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The Impact of the National Credit Act on the South African residential housing market

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ABSTRACT AND KEYWORDS

Purpose

The purpose of this paper is to show the impact of the National Credit Act on the South African housing market.

Design/methodology/approach

An extensive literature review was conducted as well as a number of interviews with consultants from the credit and residential industries as part of the research methodology. The data collection instrument had a structured as well as an unstructured section. The results were then analyzed and the findings were grouped relative to the sub-problems.

Findings

The critical finding from the literature review was that the effect of the National Credit Act 34 of 2005 as well the work of the National Credit Regulator imply that it is becoming increasingly difficult to access home loans from commercial banks. The field study finding was that the implementation of the National Credit Act 34 of 2005 had a temporary negative effect on the South African residential industry as a result of the strict lending criteria. However, these findings also show that the long term effects seem to outweigh the problems faced by the residential market at the time.

Originality/Value

This research contributes to Property Economics and Management body of knowledge and provides a further understanding of the

South African residential and credit industries at large. The conclusion is that the South African residential industry may suffer temporary setbacks whilst the system stabilizes, but will benefit from a healthy, self regulating credit system in the future.

Keywords

National Credit Act, Mortgage bonds, Banks, Residential market

1. INTRODUCTION

Mortgage bond agreements play a prominent role in the South African residential industry as a result of the considerable percentage of change in ownership of immovable property financed. Mortgage bond agreements are governed by the National Credit Act 34 of 2005 which came into effect on 1 July 2007. The emphasis of the Act is on responsible credit provision. It has been put in place to slow down the rate of lending by making it more difficult for consumers to gain access to credit (Planting & Radebe, 2008: 32). Furlonger (2008: 38) states that there can be no dispute that the National Credit Act was introduced for the right reasons and that consumers in the credit market needed protection from reckless lending and over-indebtedness.

Consumer credit recently increased substantially before the National Credit Act 34 of 2005 was enacted. Figures published by Planting & Radebe (2008: 33) show that the consumer credit market grew from R340 billion in 2002 to R640 billion in 2006 and to R1, 1 trillion at the end of 2007. There was also little sign of the consumer credit market slowing down despite four successive interest rate hikes during 2007 (Planting & Radebe, 2008: 33). Otto (2006: 5) states that it is an unfortunate fact that many South Africans entered into credit agreements which they as consumers could not afford and that the National Credit Act 34 of 2005 *"goes a long way"* to protect the consumer from becoming over-indebted. Prominent property economist Erwin Rode (Planting & Radebe, 2008: 32), agrees with Otto (2006: 5) and adds that, *"the National Credit Act will save South Africans from themselves".*

Before 1 July 2007, the credit market was regulated by the Usury Act, 73 of 1968; the Usury Act Exemption Notice 1407 of 2005 (exemption notice); the Credit Agreements Act 75 of 1980; the Alienation Of Land Act, 68 of 1981 and the Lay-by regulations promulgated under the Sale and Services Matters Act 25 of 1964. The laws previously used were incapable of addressing modern-day issues in the credit market. The National Credit Act 34 of 2005 was designed to comprehensively regulate the credit industry. Previous legislation did not adequately address issues such as reckless lending, over-indebtedness and access to credit (Khanye, Sekati & Kunene, [s.a.]: 12). Otto (2006: 2) posited that the National Credit Act 34 of 2005 will replace the Usury Act 73 of 1968 and the Credit Agreements Act 75 of 1980. Khanye *et al*. ([s.a.]: 17) concurs with Otto's statement by asserting that the National Credit Act 34 of 2005 will also replace the exemption notice 1407 of 2005 which deals with the micro-lending credit industry.

The National Credit Act 34 of 2005 is more "user-friendly" than previous acts which regulated the credit industry in that it is more accurately worded. The Act is also clear on which regulations apply to a commodity in question within the South African context (Otto, 2006: 4). Furthermore, Otto (2006: 3) suggests that a definite improvement has been made by instituting a single Act instead of multiple acts which were used in previous legislation governing the South African credit industry.

The aim of this research was to determine the impact of the National Credit Act 34 of 2005 on the South African residential housing industry. More specifically it aimed at identifying the issues faced by home loan applicants relative to previous as well as current legislation.

