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The National Command Council

Per email: lockdowncomments@cogta.gov.za

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SUBMISSION BY THE BANKING ASSOCIATION SOUTH AFRICA IN RESPECT OF THE DRAFT FRAMEWORK FOR CONSULTATION ON COVID-19 RISK ADJUSTED STRATEGY DOCUMENT

The Banking Association South Africa ("The Banking Association") would like to thank the National Command Council for the opportunity to comment on the draft framework for the "Risk-adjusted strategy for economic activity" which was published on 22 April 2020.

As the Banking Association we acknowledge the importance of collaborative efforts between government and key stakeholders towards the creation of a delicate balance between the economic and the social implications of Covid-19. We are fully supportive of a proposed risk adjusted strategy. The Banking Association, together with some of our member banks have also had the opportunity to work closely with government on creating the risk adjusted framework, for which we thank you.

On 25 April 2020, Minister Patel released a document entitled "Schedule of Services Framework for Sectors" wherein real estate activities and residential construction development were to be classified as a level 2 sector which is of medium risk.

We write to you today to highlight the economic importance of the real estate sector, the need for the sector to be viewed as an inter-dependent eco-system which requires multiple stakeholders to collectively be unlocked for the real estate eco-system to function and to suggest that through the application of strict regulations, that the risk that this sector poses could be reduced considerably, thus becoming a lesser risk sector.

COVID-19 Impact on Residential Mortgages

Context

The real estate market contributes approximately 5% to South Africa's GDP. It employs approximately 150 000 to 200 000 intermediaries, including professionals, most of whom are earning no income at present due to the Covid-19 lockdown, due to the commission and fee-based nature of the industry.

The 2008 global financial crisis was triggered by sub-prime mortgages in the USA. On the other hand, it was the residential housing market which led the USA out of the recession it was in due to the global financial crisis.

Registration Number : 1992/001350/08 A non-profit company under the Companies Amendment Act, 3 of 2011
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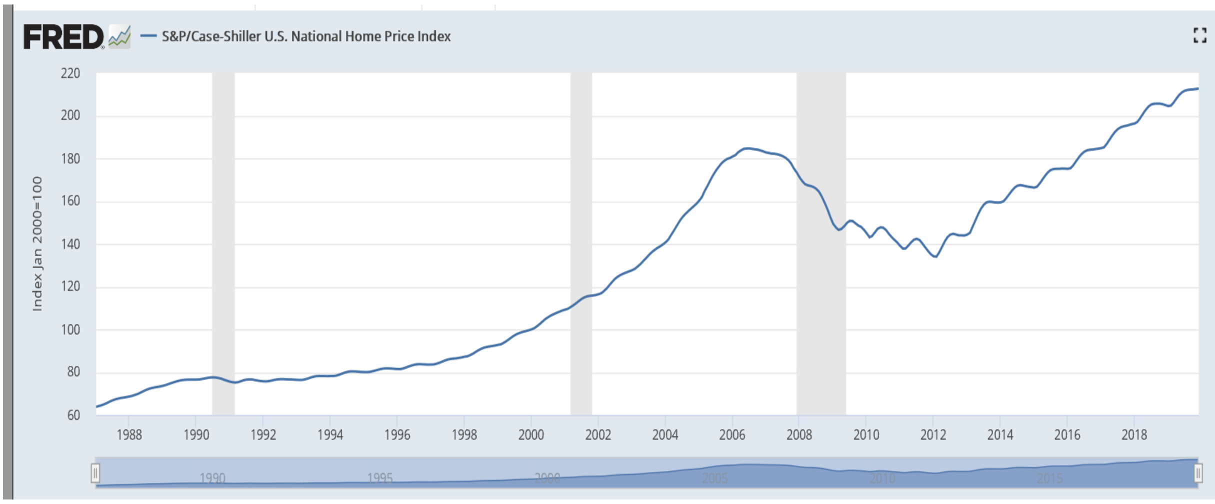
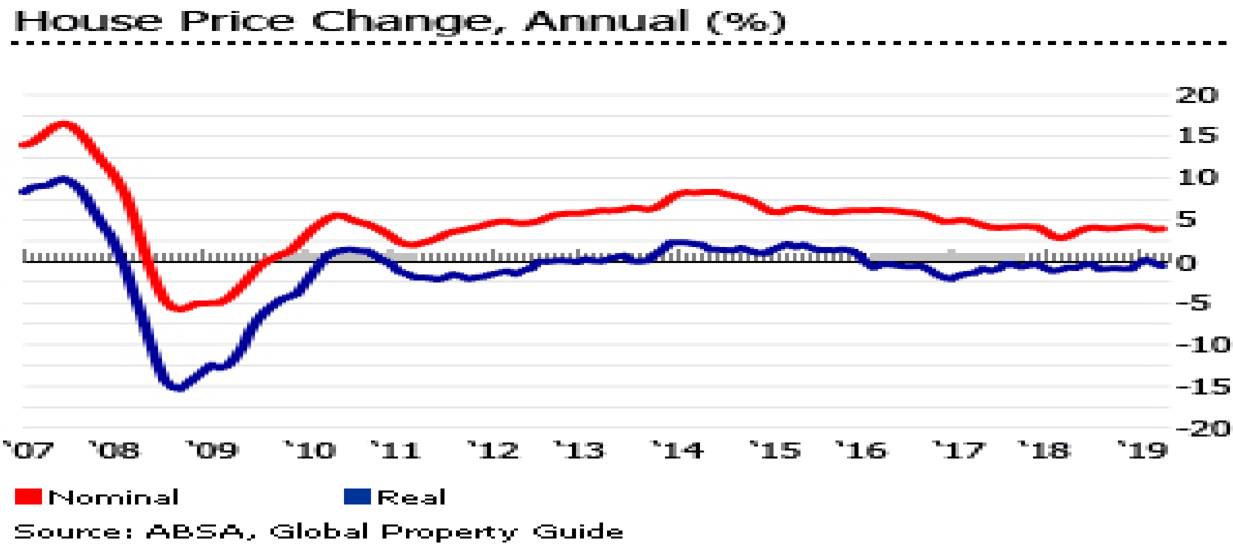


