# MORTGAGE MARKET UPDATE

*–Growth in the value of mortgage loans outstanding continues its multi-year decline, despite new lending starting to pick up*

HOME LOANS DIVISION

PROPERTY AND MORTGAGE MARKET ANALYTICS

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## PROPERTY AND MORTGAGE MARKET ANALYTICS

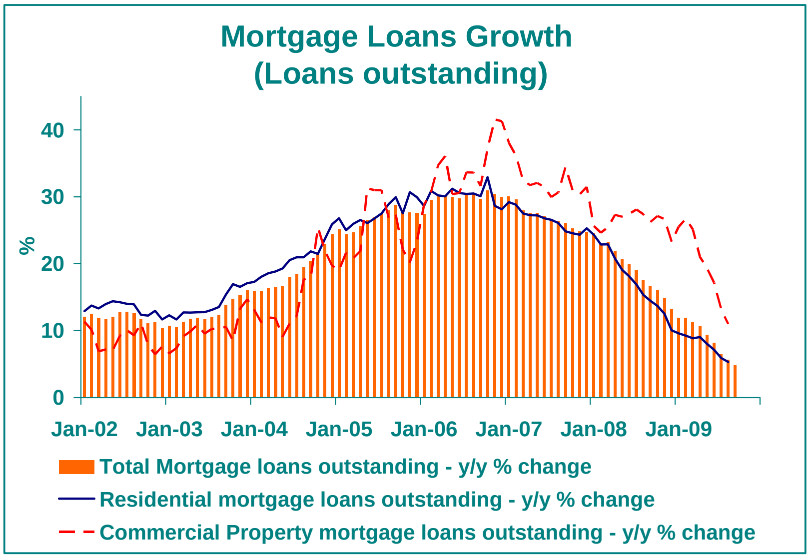
*JOHN LOOS:*
*FNB HOME LOANS STRATEGIST*
*011-6490125*
*John.loos@fnb.co.za*

*EWALD KELLERMAN:*
*PROPERTY MARKET ANALYST*
*011-6320021*
*ekellerman@fnb.co.za*



### THE HOUSEHOLD SECTOR MOVE TOWARDS LOWER CREDIT GROWTH CONTINUES, HELPED BY SLOWER MORTGAGE GROWTH

Given the leads and lags between changes in direction in new mortgage lending and the catch-up of capital repayment trends, it comes as little surprise that total mortgage advances outstanding continued its multi-year declining growth trend in September 2009. Total mortgage advances outstanding grew in value by 4.8% year-on-year in September, down from the previous month's 5.6%.

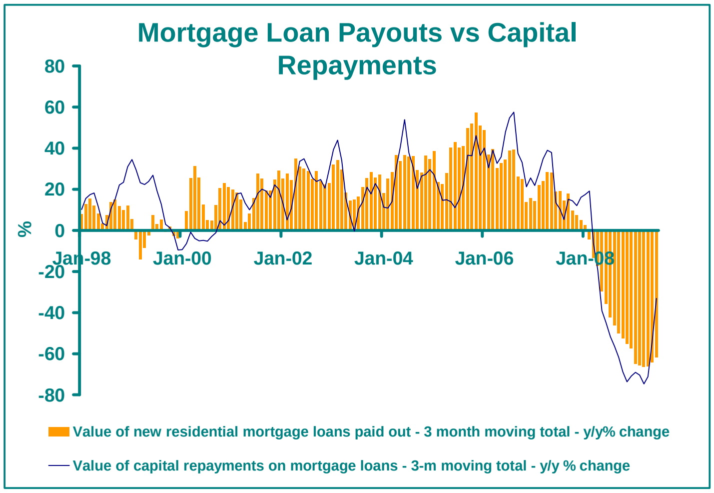



The downward trend is very much household and residential market driven, purely due to residential mortgage loans accounting for near 80% of the total mortgage market. The value of residential mortgage loans outstanding grew by a mere 5.3% in August, down from 5.9% in the previous month and now well down from the 32.9% high reached in October 2006.

However, the far smaller commercial mortgage sector has also come under pressure during these recessionary times, and the growth in value of commercial mortgage loans outstanding has also slowed considerably from a November 2006 high of +41.6% year-on-year to 11% as at August.

