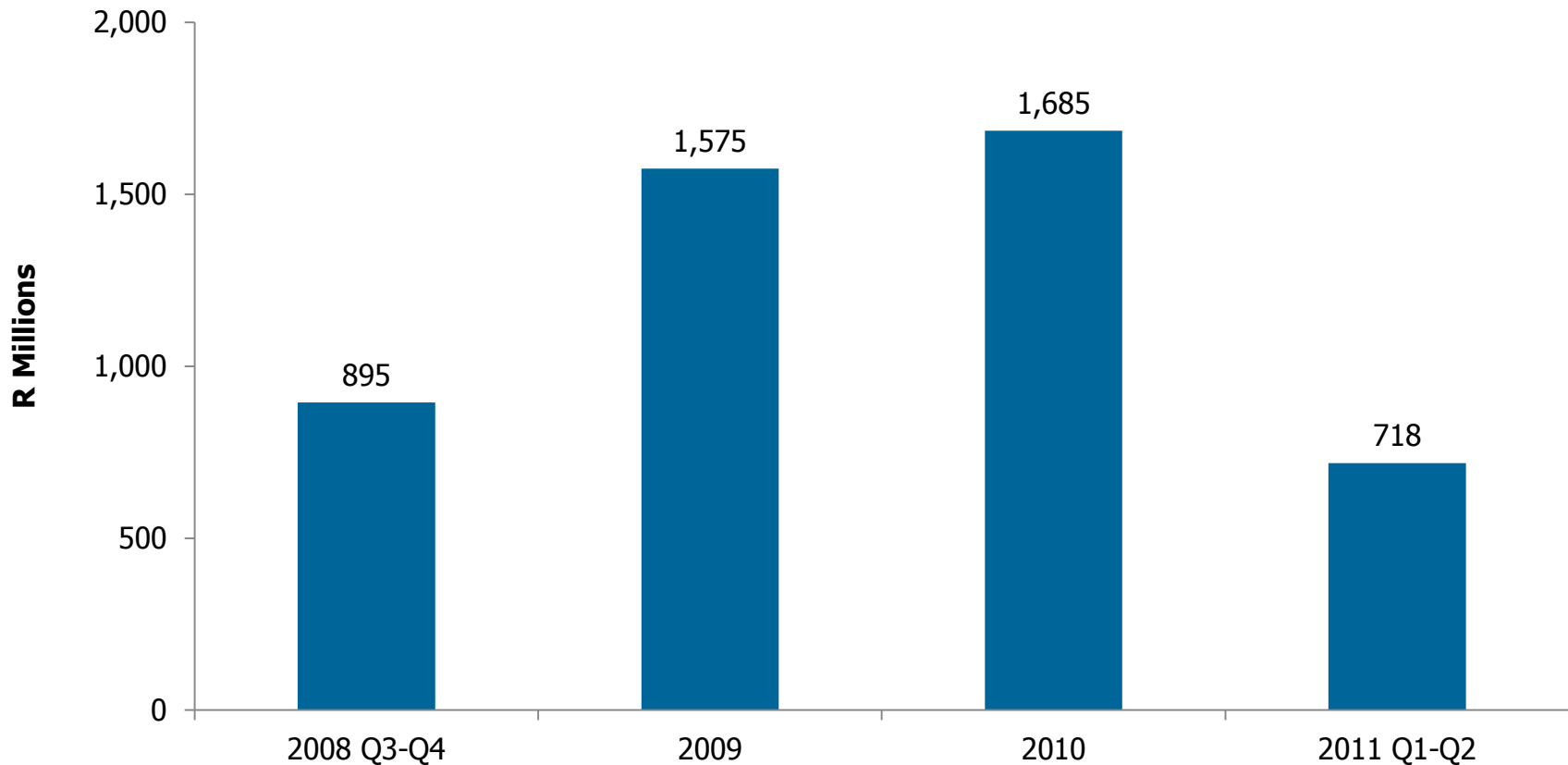
Average value





There is no good data on the size of the PBL book. The NCR publishes origination data for the large lenders (primary banks). In 2010, just under 1.7bn was originated

Value of loans secured through retirement benefits (R Millions)

