

**14 March 2012**

**JOHN LOOS:**  
**HOUSEHOLD AND PROPERTY**  
**SECTOR STRATEGIST**  
**011-6490125**  
[John.loos@fnb.co.za](mailto:John.loos@fnb.co.za)

**EWALD KELLERMAN:**  
**PROPERTY MARKET ANALYST**  
**011-6320021**  
[ekellerman@fnb.co.za](mailto:ekellerman@fnb.co.za)

**RYNOMEY:**  
**HEAD: REAL ESTATE**  
**DISTRIBUTION**  
**011-6320130**  
[rmey@fnb.co.za](mailto:rmey@fnb.co.za)

The information in this publication is derived from sources which are regarded as accurate and reliable, is of a general nature only, does not constitute advice and may not be applicable to all circumstances. Detailed advice should be obtained in individual cases. No responsibility for any error, omission or loss sustained by any person acting or refraining from acting as a result of this publication is accepted by FirstRand Group Limited and / or the authors of the material.

First National Bank – a division of FirstRand Bank Limited. An Authorised Financial Services provider. Reg No. 1929/001225/06

## PROPERTY BAROMETER –ASPIRANT HOME BUYERS HAVE BIG DISADVANTAGES, AND BANKS CAN HELP

Home buyers often lack the knowledge and information related to the home and the buying process. Banks work for the buyer, and can both inform their clients' decisions to a far greater extent, as well as increase their bargaining power.

**14 March 2012**

*Whereas estate agents arguably represent more the residential property seller, banks represent the "other party" in the residential property transaction, not with all aspects of the transaction but in the important area of providing the finance to qualifying buyers. This does not mean that the bank and the estate agent are adversaries. To the contrary, both parties are crucial in enabling the property transaction to take place. But, whereas good estate agents work closely with their client, providing advice and information, the same involvement with the client cannot always be seen by the banks, despite having a wealth of expertise, and despite the fact that many buyers could do with some assistance.*

***Infrequent nature of residential property transactions means that buyers/sellers often lack required knowledge.***

The residential property market has some unique characteristics not always as common in other asset markets. These are brought about by the nature of the asset as well as the make-up of its role-players. Investors in share and bond markets are arguably more often frequent buyers and sellers of these assets. By contrast, in the residential market for most home buyers and sellers, trading a property is a very infrequent occurrence. According to the FNB Estate Agent Survey for the 1<sup>st</sup> quarter of 2012, 87% of total residential buying was for primary residential purposes. In other words, the seasoned property investor, who buys to let or to speculate, makes up a very small percentage of the total residential market.

The infrequent nature of residential buying/selling means that aspirant home buyers/sellers generally have very limited knowledge regarding it, and often very little information at their disposal with which to make a good decision. Their challenge is made more significant by the fact that every home is different, so to have a feel for its value is difficult, and then for many there is the added challenge for many of not knowing how much property finance they qualify for.

***Banks have an important property information role to play with their clients.***

In this regard, banks have an important role to play, and the role that they have played to date has perhaps been somewhat disappointing. Banks sit on a wealth of property and market information, collected over a long period from financing hundreds of millions of property transactions, and conducting valuations on as many properties. Not only do we possess transaction values of properties, but also many of the characteristics of the properties financed.

This information, regarding suburbs and sales values of comparative suburbs in a particular area, can greatly assist the aspirant buyer in gaining a more educated view of how much to offer on a particular property.

To support this information need, a buyer seeking to obtain pre-approved finance through FNB's Property Leader offering will have access to free property and area reports regarding his targeted property(ies) and area(s). Such reports include a wealth of information regarding area characteristics, including age profile of buildings, the dominant soil types on which homes are built, stand and building sizes in the area, bedroom numbers and the percentage of properties in the area with "add ons" such as swimming pools. Age demographics of home owners and buyers entering the market are also included. And arguably most importantly, recent sales values of other homes in the area are included for comparison and "reality check" purposes.

How should an aspirant buyer be using such property and area information? Probably in two key ways. Firstly, the comparable sales values in the area should give the buyer an idea of the offer he/she should make. Secondly, the asking price of the property being targeted by the buyers, along with the general characteristics of properties in the area, enables the buyer to get an idea of the investment value of the property. For example, it could be very useful in informing him as to whether the property is over-capitalised or not. An over-capitalised property is one in which the level of investment in the property is too high for the type of market that a buyer seeks to buy in that area. For instance, if the home is the only R2m priced home in a suburb where the general price level is nearer to R500,000, and possesses the only swimming pool and tennis court in the entire area, the chances are that re-selling it may be difficult given that the income category of people generally seeking to buy in that area is not one looking for such luxury.

