Impact of Mortgage Down Payment Deregulation on the Banking Industry

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PEFINDO views the banking industry to be stable mainly due to its high level of capitalization, close regulatory oversight, good balance of credit growth and asset quality maintenance, and its role as the main funding source for most of country's business activities. The emphasis on asset quality since 2014 has put a damper on credit growth. But as credit growth is often viewed as the main catalyst for the economic growth, this became one of the culprits behind the slow gross domestic product growth.

A recently issued regulation from the central bank, Bank Indonesia Regulation No. 20/08/PBI/2018 regarding mortgage down payment, in our view, is one of the efforts to stimulate credit growth particularly in the asset-based financing segment, which is considered to have a better risk and recovery profile.

Banking industry loan growth

The banking industry's credit book recorded a growth of 12.7% year-on-year as of September 2018. The recent pickup in growth from May to September is mostly due to the weakening rupiah, which made foreign currency denominated loans (especially USD ones) higher in rupiah terms, and also pickup in infrastructure-related loans.

Chart 1. USD-IDR rate year-to-date

Source: Bloomberg

Table 1. Loan growth month by month in 2018

	Jan	Feb	Mar	Apr	Mei	Jun	Jul	Agt	Sep	YTD Avg
Total loan growth	7.4%	8.2%	8.5%	8.9%	10.3%	10.8%	11.3%	12.1%	12.7%	9.4%
Rp loan growth	8.0%	7.8%	8.4%	8.6%	9.9%	9.8%	10.6%	10.8%	11.1%	9.0%
Forex loan growth	3.9%	10.7%	9.6%	11.1%	12.4%	16.5%	15.8%	20.0%	22.2%	11.4%

Source: OJK

Out of the total credit issued, wholesale and retail trade remains the largest contributor at 18.8% with a sectoral non-performing loan (NPL) ratio of 4.0%, followed by processing industry, other household loans and home ownership. In terms of loan purpose, the industry recorded a mixture of 47.3% for working

capital with 3.2% segmental NPL ratio, 24.8% and 2.6% in investment loans, and 27.9% and 1.7% in consumption loans. In terms of growth, home ownership sector led at 14.0% year-on-year; other non-industrial household loans 13.7%, and wholesale retail trade 12.3%:

Table 2. Sectoral loan and NPL contribution in September 2018

Sector	Contribution to total loan	Loan growth	NPL sectoral	NPL overall
Wholesale and retail trade	18.8%	12.3%	4.0%	0.7%
Processing industry	17.0%	9.7%	2.9%	0.5%
Others – non industrial	11.3%	13.7%	1.1%	0.1%
Home ownership	8.4%	14.0%	2.7%	0.2%
Agricultures, hunting, forestry	6.6%	11.3%	1.5%	0.1%

Source: OJK

Table 3. Segmental loan and NPL contribution in September 2018

Types	Contribution to total loan	NPL segmental
Working capital	47.3%	3.2%
Investment	24.8%	2.6%
Consumption	27.9%	1.7%

Source: OJK

...with dominant sectors remain consistent over times.

Table 4. Annual loan by sector since 2014

Loan by sector	2014	2015	2016	2017
Wholesale and retail trade	19.5%	21.6%	22.9%	24.1%
Processing industry	18.0%	20.7%	21.3%	22.4%
Others – non industrial	10.0%	11.7%	12.7%	14.8%
Home ownership	8.2%	8.9%	9.6%	10.7%
Agricultures, hunting, forestry	5.8%	6.9%	7.7%	8.6%

Source: OJK

Table 5. Annual sectoral NPL since 2014

Sectoral NPL	2014	2015	2016	2017
Wholesale and retail trade	3.2%	3.5%	4.3%	4.1%
Processing industry	1.9%	2.5%	3.4%	2.7%
Others – non industrial	1.0%	0.9%	0.8%	0.9%
Home ownership	2.2%	2.3%	2.5%	2.5%
Agricultures, hunting, forestry	1.8%	1.9%	2.2%	1.4%

Source: OJK

Balancing credit growth with quality

We are of the view that one of the compensating factor for credit growth is the focus of banks on asset quality, which has been stable at 2.7% to 3.0% since the end of 2016. During a soft economy period, focusing on quality may threaten credit growth since the pool of high quality debtors becomes smaller. The situation is mainly due to the prolonged downturn in commodities due to price volatility, which also affected its derivatives, including supply-chain related sectors and consumer loans particularly in areas focused on commodity-based business activities. The problem may be compounded by the higher interest rate environment and unfavorable currency movements that can hamper the ability of debtors to repay loans.