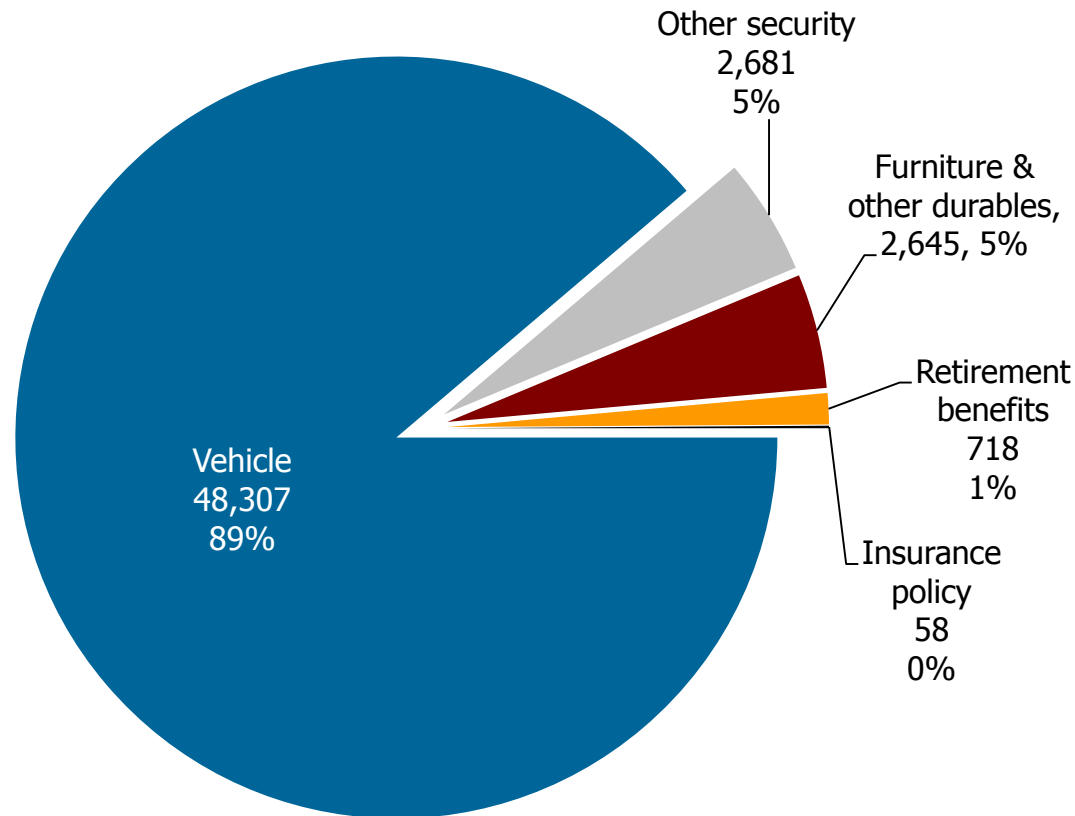




According to the NCR, just 1% of secured lending is secured by retirement benefits. Note however that NCR data does not cover all lenders