2. BACKGROUND

2.1 National Credit Act 34 of 2005

Some of the important sections of the National Credit Act 34 of 2005 are as follows:

Chapter 1 Part B of the National Credit Act 34 of 2005: 30

This part summarises *the purposes of this Act. These are to promote and advance the social and economic welfare of South Africans, promote a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and industry, and to protect consumers, by promoting the development of a credit market that is accessible to all South Africans, and in particular to those who have historically been unable to access credit under sustainable market conditions;"*

Chapter 1 part C of the National Credit Act 34 of 2005: 40 Section 9: provides the *"Categories of credit agreements". These include small agreements, intermediate agreements, and/or large agreements,*

Otto (2006: 69) states that credit providers are in business to make a profit, whereas Govindjee *et al*. (2006: 5) claim that the general public does not have a fair understanding of the effects of interest on debt. For this reason, the law has made an attempt to regulate the credit market in order to protect consumers from exploitation by the credit providers (Govindjee *et al*., 2006: 5). Maximum fees and interest rates which can be

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charged by a credit provider are considered to be one of the most important sections of the National Credit Act.

The National Credit Act 34 of 2005 provides additional security to the credit provider in cases of debtor default. For instance if a property acquired on credit has been sold to repay the credit obligations, there could still be monetary obligations in arrears by the debtor. In such cases, section 127 of the National Credit Act 34 of 2005 states that the creditor may apply for a court order to enforce the remaining obligations due. However, this rule is restricted to credit agreements such as instalment agreements, leases or secured loans (Otto, 2006: 96). Otto (2006: 96) points out that it is peculiar that mortgage agreements are not included in instances such as those mentioned above. Therefore, the only property of the debtor which the credit provider can claim and sell is the mortgaged property and the proceeds will have to settle the amounts owing by the debtor. Therefore the legislation protects the consumer while the credit providers are expected to look after their own affairs (Otto, 2006: 97).

2.2 The National Credit Regulator

The office of the National Credit Regulator was established by the National Credit Act 34 of 2005. This organizational body was established to effectively and comprehensively regulate the credit market in South Africa. (Khanye *et al*., [s.a.]: 12). Otto (2006: 3) stated that about 40% of the National Credit Act's printed text deals with the sections on the establishment and powers of the National Credit Regulator and National Consumer Tribunal (Khanye *et al*., [s.a.]: 3).
The predecessor of the National Credit Regulator is the Micro Finance Regulatory Council (MFRC) which regulated the micro-loans credit industry. The following traits are similar between the MFRC and The National Credit Regulator (Khanye *et al*., [s.a.]: 14):

- There is a registration process of lenders;
- The current credit market also has a regulatory body that can investigate non-compliant conduct of lenders in terms of the Act and prosecute the lenders by means of a disciplinary committee;
- Over-indebtedness and reckless lending was introduced by the exception notice which governed the MFRC and similar legislation is currently used by the National Credit Regulator to control over-indebtedness and reckless lending;
- The current legislation on control of the National Credit Regulator has a requirement for lenders to do an affordability check on consumers to prevent over-indebtedness which corresponds to the legislation governing the MFRC; and

- The conduct of lenders in the micro-finance industry previously was also regulated as the lenders are currently.

Khanye *et al*., ([s.a.]: 66) state that in previous credit law systems, common law always favoured the rights of the creditor. The National Credit Act 34 of 2005 gives more attention to the problems of the consumer and attempts to balance the scale between the debtor and the creditor.

The concept of reckless lending and over indebtedness was first introduced in the MFRC to regulate the micro-lending industry and was seen to work exceptionally well in the circumstances; which was the reason why these concepts were implemented in the National Credit Act 34 of 2005 (Khanye *et al*., [s.a.]: 69).

Over indebtedness occurs when a consumer does not have the financial capability to finance all their credit obligations. Reckless lending by financial institutions is seen as being one of the main problems which lead to consumers being over-indebted (Khanye *et al*., [s.a.]: 75)

When consumers have over-extended themselves financially, they may apply for a debt review at a debt counsellor. Section 86 of the National Credit Act 34 of 2005 sets out the procedure to be followed. The debt counsellor will then asses the consumers' financial situation and determine whether the consumer is over indebted or not (Khanye *et al*., [s.a.]: 84).

