Here's how the interest-on-interest debt bill hurts home buyers

South African delinquent consumers are paying R20,7bn in overdue interest each year. This is the equivalent of nearly 0.5% of the country's Gross Domestic Product according to research by HomeTimes.co.za.

As at Q1 2016, the total personal debt position in South Africa was R1,66tn, with 52% of these borrowers more than one month in arrears. And with interest on the overdue amount in the region of 2% a month being added to the principal debt, annualised interest-on-interest adds up to some R20,7bn. In 2015 there were 1,052,700 credit applications approved in South Africa every single month, which means consumers were borrowing money to acquire something they couldn't afford to pay for with cash.

With 52% of borrowers in arrears on their credit accounts, it's little wonder the economy is stalled as the interest-on-interest clock ticks away. The money that should be going back into the economy through the purchase of goods and services is being funnelled into the hands of credit providers who simply lend out more and more money knowing that they will be earning interest upon interest from 52% of the people they lend to.

South Africans swipe-happy

South Africa's consumerism culture is turning our economic engine – this is evident in the fact that South Africa is home to approximately 1,785 malls, according to property research company Urban Studies, with township and rural centres numbering around 300 (16%). The three major metropolitan areas (Gauteng, Western Cape and KwaZulu-Natal) contain around 75% of the country's shopping centres, with Urban Studies MD, Dirk Prinsloo, saying South Africa is placed sixth in the world in terms of the largest number of shopping centres, behind the US, Japan, Canada, the UK, and China.

It's unsurprising, then, that the retail and wholesale sector is the country's third-largest economic sector, contributing approximately 15% to our GDP, says Urban Studies. One cannot, however, also ignore the fact that it employs more than 600,000 permanent employees, and creates another half a million indirect jobs.

In 2015, the number of new mortgage finance loans comprised some 13,700 a month, a paltry 1.3% of the total of new loans granted; compared with overdrafts, new credit card and retail accounts which totaled 703,000 successful applications a month - 67% of new loans granted. Unsecured loans totaled 336,000, or 32%, of new loans granted each month.

As at Q1 2016, total outstanding consumer credit amounted to R1,66tn - over half of which was mortgage debt (52%). Secured credit agreements accounted for 22%, credit facilities made up 13% and unsecured credit made up 10% of outstanding debt. The remaining 2% was made up of developmental and short-term credit. These credit figures are monitored by HomeTimes.co.za as they affect the housing market.

Less than half (48%) of the 23,9m credit-active consumers in South Africa are current on all their accounts: 12% are one to two months in arrears, 22% are three months or more in arrears, and the remaining 18% have either an adverse listing, judgement or admin order against them. This means almost one in five consumers is facing a judgement and/or blacklisting.

Homes harder to come by

HomeTimes.co.za is concerned that this is affecting the home sales marketplace, where a meaningful proportion of potential buyers are being rejected for home loans due to credit impairment records. According to bond originator, BetterLife, some 28% of the applications for a bond it applies for at the banks is rejected; mortgage originator, ooba, quotes a similar number.

This fact, coupled with a virtual no-growth economy, is seeing a sizeable drop off in the rate of sales of homes compared to recent years. In January, HomeTimes, reported that deeds office registrations of homes for 2015 were 289,631, a drop 0.2% on 2014; average house prices also only rose 0.94% year-on-year to R1,234,120.

The interest charged on overdue amounts on credit and store cards is set at a maximum of 21.48% per annum, while rates on unsecured loans have a ceiling of 26.48% per year. How does it happen then that 52% of consumers are battling to make ends meet? How, since the introduction of the National Credit Act in 2007, are credit providers still allowed to drag down the economy and trap South Africans in a cycle of debt and interest charged on interest? Maybe it's because banks are allowed to run radio adverts telling consumers to get credit cards to purchase big screen TVs, or maybe it's because a five-step process on your cellphone can get you access to up to R150,000 in credit.

What game is being played?

The interest-on-interest money charged by credit providers totalling some R20,7bn a year is robbing the economy of much-needed spending to stimulate it and ultimately create more jobs.

The profit margin on some 24% per annum (2% per month) on overdue interest is higher than the profit margin on the sale of goods and services for most retailers and others providing credit. To put it simply, credit providers are borrowing their money at below the prime rate of 10.5% per annum and defaulting debtors get charged an annualised rate of 24% per year – more than double the interest they are charged. With credit default statistics showing that more than half the people they lend money to will be paying interest on interest, one has to wonder if they are in the business of selling goods and services, or in the finance business preying on consumers who may be less-than-sound credit risks.

Placing the blame

While the real fault lies with the need for instant gratification of consumers, especially younger consumers, "responsible" credit providers continue to play a dangerous game. Young people want fancy clothes and accessories, motor cars and the like and are less likely to save for what they want. They want it and they want it now, and the money lenders are only too happy to give them what they want knowing that most will be paying interest on interest in the near future.

This debt trap situation is robbing our citizens of the privilege of owning their own homes – now and in the future.

Can we honestly sit back and say the National Credit Act has had the envisioned positive effect on credit expansion and credit worthiness verification if 52% of borrowers are in arrears with their loan repayments? The short answer is no, it probably has not.

Article originally published at http://hometimes.co.za/2016/09/heres-how-the-interest-on-interest-debt-bill-hurts-home-buyers/