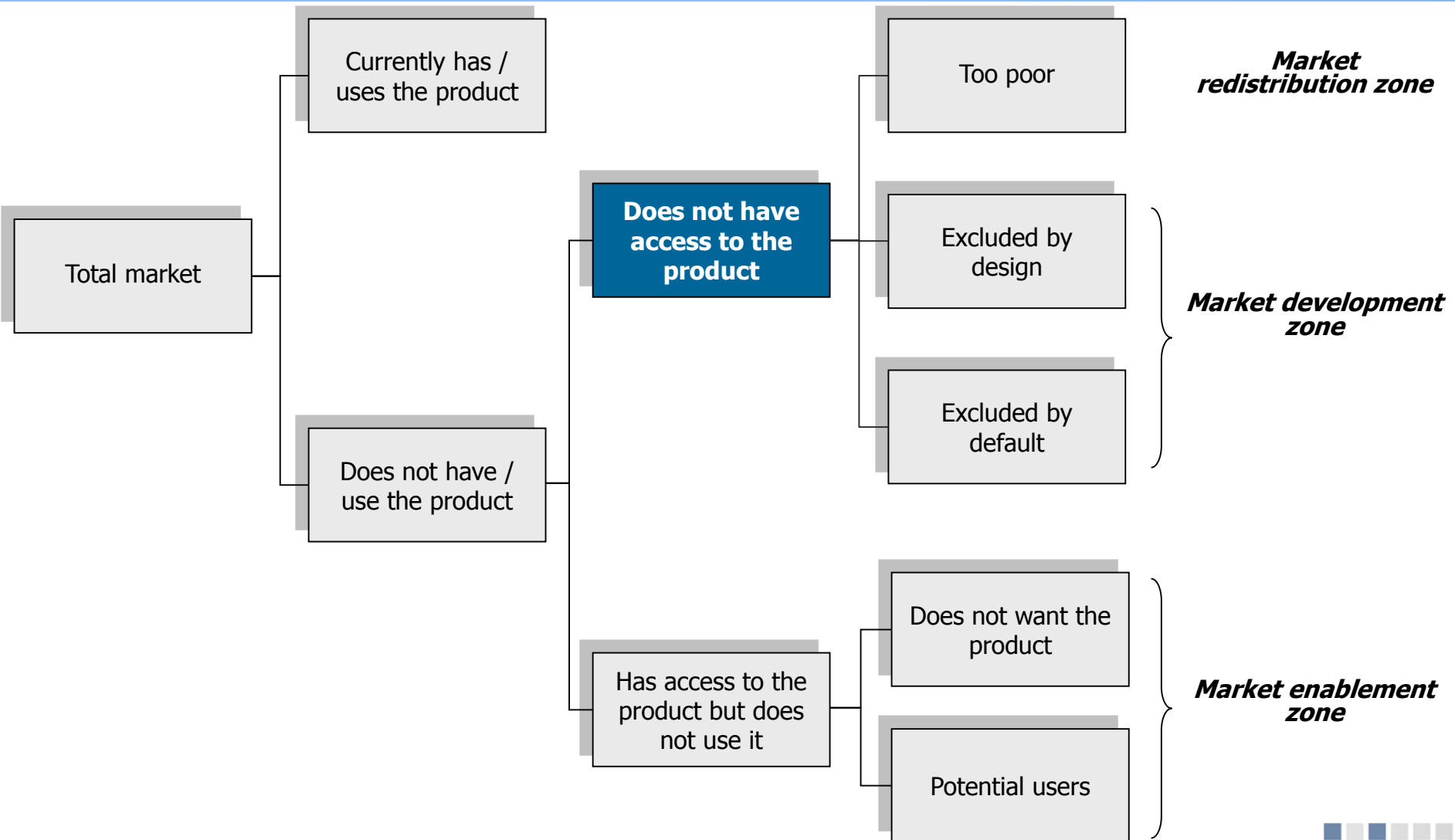
Breakdown of secured loans 2011 Q1-Q2

(Loans granted, R Million)