The global financial crisis resulted in the following impact on the South African real estate market in 2008:

- Real house prices decreasing by 15,4%;
- Sales decreasing by 27% in value terms;
- Mortgage bonds decreasing by 34% in value terms.

Since then house price growth has been reasonable, but pedestrian, and the price gains made since 2008 could well be undone due to the Covid-19 pandemic.



The ability to purchase and sell properties fulfils a vital liquidity function which in turn supports property values (estimated turnover is approximately R15 billion per month).

Housing statistics also reflect that:

- the number of property transfers decreased by 18,7% (Q4 2019 vs Q1 2020) with a 10,5% decrease on the average number of transfers for the year 2019 vs Q1 2020;
- the average median sectional title house price decreased by 5,9% (Q4 2019 vs Q1 2020) and by 8.2% as measured against the average median price for 2019. Freehold properties on the other hand, increased by 4,6% (Q4 2019 vs Q1 2020) and by 5,5% as measured against the average median price for 2019;
- The average value of mortgage bonds decreased by 0.4% (Q4 2019 vs Q1 2020) and by 1.2% as measured against 2019.

As the Covid-19 lockdown was only incepted on 27 March 2020, these statistics reflect an already strained residential property market. Given that property is reflective of long-term investor confidence, we expect both the Covid-19 lockdown, together with investor uncertainty (junk bond status, deep recessionary conditions and job losses) to reflect a similar trend to that of the global financial crisis where on average property values reduced by approximately 30% in the USA. A reduction in property values in South Africa would result in the destruction of approximately R 2 trillion in the wealth of homeowners, which bodes poorly for the financial well-being of retirees who use the equity they have accumulated in their properties to subsidise their retirement. Property operates in a "bubble" which contracts and expands dependent upon economic circumstances within a country, as well as long-term investor confidence. Historically, there has been an approximate 23-year gap between property booms. Given that the Covid-19 pandemic is expected to create a "new normal" and that Covid-19 related restrictions could be in pace for up to two years, we expect this, together with adverse economic conditions to have a marked negative impact on the recovery of the property market.

Current Covid-19 lock down Regulations only permit real estate and construction activity as follows:
Level 3:

- Commercial developments.

Level 2:

- Residential developments;
- All real estate activity;
- Repair work (plumbers, electrical, roof repairs etc.)

It may therefore be some months before the real estate market is unlocked. Whilst the Covid-19 risk-adjusted strategy envisages differentiated lock down levels at a provincial and even district level going forward, it is important to note that approximately 85% of residential property activity emanates from the Gauteng, Western Cape and KwaZulu/Natal provinces, all of which currently portray high levels of infection cases. Based on the current Covid-19 projected infections, this could well result in these provinces remaining at these levels for a protracted period.