2.3 The role of commercial banks in the residential industry.

Consumers often use the option of mortgage bond finance in the acquisition of Real Estate. It is unusual for a property investor to purchase property without the use of a mortgage bond (Fish, 2005: 76). A mortgage bond is a credit transaction between a consumer and a credit provider where the consumer borrows money from the credit provider and the credit provider holds a mortgage bond over the immovable property being purchased by the consumer. In the event of the consumer defaulting on repayment of debt, the credit provider has first right to claim the mortgaged property (Khanye *et al*., [s.a.]: 4). Mortgage bonds are used by consumers who do not have sufficient cash at hand to purchase property or for strategic investment reasons. Thus mortgage bonds propel commercial banks to the centre role in the residential property industry. In cases such as these, the consumer has to put down a deposit of normally 10% of the purchase price unless they qualify for a 100% housing loan (Delport, 2009: 15).

Before the National Credit Act 34 of 2005 was implemented, banks would require a statement of the applicants' provable dependable income. Repayments of the mortgage were restricted to no more than 30% of the applicants' dependable income (www.wizardmidrad.com).

After the promulgation of the National Credit Act 34 of 2005, commercial banks require on application for a bond, a declaration of the applicants' incomes and expenditures (www.wizardmidrand.com). Incomes and expenditures have to be checked to determine the applicant's level of indebtedness as well as whether the applicant can successfully bear more debt. The disposable income of the applicant is utilized under the legislation of the National Credit Act 34 of 2005. Disposable income is determined monthly by deducting all expenses from the applicants' incomes. The method explained will protect the applicant so that he/she cannot secure a mortgage bond that exceeds his/her disposable incomes which, in effect, is the monthly net income after expenditures (The National Credit Act 34 of 2005, 2005). Before the promulgation of the NCA, the rule of thumb employed in the lending criteria for Real Estate, was 30% of gross income.

The National Credit Act 34 of 2005 protects both the debtor and the creditor to a contract. If the debtor is found to be over-indebted after the disclosure of all financial statements to the creditor, the creditor can be sued by the debtor as well as pay a fine for contravention of the act. If the debtor does not issue accurate financial statements, the property which was purchased on loan can be repossessed by the credit provider and the debtor can be blacklisted.

It is, thus, obvious and evident that the implementation of the NCA had a direct influence on the reduction in mortgage bond approvals for Real Estate acquisition...

3. RESEARCH METHODOLOGY

3.1 Data collection instrument

The information collecting technique took the form of an interview with the members of the residential property population. All interviews were conducted separately from one another to attain individual perceptions instead of a collective opinion.

3.2 Questionnaire development

The interviews conducted with the members of the residential property population had two sections. The first section was a structured interview where the same questions were asked to all members of the population. These questions were closed ended questions based on facts pertaining to the promulgation of the National Credit Act 34 of 2005 on the South African residential industry.

The second section was an unstructured interview. In this section an open ended question was initially asked to obtain a better understanding of the members' perception of the Act. After the first question was asked, the researcher followed the conversation by asking further unstructured questions to obtain a better understanding of each member of the populations' perception of the implementation of the National Credit Act 34 of 2005. All interviews were recorded for the purpose of analysis when all information was gathered from all members of the population.

3.3 Sampling

The target population consisted of accredited members of the residential industry such as mortgage originators, prominent Real Estate firms which are based countrywide as well as all four commercial banks in South Africa. All members of the mortgage origination firms and real estate agencies which were interviewed, were branch managers. Branch managers were specifically targeted because of their trusted insight into the residential industry as well as legislation governing implications of the National Credit Act 34 of 2005. All members from commercial retail banks who were interviewed were involved with the home loans departments of their respective banks and dealt with mortgage loan applications daily.
A homogeneous representative sampling technique was used for this study because the National Credit Act 34 of 2005 applies to the population in the same way. Hence the outcomes will be the same for all members of the population. Leedy & Ormrod (2010) describes a representative sample to be used in studies where one wishes to learn more about a particular category.