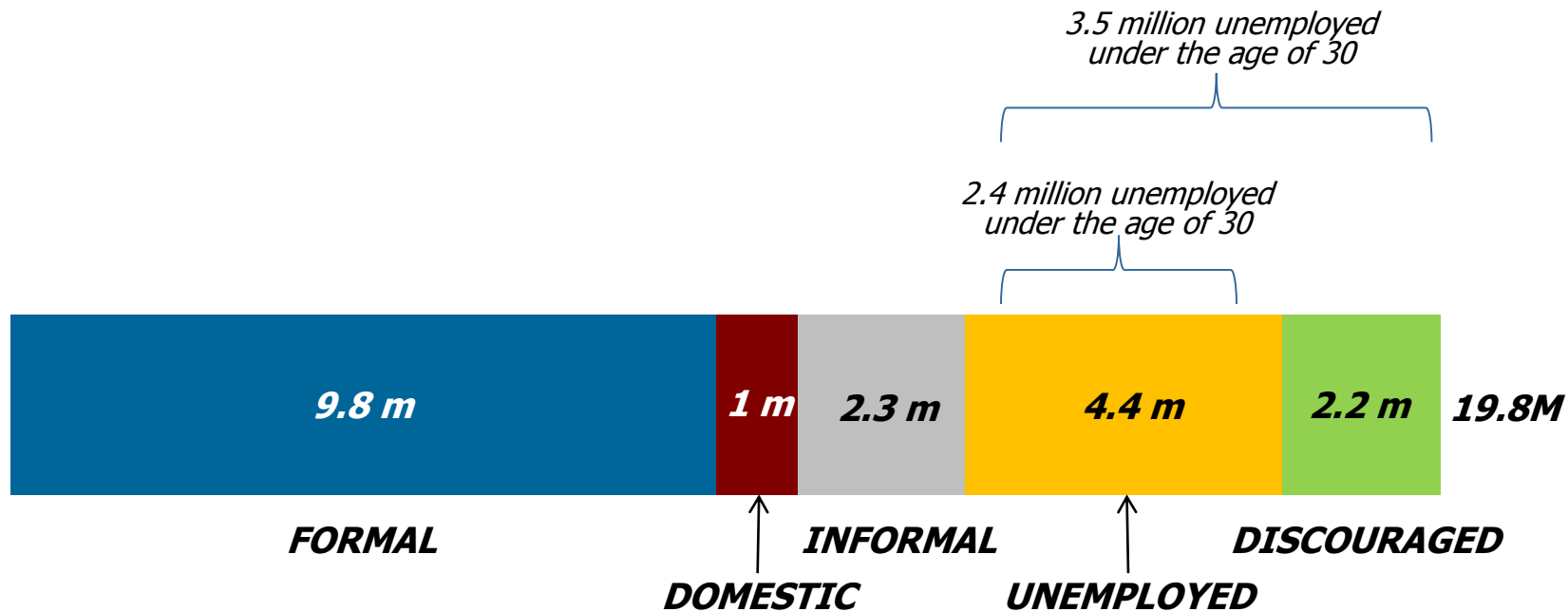


Given supply and demand-side data the Access Frontier Methodology developed by David Porteous enables an identification and quantification of access barriers. It segments those who do not yet use a product into various market zones



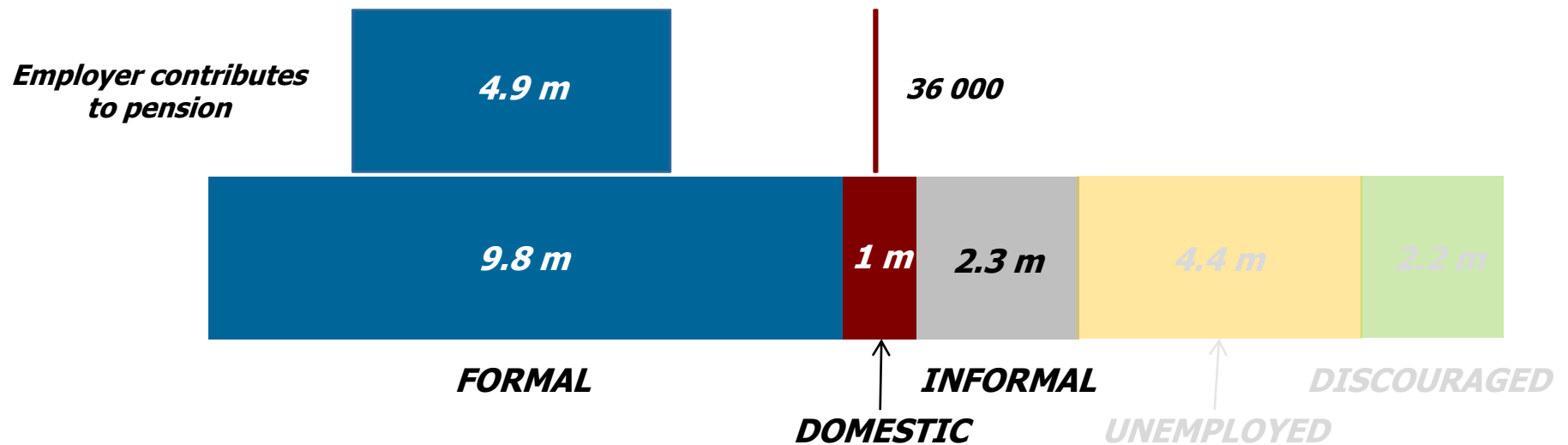


The labour force comprises almost 20 million people including those who have lost hope of finding a job





Around 5 million employed individuals say their employer contributes to their pension fund