Covid-19 Regulations for Level 4 has seen Deeds Offices being partially unlocked under strict safety and health conditions. This partial unlocking of Deeds Offices will permit them to clear lodged transactions (backlogs) and even documentation completed transactions where conveyancers simply need to lodge such transactions at Deeds Offices. We mention that the Law Society of South Africa, The Black Conveyancers Association and The Banking Association made written submissions for the partial unlocking of Deeds Offices. Whilst this should bring some relief in the near term to some intermediaries and homeowners, it also presents hardship for other homeowners who are now "trapped" (discussed below).

The volumes that Deeds Offices will be able to process will continue to be severely restricted until such time as Covid-19 Level 2 is reached, as they will be required to adhere to strict health and safety protocols which will restrict operational efficiencies to about 30%. As there are 10 geographically spread Deeds Offices, the 4 most active Deeds Offices are located within the most negatively affected Covid-19 provinces.

"Trapped" Homeowners

Given that the real estate value chain includes, amongst others

- Home-owners and renters;
- Intermediaries, such as mortgage originators, aggregators and estate agents;
- Service providers (construction industry, professionals, tradesmen and compliance certificate issuers);
- Municipalities (rates clearance certificates, plans etc.);
- Valuers;
- Conveyancers;
- Furniture removal companies;

the critical role that these inter-linked role-players fulfil, will, at varying levels only be unlocked at Covid-19 Level 2. Accordingly, it is only at Level 2 that the vast majority of the value chain can return to “normal”. This places home-owners whose property has been transferred into/out of their name from just before the 27 March 2020 lockdown until Level 2 lockdown is reached, in the invidious position of not being able to vacate their previous home (owned or rented) and to move to their new one. In many cases such “trapped” homeowners will be required to pay both rental and mortgage loan costs, together with rates/utilities on both properties until Level 2 is reached.

We highlight that there are contractual obligations in place between a buyer/seller or multiple buyers/sellers, including intermediary fees, and that where a breach of contract is not due to altered financial circumstances, this could well result in legal cost claims and counter claims.

The Banking Association believes that there is a need for the real estate sector to be unlocked now, including the further unlocking of Deeds Offices, given the economic and social implications that a protracted unlock poses for this sector, both in terms of the loss of employment, the further demise of the construction sector (which was already distressed prior to the lockdown), “trapped” consumers, loss of income and employment for related suppliers to these sectors, loss of intermediary income and job losses and the looming destruction of property values, subject to a strict regulatory restriction regime.

Banks recognize the need to assist clients who are experiencing financial hardship due to their being “trapped” on a bi-lateral case by case at individual bank level. Similarly, property intermediaries and conveyancers, suppliers and construction companies will be experiencing financial difficulties due to the real estate industry being under lockdown. Banks will also find themselves having to try support these practitioners and businesses too.

We are aware that major estate agency and mortgage originator groupings have already made exemption submissions to the Minister which contain a plethora of proposed restrictions which will ensure minimal human contact, the usage of personal vehicle travel only, social distancing, estate agent offices to remain closed, the usage of personal protective equipment, sanitising etc. We mention that the real estate sector is technologically advanced and that the virtual viewing of homes is already well established, as is the usage of e-signature technology to sign Offer to Purchase agreements, transfer documents and mortgage related agreements etc. We believe that if such intermediaries can comply with a definitive set of restrictions which obviates Covid-19 infection risk, that they should be able to trade.

Similarly, if inter-linked stakeholders (furniture removal companies, Deeds Offices etc.), as well as the construction sector is able to demonstrate that they too are able to adhere to a strict restriction framework regime, that they too should be able to trade.

We stress though that if the real estate sector is to operate effectively, that it needs to be viewed on a holistic eco-system basis (inter-linked system) as the unlocking of parts of this sector only will create functional blockages as highlighted above.

Conclusion

Internationally there are several countries, such as New Zealand and Australia which instituted a strict restrictions regime, not dissimilar to those detailed by estate agencies seeking a relaxation of their sector which were effectively implemented. This permitted the holistic real estate sector to continue to operate during the lockdown period in these countries.

The Banking Association respectively recommends that the Minister review the risk-adjusted classification of the real estate and construction sectors premised on strict health and safety restrictions. This should include considering unlocking these sectors on a sectoral eco-system basis at level 4.

Kind regards

Bongi Kunene
MANAGING DIRECTOR