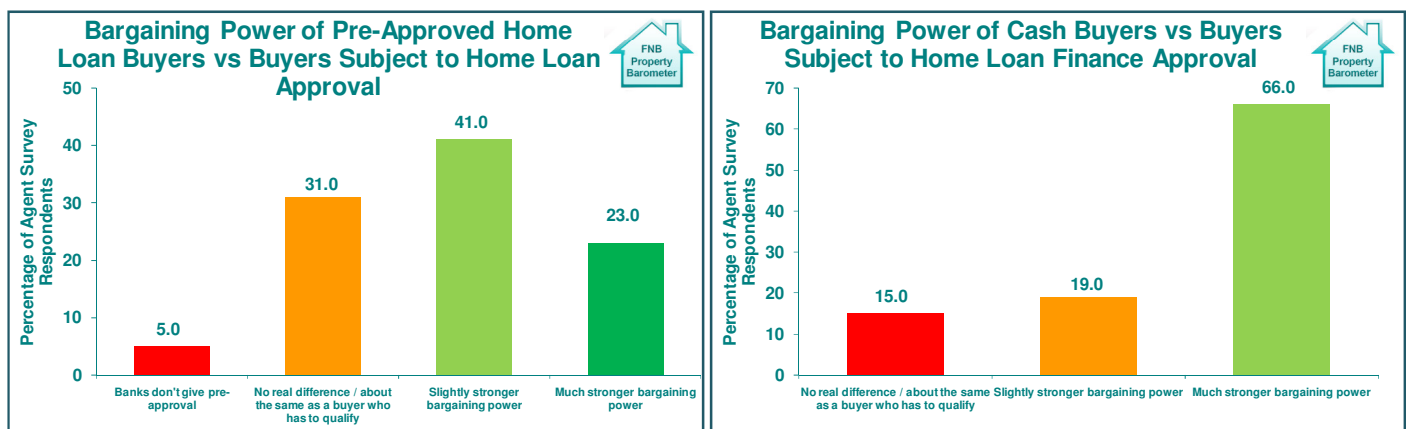
Over-capitalised homes generally underperform in terms of price growth, over time, relative to the area that they are in, while "under-capitalised" properties have a greater potential to outperform the area in terms of price growth over time. Property and area information can very useful in obtaining this picture of a property.

**Banks can improve the negotiating power of their clients, not only with area and property information, but also by turning them into "cash" buyers.**

The FNB Estate Agent Survey for the 1<sup>st</sup> Quarter 2012 includes a question regarding the "bargaining power" of cash buyers versus those buyers who still need to obtain home loan finance. 66% of survey respondents said that cash buyers had "much stronger bargaining power", while 19% said that cash buyers had "slightly stronger bargaining power". Only 19% believed that there was no difference.

A second question related to this topic refers to the bargaining power of pre-approved home loan buyers compared to buyers who have yet to obtain home loan finance. 23% of respondents claimed that this group had "much stronger bargaining power", 41% had "slightly stronger bargaining power", while only 36% claimed "no difference" or "banks don't do pre-approved loans".

The group of respondents estimated that the average discount that sellers are prepared to grant cash buyers was 8%, and a lesser 5% for pre-approved home loan buyers.



This all tells us that the majority of respondents also believe that buyers with pre-approved home loans do have improved bargaining power, but that this is not quite as strong on average as that of cash buyers.

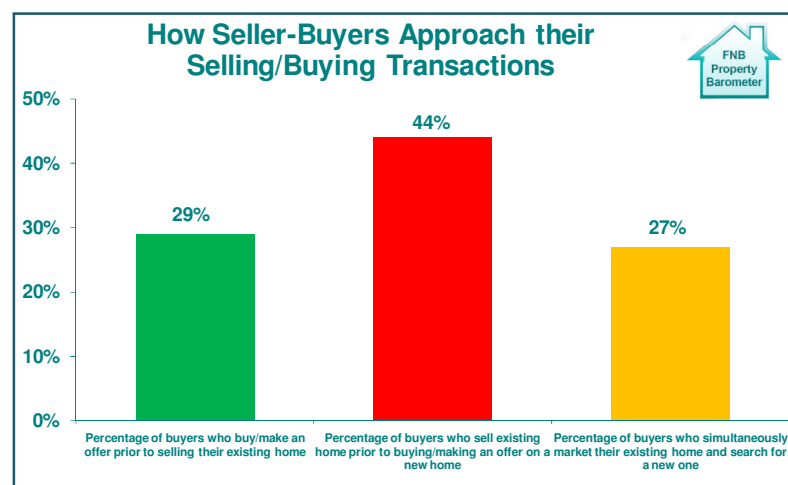
We believe we understand why this is the case. It is because many “pre-approved” home loans are subject to a variety of terms and conditions, or may not have required sufficient information to acquire, and are thus often far from “a done deal”.