3.4 The population spectrum.

The population consisted of 4 national commercial retail bank managers, 3 national bond originators and 3 national real estate agencies

3.5 Secondary data

The secondary data which was used in this study was obtained from newspaper articles, accredited journals, organizational data bases and internet sources which contributed to the findings of this treatise. Consultants in the field of the National Credit Act 34 of 2005 as well as the residential industry which stretched beyond the scope of data collection for this treatise have been interviewed previously. This information was utilized and contributed to the findings.

3.6 Interview administration

The members of the population were contacted by telephone to enquire about willingness to participate in the survey and to make appointments for when the interviews would take place. A total of 10 interviews were conducted with the professionals who were identified in the section above. Each interview took between twenty, (20) and forty, (40) minutes to complete.

3.7 Data analysis

The Data which was obtained from the population interviewed was analyzed using Excel and interpreted. The first set of questions were asked to determine whether there was in actual fact still a market for residential property even though few applicants got approved mortgage loans.
The second set of questions were designed to interpret the extent to which the National Credit Act 34 of 2005 reduced the number of home loans which were approved.

The third set of questions were asked to determine whether there were any negative outcomes from the implementation of the National Credit Act 34 of 2005 and to establish a brief list of factual outcomes of the implementation of the Act.

Section two of the Interview was included in the study to gain the population's views of the implementation on the National Credit Act 34 2005. All information which was collected during the interviews was then reported as follows:

- If there was general consensus by the interviewed population and the feedback was more or less in the same wording and perception, the information was presented in such a way.
- If there was general consensus by the interviewed population and one member of the population stated their opinion in a unique manor which encapsulated all the other members' opinions, then it would be stated in their wording and reference was made to them in the findings.
- If one or more members of the interviewed population moved away from the general opinion, their opinions were set out separately.

4. FINDINGS

The outcomes of the implementation of the National Credit Act 34 of 2005 are positive in the sense that the credit market is being controlled by a system which protects the credit applicant/ consumer from being over committed in debts. This is done by the National Credit Regulator. However, the effect of the NCA has been that fewer mortgage loans are being approved by banks and that has an adverse effect on the incomes of residential market as well as on the key role players in the credit and residential industries.

A bankers view was that one must look at an applicants' affordability of a home loan before any decision of a mortgage loan can be made and that the bank can only lend as much as what the applicant can afford. An affordability check is the calculation which determines an applicants' disposable income. After this discipline is incorporated, the magnitude of the applicants' loan can be determined. The banks also have to conduct research on every credit applicant in terms of a background check whether the applicant has an acceptable credit record. Deductions can be made from the above findings that the lending criteria used by banks has become more stringent. This is to ensure that the credit applicants which are approved home loans can afford home loans beyond doubt.

From the data which was collected, it can be deduced that more mortgage applications are declined than approved. The large number of declined applications was due to the level of rigorousness applied by the institutions during the pre-loan approval screening process.

An interesting observation made was that a banker thought that even though the quantum of loans which were approved decreased the National Credit Act 34 of 2005 did not have a major affect on this. They stated that the reason why the quantum of loans decreased is because of the global recession which was taking place during the time.

4.1 The centralized credit system.

The centralized credit system allowed the banks to evaluate and gain access to the applicants' credit profile. This meant that when an applicants' profile was drawn up, all credit agreements could be found with all banks as well as how regularly they service their credit agreements. From here one could determine whether the applicant was over indebted or not and whether the applicant has a bad credit record or not.

4.2 Disposable income vs. dependable income.

Before the implementation of the National Credit Act 34 of 2005, the banks used to look at a credit applicants' dependable income found on the

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payslips and base the loan extended to them on 30% of that monthly income. After implementation of the National Credit Act, the banks look at the applicants' disposable income. This means that the applicants' net income what is considered. This drastically reduced the affordable borrowing powers of the applicants.

4.3 The office of the National Credit Regulator

The office of the National Credit Regulator incorporated a control system to regulate the credit industry. This means that the financial institutions which lend money to consumers have to consider the implications of reckless lending before extending loans. This has an effect on the market in the sense that banks have to conduct an affordability check on all applicants before approving loans. If a bank is found to have recklessly lent to a consumer they would face prosecution by the National Credit Regulator and be liable to fines, lose their licence or forfeit the amount leant to the consumer.