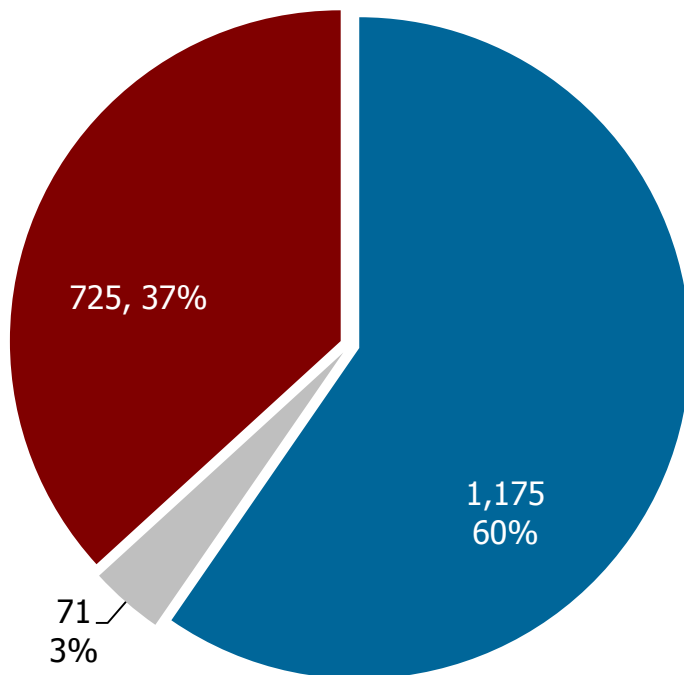




Privately administered and underwritten funds have the most members

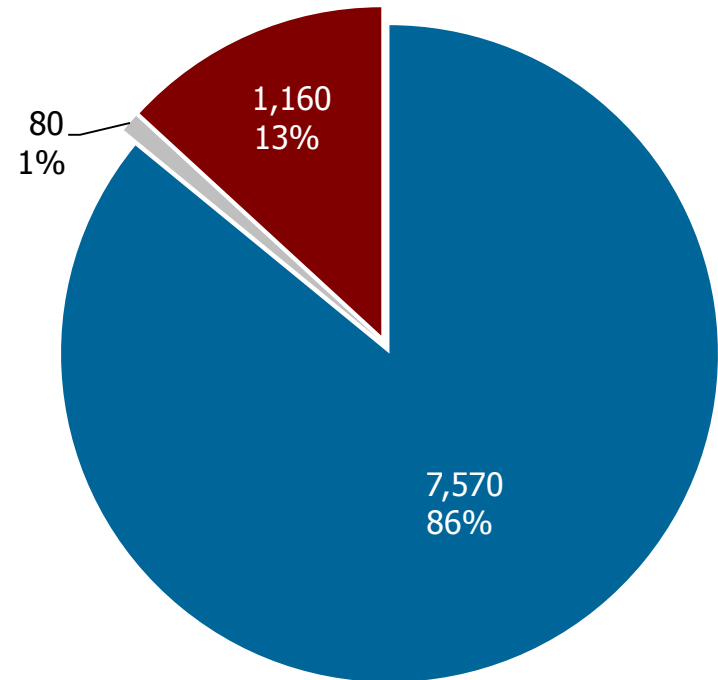
South African retirement fund industry

Total Net Assets
(R Billions)



Total assets = R2 trillion

Total active members
(000's)



Total active members* = 8.8 million

■ Privately administered and underwritten funds ■ Transnet, Telkom and Post Office ■ Government Employees Pension Fund