**The challenge for banks, therefore, is to turn pre-approved home loan applicants into “effective cash buyers” by attempting to demand as much information up front as possible so as to limit the number of terms and conditions attached to a pre-approved home loan.** The National Credit Act makes this significantly more onerous than in years gone by, because banks are not merely required to look at a household’s income in determining the amount that it qualifies for. They also need to assess the households’ expenditure and other debt commitments before approving a loan. And then, for its own security, the bank needs to value the home being purchased to see that it holds sufficient value.

To this end, FNB provides the “Passport to Purchase”, a pre-approved loan with as few terms and conditions as possible. A full credit assessment is done on the aspirant buyer, including income, expenditure commitments, other debt, and a credit record check. The Passport to Purchase is valid for 90 days. The buyer can use it as a strong negotiating tool with the seller, although it is obviously still subject to the targeted house being valued at an acceptable value so as to provide security for the home loan.

**But although Banks represent the buyer, perhaps what we forget is that a large percentage of aspirant buyers are also sellers.**

Then there is the “repeat buyer”, i.e. the person who plans to sell his home either in order to upgrade, downgrade, or to re-locate for a variety of reasons. Very often, this homeowner is in a predicament, wanting to put in an offer for a new home, but not always knowing whether his financial situation allows it because he has yet to sell his current home.



This is a challenging situation, because the seller can never be sure what price he will get for the home being sold, and whose proceeds may form a large portion of the funding of the home he is about to buy. In addition, if he doesn’t have a solid pre-approved loan, then making an offer on a new home is difficult for a second reason too.

And so, the FNB Estate Agent Survey indicates that only an estimated 29% of “repeat-buyers” actually make an offer on a new home prior to selling their existing home. By comparison, 44% wait for the sale of their existing home before making an offer on a new home, while 27% are

“simultaneously marketing their home while searching for a new one”.

And all of the uncertainty surrounding the availability of funding must surely contribute to the high percentage of “subject to” offers received by sellers, in which the offer by the aspirant buyer is subject to the sale of her home. According to the Estate Agent Survey, 54% of home sales were unconditional sales, while 46% were “subject to” sales.

**In order to improve the smooth functioning of the market, FNB Property Leader programme goes further to aid the “seller-buyer”.** Firstly, the seller can be pre-qualified for finance for her next home, obtaining a Passport to Purchase. The second step in the seller-buyer process is then to avail FNB’s professional valuers, in support of the estate agent, for a valuation of the seller’s home. This is the “price counseling” part of the programme. So, while it is never possible to exactly predict what the ultimate sale value will be, the seller counseling is an attempt to get a professional valuer to set the price at an appropriate “market-related” level in order that the home not remain on the market for an inappropriately long period of time, nor be sold unintentionally at a discount.

Pitching the seller's property at the correct price can cause significant cost savings through reducing the often significant holding costs associated with holding onto a property for a lengthy period due to an inappropriately high asking price, especially when the seller has often already relocated for employment purposes to another region, and her property on the market is standing empty. On the other hand, should the marketing price be below the potential realistic market value for the property, a seller can almost immediately lose a great deal of wealth by selling at an incorrect price.

### ***IN CONCLUDING***

*Home loans banks represent the buyer, be it 1<sup>st</sup> time buyer or repeat buyer. They do not have a good history of pro-actively supporting their client to improve the quality of his home investment decision-making, nor in improving his ability to enter into property trades due to increased certainty regarding the level of funding availability.*

*Banks most often get criticized for negatively impacting the residential market due to turning down loan applications, even when the applicant clearly won't be able to service the debt. We often hear industry people saying that "the demand is there but banks don't want to lend". Much of this "demand" that they refer to is NOT real demand. It is people punching far above their weight in terms of their home search, under the mistaken impression that they will get the required finance, and they waste the agent's time. The banks are blamed even though the bank had not necessarily ever promised these aspirant buyers finance.*

*But where banks can make a greater contribution to the smooth functioning of the market is through supporting their client, the buyer and future buyer, with far better information, in the form of market information with which to improve the investment decision and the quality of the offer, and information regarding the finance available to the particular client. Better information in this regard is bound to improve efficiencies in the residential market, as a greater number of people adjust their aspirations "upfront" to get them into line with the resources available to them.*