*This all begs the question as to whether the total mortgage book of the financial sector will head into negative growth territory before it reaches its turning point? Quite possible now, given the extreme nature of the lending/borrowing pullback from around 2007 until very recently, and given the lag time before this is fully reflected in the trend in loans outstanding.*

## ONGOING DECLINE IN MORTGAGE ADVANCES OUTSTANDING IS STILL THE LAGGED EFFECT OF THE MASSIVE PULLBACK IN NEW LENDING ORIGINATING BACK IN 2006




If one examines the pull-back by banks on mortgage lending in recent years, the drop in new lending was quite extreme to put it mildly, and as recently as the 2nd quarter of this year the mortgage loan payout rate of decline was still around -61.7% year-on-year, only marginally better than the -66.4% registered in the 1st quarter..

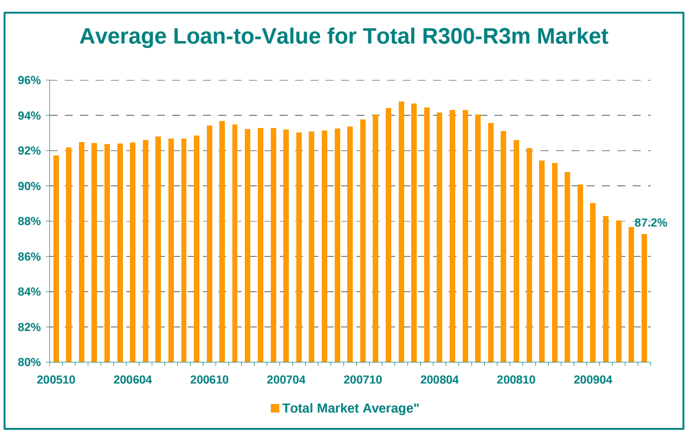
Keeping pace with this decline in payouts until recently, according to SARB figures, was the sharp decline in capital repayments (understandable, given a sharp drop in volumes of new loans and implicitly a drop in the settling up in many cases of existing loans as less homes swap hands). This corresponding decline in capital repayments enables the total mortgage advances outstanding to still show positive growth despite the huge pullback in new lending.

However, we did see a noticeable diminishing in the rate of decline in capital repayment value in the 2nd quarter from -74.6% in the 1st quarter year-on-year to -33.1% in the 2nd quarter, signalling a substantial widening in the gap between loan payout rate of decline and that of capital repayments. Does this signal a household sector stepping up its efforts to pay down mortgage debt? The next few quarters' numbers will tell, but the recent times of recession and uncertainty could be expected to lead to increased caution and in many instances to attempts to increase saving and pay down debt.

Let's re-cap as to what caused the massive pullback in lending/borrowing from extremely high levels a few years ago. The main drivers were:

- Rising interest rates from mid-2006
- Declining real household disposable income growth from early-2007, as first inflation ate into income and then came deteriorating economic growth
- The introduction of the National Credit Act in mid-2007
- And then, from around early-2008, as it became clear that widespread house price deflation was beginning, banks took action to protect themselves from depreciating values in the security backing the residential mortgage loan, lowering their so-called loan-to-value limits and re-introducing deposit requirements on home loans on a large scale.

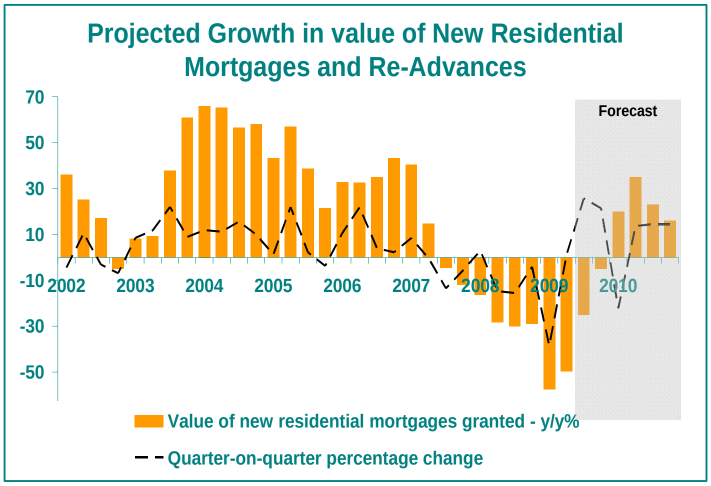
The 4th point above was arguably the biggest "bone of contention" in the industry, as banks had unintentionally exposed one of SA's greatest economic weaknesses, i.e. an extreme lack of saving and therefore in many instances the inability to put down a deposit and qualify for a home loan.