To improve credit growth without sacrificing asset quality, banks are focusing on sectors perceived to be less exposed to high NPLs, particularly consumer ones. But in this segment, the choice is also limited since banks tend to avoid vehicle ownership loans, given the unfavorable domestic automotive sales condition and recent governance problems in several independent vehicle financing companies. Thus, the choice narrows down to home ownership loans or the mortgage segment, and this is exactly why the growth in this sector – despite it being the largest ticket item in the consumer segment – is well above the growth of overall credit.

Unfortunately, not all banks have the luxury to be aggressive in this sector because of the price sensitivity of borrowers. Only banks with strong experience in mortgages and superior deposit-taking ability can compete in this attractive segment. In our view, only a few banks have significant exposure in mortgages, with the five largest mortgage lenders controlling almost 90% of the market in the past few years. The largest mortgage lender as of September 2018 is Bank Tabungan Negara (BTN), a state-owned bank with a market share of 46.5%, which carries a special mission from the government to provide mortgages to the lower middle-class segment. Bank Central Asia, as the bank with the highest current account savings account (CASA) portion at 77.6% on average, comes in second place with 18.3%. Two other state-owned banks, Bank Negara Indonesia (BNI) and Bank Mandiri, have market shares of 9.1% and 8.3%, respectively, while Bank CIMB Niaga rounds up the top five with a 6.8% market share.

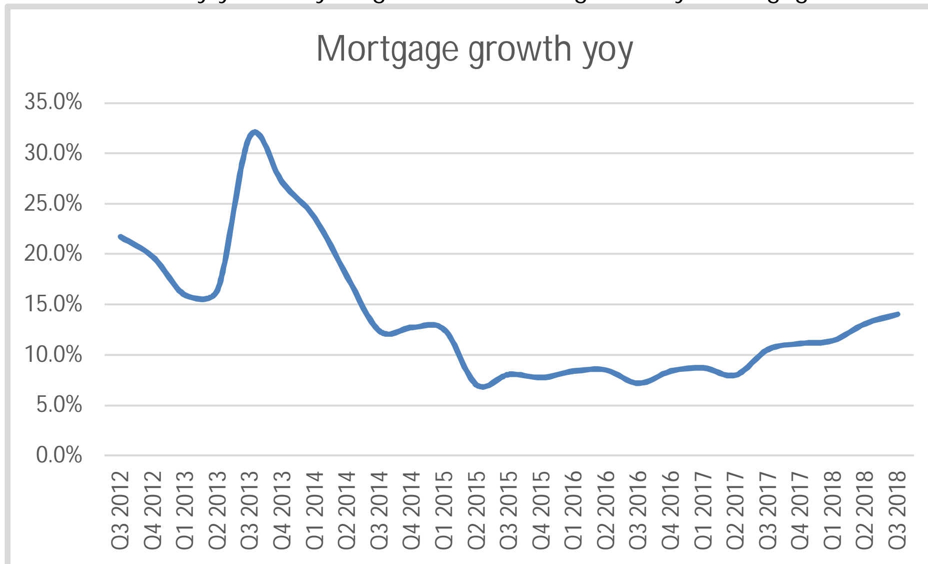
Table 6. Major mortgage players

	Mortgage market share (%)	Total mortgage loans (IDR trillion)	Total loans (IDR trillion)	Mortgage to total loans (%)	CASA (%)
BTN	46.5	200.4	220.1	91.1	46.5
BCA	18.3	78.8	515.8	15.3	77.6
BNI	9.1	39.3	487.0	8.1	61.9
Mandiri	8.3	35.6	781.1	5.0	70.2
CIMB Niaga	6.8	29.1	180.5	16.0	53.2

Source: Companies' financial reports

The previous mortgage regulations, PBI No.16/11/PBI/2014 and PBI No.17/10/PBI/2015, focus on managing risks in overlending and speculation. These were issued at the tail-end of the last economic boom in the country. The regulations addressed the speculation issue, which was indicated by a growing number of second and third home ownership loans or more. It introduced higher down payment requirements for non-first home ownership to curb property speculation and unjust increases in prices. Backed by the commodity-driven buoyant economy, property became one of the most lucrative investment vehicles in 2010-2013. There was a significant increase in properties in big cities, where Bank Indonesia's house prices survey indicated a quarterly average of 12.0% year-on-year (YoY) increase in 2013, and sales of middle- and upper-class houses increased 33.6% YoY in the same period. During the high period in 3Q2013, housing loans grew 31.8% YoY (whereas the latest in August 2018, it grew 13.8%). Thus, in those expansion periods, the regulation became much more of a countercyclical tool to prevent any bubble formation.