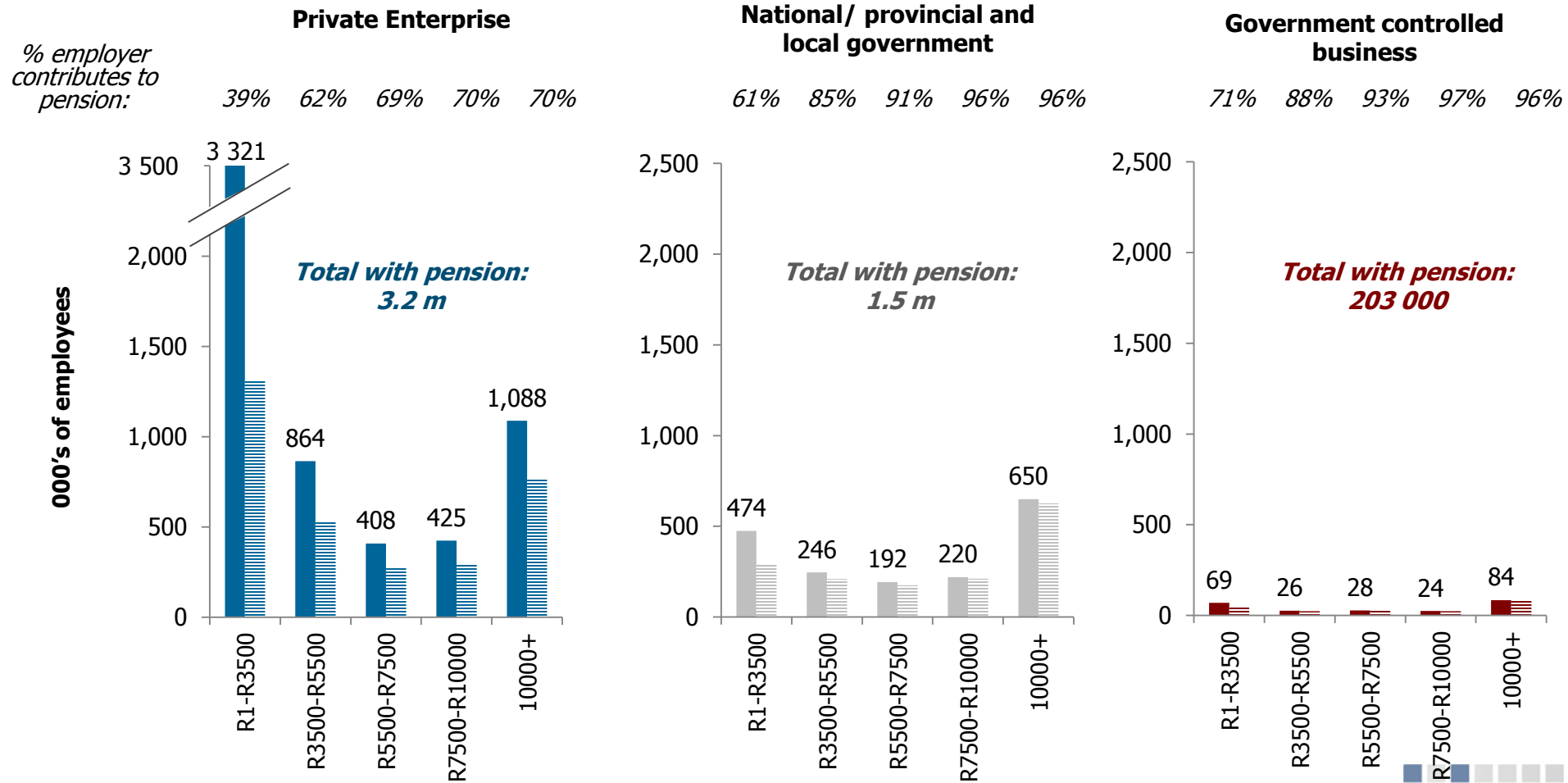
Source: Financial Services Board, Registrar of Pension Funds annual report 2007/08