Based on Deeds data, for the R300k-R3m (FNB Home Loans main area of focus) section of the mortgage market, the accompanying graph shows a steady decline in the average loan-to-value ratio, from up near 95% at the beginning of 2008, to 87.2% at August 2009.

Although not apparent in the Deeds data yet, this average loan-to-value trend should have been turning upward in recent times as banks gradually loosen up on lending criteria in response to signs of economic and market improvement.

## NEW RESIDENTIAL LENDING BEGINS TO IMPROVE, AND NEW MORTGAGE NUMBERS PROMISE TO LOOK SIGNIFICANTLY BETTER IN 2010, ALTHOUGH TOTAL ADVANCES OUTSTANDING WILL PROBABLY CONTINUE THEIR DECLINING GROWTH FOR A WHILE




In the mean time, what we do know is that the value of new mortgage loans granted, very well correlated to the Leading Business Cycle Indicator of the SARB, have begun to turn for the better, albeit at a moderate pace. In the 2nd quarter, the year-on-year rate of decline in the value of new residential loans granted had diminished from -57.5% in the 1st quarter to -49.6%, but on a quarter-on-quarter basis the 2nd quarter showed slightly positive growth to the tune of 1%, and this is believed to have accelerated considerably in the 3rd quarter.

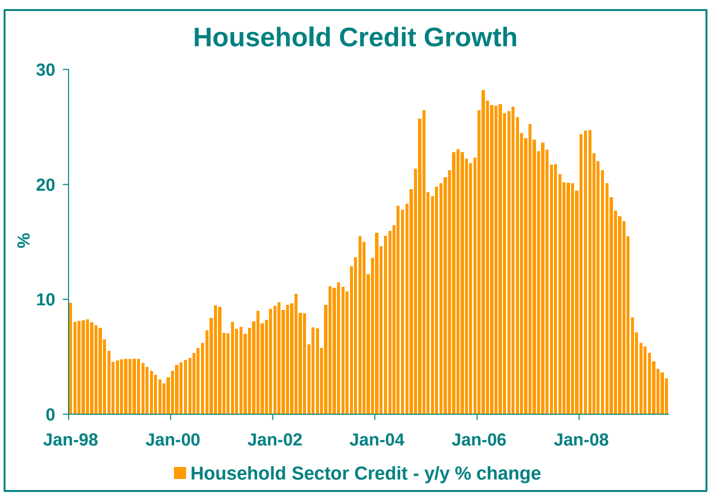
With interest rates now 5 percentage points lower than late in 2008, and the SARB Leading Indicator suggesting better economic times towards 2010, the prospects are for significant growth in new mortgage loans next year, admittedly off a very low base.

Projected growth in new loans and re-advances granted for 2010 as a whole is +22.7%, following an expected overall decline of -37.2% for 2009 when all is said and done (the extreme decline in the first half of the year accounting for the year's decline). On a quarterly basis, the second quarter of 2010 is expected to show the highest year-on-year growth in new lending (+35%), where-after it is anticipated that the positive stimulus from the recent huge interest rate cuts will start to wear off and growth in new lending will stagnate somewhat.

*Is this promising surge in new residential mortgage lending enough to prevent total mortgage loans on the book from declining in value? Probably not, and a short period of negative growth on overall mortgage loans outstanding is anticipated in 2010.*

## HOUSHOLD SECTOR CONTINUES TO MAKE PROGRESS IN REDUCING ITS OVERALL CREDIT GROWTH

Finally, against the background of a very high debt-to-disposable income ratio for SA's household sector, the good news is that overall household sector credit growth outstanding continued to slow in September, from a year-on-year rate of 3.1% in August to 3.6%. It would appear that overall household sector credit will go into a period of negative growth towards 2010, which will assist in making progress with the reduction of the high debt-to-disposable income ratio, which stood at 76.3% as at the 2nd quarter. In the current credit cycle, little progress has been made in reducing the debt ratio due to severe recession pressure on household income growth. The ongoing high debt ratio has been the key reason why the household sector's response to sharp interest rate cuts this year has been muted compared to the previous 2 interest rate cycles. A lower debt-to-disposable income ratio in the coming years would thus be a welcome improvement to the household sector's currently weak financial fundamentals.