A total of 80% of the population which was interviewed suggested that there were no negative outcomes from the implementation of the National Credit Act 34 of 2005 and that all outcomes were positive in terms of long term goals for South Africa. In essence therefore the banks have become the custodians of positive conduct and responsibility.

Absa stated that most of the outcomes of the implementation of the National Credit Act were positive but there is only one negative outcome. This problem is in the form of loss of a personal relationship with their long term clients. First National Bank also stated that that the outcomes from the implementation of the National Credit Act were positive except for one aspect, that is, financial institutions such as banks had to retrench personnel because of the decrease in work load. Even though there is still a large quantity of credit applicants there was definitely a decrease in the number of loans which were applied for.

The system which was enacted to govern the credit industry is highly effective in controlling the credit industry. This forces the financial institutions such as banks and other credit providing organizations to ensure that the credit consumer is protected from becoming over indebted. The pre-screening system protects the banks from consumers who cannot afford loans or consumers who have bad credit records and would otherwise not repay their debts.

The Act also provides for the amounts which can be added to the loan amount and these have to be presented to the loan applicant. No concealed costs or added costs are allowed beyond the amounts specified by the framework in the Act. This is another method of protecting the credit applicant.

The general population of South Africa were made more aware of the implications of credit and that other credit facilities such as credit cards

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and clothing accounts could determine whether their mortgage loan will be approved or not. The general public who live with low levels of credit were not affected as adversely as those who lived with high levels of credit when it comes to applications for home loans.

The Implementation of the National Credit Act 34 of 2005 could only have positive long term effects on the South African property market. The legislation is governing the credit industry in a fair and orderly fashion and all parties involved with credit agreements are protected. In addition, the National Credit Act has informed the general population about the implications of credit and makes them more credit aware.

The Act could possibly have been implemented in a more informative fashion than it was. Key role players such as the banks and the National Credit Regulator were not aware of the complete extent of their functions and powers in the industry. These key role players had to rely on themselves to determine the extent of these.

5. INTEPRETATION OF THE FINDINGS

The demand for residential property is based on:

- The basic need for shelter
- Investment
- Strategy
- Opportunity

Statistical data form the 16th Century in South Africa and beyond indicated that the criteria for residence will not be completely governed by specific legislation. It is however evident that legislation governing Credit in market that is predominantly financed, will play a significant role. The credit application rate for the whole mortgage agreement sector in South Africa is more than double the number of loans which are approved.

From the information which was gathered, it can be deduced that the National Credit Act has reduced the number of loans being approved in South Africa because of the higher level of scrutiny of mortgage loan applicant. Moreover the National Credit Regulator office which was created by the National Credit Act 34 of 2005 ensures that reckless lending does not occur.

It can be concluded that the negative effects on the residential and credit industries are short term issues and that the positive aspects from the implementation of the National Credit Act 34 of 2005 far outweigh the negative aspects. When the effects of the Act are considered in retrospect, the effects are positive in terms of long term visions for the future prosperity of South Africa.

6. CONCLUSIONS

The National Credit Act 34 of 2005 has a positive influence on the responsible disbursement of Credit especially in the residential homeloan market.

Although a decrease of approvals of mortgage bonds has been experienced, the consequence on the credit market should be understood in the light of the international recessionary trends as well as the declice in over-indebtness.

The credit industry is now self regulating and protects all South Africans from reckless lending and over-indebtedness. The National Credit Act 34 of 2005 has educated South Africans on the implications and consequences of credit and has resulted in a more conservative population as well as more realistic terms of borrowing money. In the opinion of many consultants in the residential and credit industries, the National Credit Act 34 of 2005 will be part of South Africa's legislation for decades to come, hence the research conducted on the Act is timely.

7. RECOMMENDATIONS

- The recommendation for the industry is that key role players need to gain a more in-depth understanding of their functions and powers within the industry.
- The consumer should also take responsibility in providing correct information in when applying for credit.

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