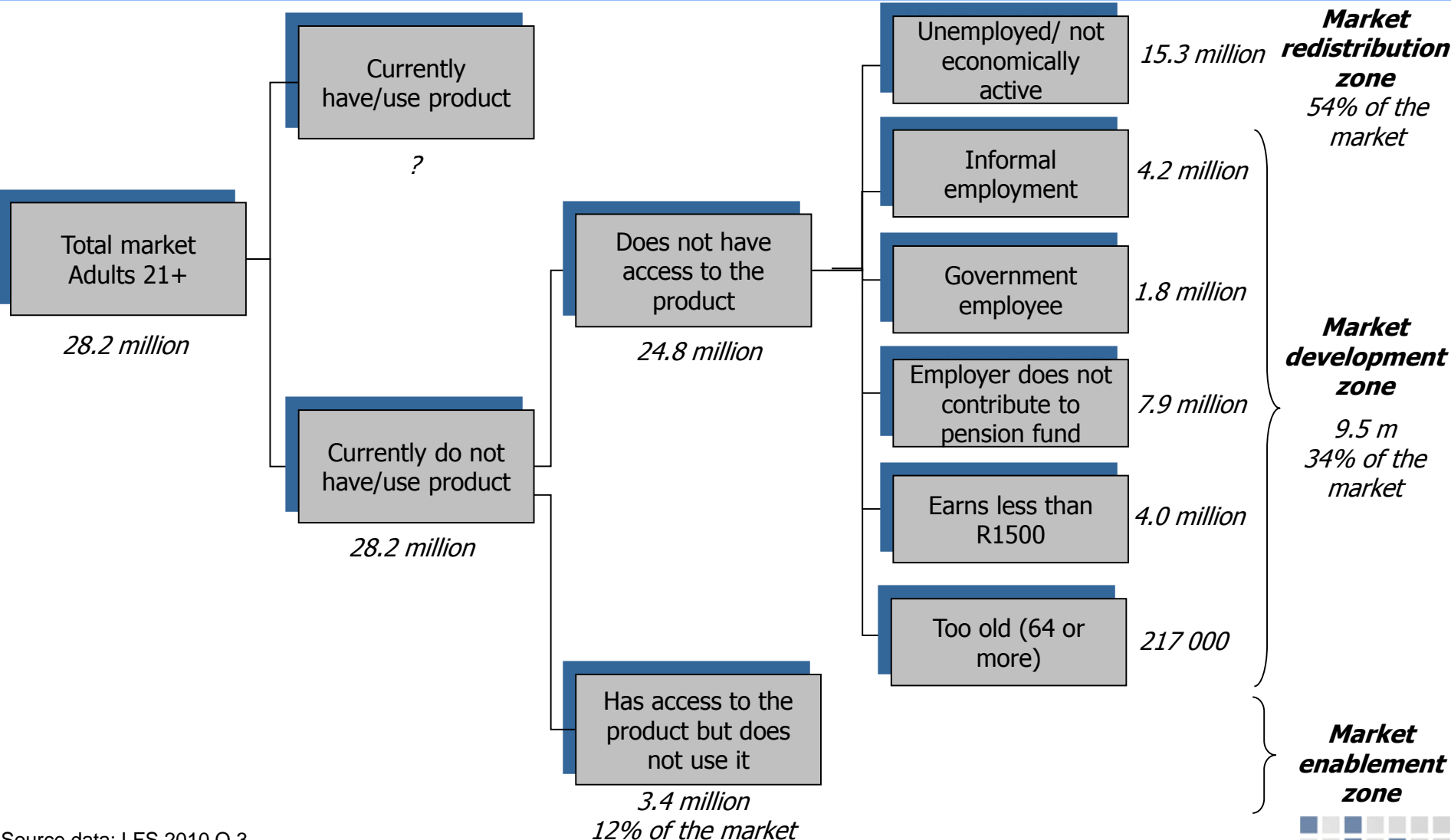
*Note that there will be some double counting as some individuals belong to more than one retirement fund