## Mortgage Market Summary

| END OF PERIOD | 2004 | 2005 | 2006 | 2007 | 2008 | Q3-2008 | Q4-2008 | Q1-2009 | Q2-2009 | May-09 | Jun-09 | Jul-09 | Aug-09 | Sep-09 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Total Mortgage Market (R'm)** | | | | | | | | | | | | | | |
| Total Mortgage Advances (R'm) | 412 769 | 526 647 | 684 593 | 853 819 | 966 921 | 941 733 | 966 921 | 981 192 | 983 387 | 982 266 | 983 387 | 982 819 | 985 225 | 986 765 |
| *y/y % change* | *24.4* | *27.6* | *30.0* | *24.7* | *13.2* | *16.6* | *13.2* | *11.2* | *8.2* | *9.4* | *8.2* | *6.4* | *5.6* | *4.8* |
| **Banking Sector - New mortgage loans and re-advances granted per property type (R'm)** | | | | | | | | | | | | | | |
| Residential dwellings | 179 316 | 248 800 | 338 327 | 364 575 | 271 276 | 59 867 | 57 399 | 35 347 | 35 718 | 11 611 | 13 761 | - | - | - |
| *y/y % change* | *60.9* | *38.7* | *36.0* | *7.8* | *-25.6* | *-30.0* | *-28.9* | *-57.5* | *-49.6* | *-52.9* | *-27.3* | - | - | - |
| *Of which: Residential re-advances* | | | | | | | | | 11 400 | 3 487 | 4 614 | - | - | - |
| Commercial premises and other | 49 668 | 82 171 | 79 491 | 73 207 | 23 578 | 5 327 | 3 787 | 4 767 | 4 192 | 1 516 | 1 587 | - | - | - |
| *y/y % change* | *25.3* | *65.4* | *-3.3* | *-7.9* | *-67.8* | *-71.9* | *-81.4* | *-38.1* | *-38.1* | *-11.2* | *-37.3* | - | - | - |
| Farms | 3 251 | 4 373 | 5 125 | 3 626 | 3 794 | 1 034 | 866 | 558 | 499 | 166 | 173 | - | - | - |
| *y/y % change* | *116.0* | *34.5* | *17.2* | *-29.2* | *4.6* | *8.5* | *-12.2* | *-33.8* | *-52.5* | *-54.4* | *-52.1* | - | - | - |
| Total | 232 234 | 335 348 | 422 941 | 441 410 | 298 643 | 66 227 | 62 050 | 40 674 | 40 406 | 13 290 | 15 522 | - | - | - |
| *y/y % change* | *52.2* | *44.4* | *26.1* | *4.4* | *-32.3* | *-37.2* | *-39.2* | *-55.6* | *-48.7* | *-50.2* | *-28.9* | - | - | - |
| **Banking Sector - New mortgage loans granted per application (R'm)** | | | | | | | | | | | | | | |
| Construction of buildings | 27 565 | 32 445 | 30 941 | 28 574 | 29 927 | 7 231 | 4 658 | 3 757 | 4 185 | 1 618 | 1 401 | - | - | - |
| *y/y % change* | *73.4* | *17.7* | *-4.6* | *-7.7* | *4.7* | *-0.3* | *-22.3* | *-60.5* | *-50.9* | *-46.5* | *-39.9* | - | - | - |
| Existing Buildings | 189 411 | 277 697 | 357 851 | 384 052 | 256 668 | 56 462 | 55 677 | 35 916 | 35 268 | 11 294 | 13 823 | - | - | - |
| *y/y % change* | *48.4* | *46.6* | *28.9* | *7.3* | *-33.2* | *-38.3* | *-38.0* | *-53.9* | *-47.1* | *-49.9* | *-25.3* | - | - | - |
| Vacant Land | 15 261 | 25 206 | 34 149 | 28 784 | 12 049 | 2 534 | 1 715 | 1 000 | 953 | 378 | 298 | - | - | - |
| *y/y % change* | *68.1* | *65.2* | *35.5* | *-15.7* | *-58.1* | *-62.6* | *-72.8* | *-76.4* | *-73.3* | *-66.2* | *-69.8* | - | - | - |