Chart 2. Quarterly year-on-year growth on banking industry's mortgage loans



Source: OJK

Chart 3. Property price index year-on-year growth – BI survey

Source: Bank Indonesia

Now, the latest regulation on mortgage loans, PBI No.20/08/PBI/2018, is geared towards strengthening credit growth while maintaining asset quality. The first adjustment in down payments after 2013's stringent rule happened in 2015, when the down payment was lowered with the added condition that the bank had to maintain its gross NPL level under 5%. The second one happened in 2016, when the 2015 down payment level was used across the board regardless of the bank's NPL. The latest adjustment came in July 2018 after Bank Indonesia's board of governors' meeting, stipulating that the down payment could be waived with a condition that the lending bank must have an NPL level of less 5%, and the loan must be for a first home purchase.

We are of the view that the regulation has a sound base, given that the NPL ratio in the housing segment is relatively low and the pace of growth can still support further increases. However, the requirement that

the bank must have an NPL ratio lower than 5% and that the purchase must be for a first home only limits the impact of the regulation on overall credit growth. We share the regulator's view on keeping asset quality intact and allowing only qualified lenders to avail of such loans. However, in our portfolio of rated banks – which include all major state-owned banks and regional development banks – only a handful have NPL ratios lower than 5%. In reality, the latest regulation will not immediately impact the mortgage lending landscape. Only banks with more than adequate liquidity, supported by a superior funding base, can compete in the sector. There are also joint venture banks that qualify based on their NPL ratios and abundant liquidity, however the mortgage segment unlikely meets their appetite as the long tenor and relatively small loan sizes may not qualify under their underwriting terms.

The typical mortgage tenor is 10 to 15 years, which depends on lender's age, and if the 0% down payment stretches the tenor to over 15 years, the banks may have to review their tolerance for longer loan tenors, which again must match their funding base. While longer tenor mortgage loans can be matched with longer tenor deposits, in terms of cost of funds, the margin would not be very attractive since longer term deposits usually entail higher interest rates. The vital edge would be in how large the bank's CASA is and how sticky those funds are. This narrows the field down to the existing top mortgage players.

The alternative incentive is to take on small margin mortgage businesses for banks with less CASA or low-cost funding bases, and securitize the loans to refresh their liquidity. However, the problem here is two-fold. It is very likely that the bank must retain the role as the servicer or the collecting agent, and while the asset quality will not be of the bank's concern once the loans are offloaded to asset-backed securities. Any significant delinquency will deteriorate the bank's reputation and franchise value, which in turn will not positive for the business going forward.

There is also a more feasible way to better distribute mortgage loans by using regional development banks. In terms of low-cost funding, regional development banks are usually well covered by having the privilege of providing cash management services for regional government offices. In terms of NPLs, most of the top regional banks are able to deduct loan payments directly from the salaries of their civil servant debtors. However, a problem lies in their limited ability to underwrite mortgage loans. Sarana Multigriya Finansial (SMF), a state-owned institution with a mission to provide liquidity to the mortgage market and alleviate pressure from the national budget, is stepping in to improve the mortgage underwriting skills in those regional banks. The expectation is to have enough well-performing mortgages to be securitized by SMF, increasing the securitization fee for the company and at the same time gradually fueling the progress of the securitization industry, which is developing very slowly.

To conclude, we view positively the regulator's initiative to further relax the criteria for mortgage down payments. It has several safety mechanisms, such as maximum NPL levels and exclusivity to first home buyers, ensuring that it addresses the risk of market speculation and a property price bubble. However, we are less certain on its effectiveness in spurring credit growth, since the major players will not be significantly different, and they already have underwriting standards that will not be significantly altered once this regulation is implemented. At the current rate of overall credit growth, and given all things remaining the same, we project that a 1% increase in housing loans would result in only an increase of 8 basis points in overall credit growth. If the mortgage market can grow 20% YoY, which happened in the past during the commodity bull market, then overall credit growth can experience a 1.6 percentage point boost. Our view is more moderate that the mortgage sector will most likely maintain its current growth rate or could only nudge up to 15% in out best-case scenario, which will lead to an increment to credit growth of around 1.2 percentage point. Given the most optimistic anchor effect of the housing offtakes, the projection is still in the range of 11-13% given the Rupiah does not fluctuate heavily from the current level. In reality, of course, this will also have to be matched by market demand and economic sentiments, whether consumers are confident enough to make large purchases and long-term financial commitments.

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