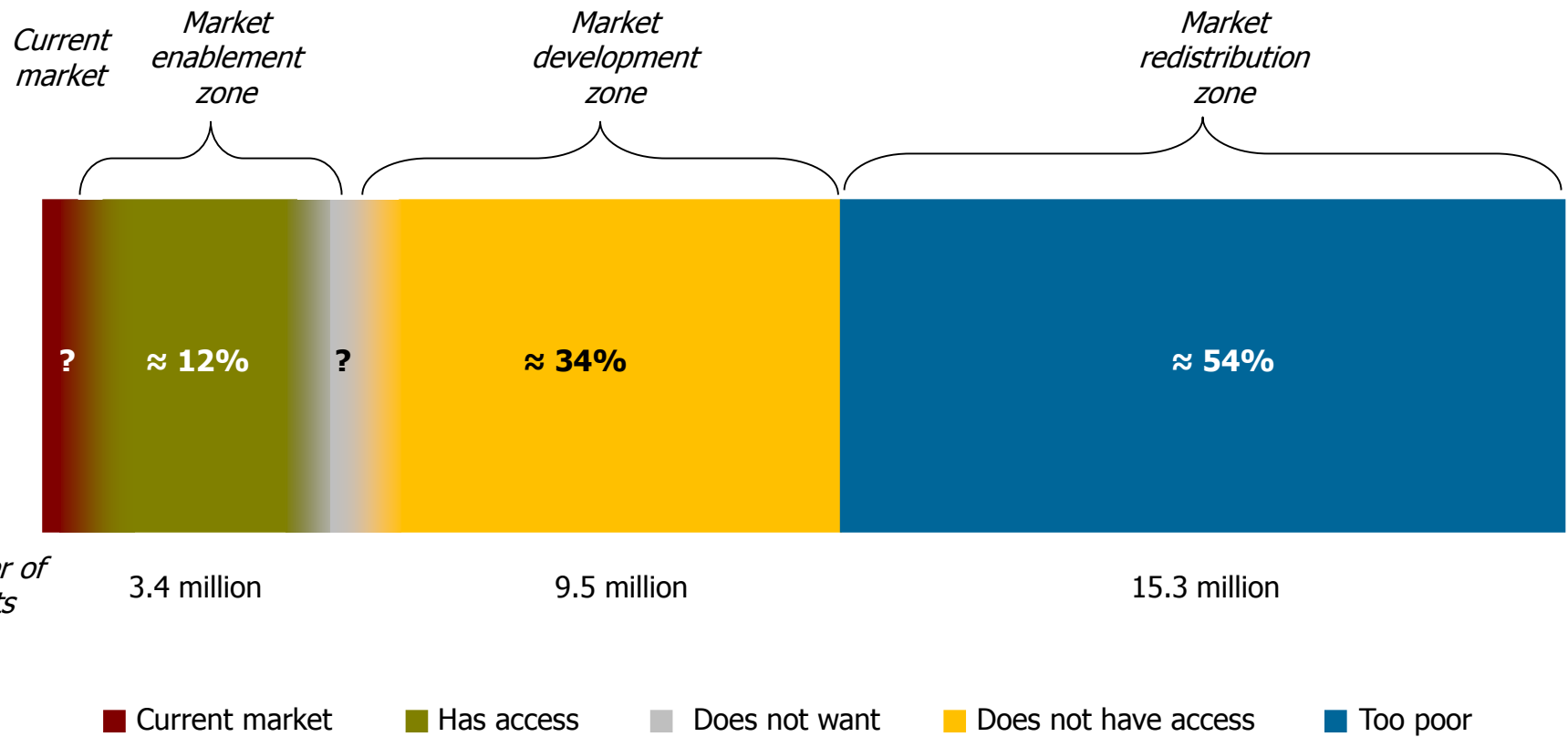
Relatively few lower income workers would be able to access this product. In addition, the fund needs to allow access – Government's pension fund does not

Number of employees by employment sector (Formally employed individuals)



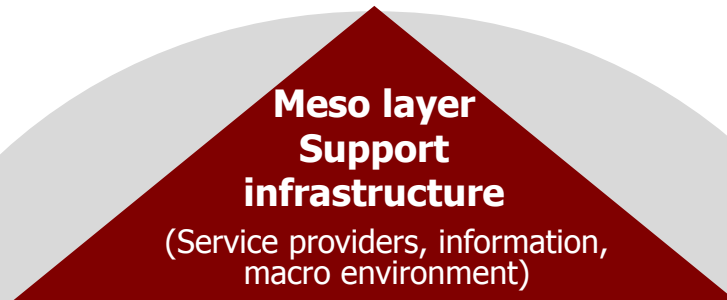


Source data: LFS 2010 Q 3
 Based on a paper entitled "The Access Frontier as an Approach and Tool in Making Markets Work for the Poor" by David Porteous





Some hypotheses: Access problems and PBLs



**Micro layer
Organisational infrastructure**
(diversity, capacity, innovation,
competition)

**Macro layer
Institutional infrastructure**
(policies, laws, regulations)

The consumer

- Pension fund administrators / lenders and payroll administrators need to work together
 - Difficult to monitor use of funds
-
- Captive markets (typically lender is the fund or is associated with the fund administrator)
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- No requirement in terms of asset protection
 - No requirements relating to housing as a financial asset
 - Weak verification required for loan purpose
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- Moral hazard - PBLs are significantly cheaper than mortgages or unsecured housing loans. Borrowers have an incentive to misstate the purpose of the loan
 - Consequences of default cushioned by means-tested state old age pension



Thank you



Questions

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