| **Banking Sector - Payouts and Capital Repayments (R'm)** | | | | | | | | | | | | | | |
| Total loans paid out per period | 220 206 | 313 886 | 399 295 | 461 727 | 276 271 | 62 127 | 51 233 | 29 845 | 28 396 | 9 010 | 10 191 | - | - | - |
| *y/y % change* | *32.2* | *42.5* | *27.2* | *15.6* | *-40.2* | *-50.0* | *-57.3* | *-66.4* | *-61.7* | *-61.0* | *-53.7* | - | - | - |
| Capital repayments per period | 146 613 | 183 527 | 250 359 | 297 877 | 156 192 | 28 659 | 24 441 | 16 294 | 25 974 | 8 092 | 9 101 | - | - | - |
| *y/y % change* | *28.7* | *25.2* | *36.4* | *19.0* | *-47.6* | *-61.7* | *-70.9* | *-74.6* | *-33.1* | *-34.5* | *-12.3* | - | - | - |
| **Total Banking Sector Mortgages Outstanding (R'm)** | | | | | | | | | | | | | | |
| Farm Mortgages | 3 559 | 4 126 | 4 700 | 5 372 | *6771.0* | 6 417 | 6 771 | 7 132 | *7297.3* | 7 257 | 7 297 | 7 280 | 7 328 | - |
| *y/y % change* | *5.2* | *15.9* | *13.9* | *14.3* | *26.0* | *24.6* | *26.0* | *23.6* | *19.4* | *19.5* | *19.4* | *16.6* | *17.2* | - |
| Housing Advances: Total | 327 953 | 426 205 | 546 197 | 684 317 | *753122.0* | 736 735 | 753 122 | 766 362 | *768659.6* | 767 694 | 768 660 | 768 945 | 770 587 | - |
| *y/y % change* | *25.9* | *30.0* | *28.2* | *25.3* | *10.1* | *14.5* | *10.1* | *8.9* | *7.1* | *8.0* | *7.1* | *5.9* | *5.3* | - |
| Commercial Property Advances: Total | 74 336 | 91 644 | 129 488 | 170 252 | *209882.2* | 198 016 | 209 882 | 212 018 | *214161.8* | 213 488 | 214 162 | 213 728 | 214 443 | - |
| *y/y % change* | *19.7* | *23.3* | *41.3* | *31.5* | *23.3* | *26.3* | *23.3* | *25.1* | *17.2* | *19.3* | *17.2* | *13.2* | *11.0* | - |
| Total Banking Sector Mortgage Loans Outstanding | 405 847 | 521 974 | 680 384 | 852 639 | *969775.0* | 941 168 | 969 775 | 985 750 | *990127.0* | 988 439 | 990 127 | 989 953 | 992 357 | - |
| *y/y % change* | *24.5* | *28.6* | *30.3* | *25.3* | *13.7* | *16.8* | *13.7* | *12.1* | *9.3* | *10.4* | *9.3* | *7.5* | *6.6* | - |
| **Household-Related Debt and Deposits (R'm)** | | | | | | | | | | | | | | |
| Household Debt | 478 741 | 585 541 | 726 270 | 867 635 | 1 002 020 | 986 973 | 1 002 020 | 1 013 684 | 1 012 116 | 1 014 080 | 1 012 116 | 1 014 223 | 1 017 133 | 1 017 827 |
| *y/y % change* | *26.5* | *22.3* | *24.0* | *19.5* | *15.5* | *17.7* | *15.5* | *6.2* | *4.6* | *5.3* | *4.6* | *4.0* | *3.6* | *3.1* |
| Household Deposits held by banks | 283 750 | 319 095 | 363 113 | 423 700 | *501878.0* | 482 385 | 501 878 | 508 165 | *511738.0* | 511 165 | 511 738 | - | - | - |
| *y/y % change* | *9.7* | *12.5* | *13.8* | *16.7* | *18.5* | *16.1* | *18.5* | *14.1* | *9.4* | *11.6* | *9.4* | - | - | - |