3

Mortgage defaults and repossessions

3.1 It is argued that changes in the housing lending market have had both positive and negative effects. One example on the positive side is that low doc loan products have given access to affordable mortgages for the self-employed.

3.2 On the negative side, there has been growing concern that too many people are taking on unaffordable mortgages. It is argued that this has been facilitated by reduced lending standards on the part of financial institutions.

3.3 The RBA and APRA observed that most Australian households are actually in a good financial position: 'Overall, the household sector remains in sound financial shape, supported by the ongoing strength in the economy.'[1]

3.4 This assertion is supported by data that show real disposable incomes have continued to grow strongly over the past few years, even when allowing for increased mortgage payments (see figure 3.1 below).

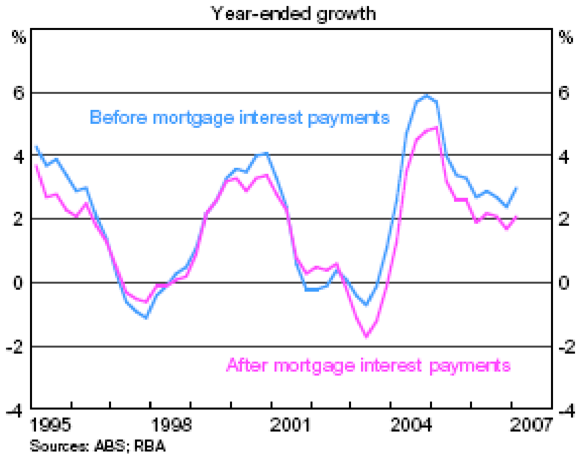
3.5 But these aggregate data conceal the fact that some households are facing financial difficulty. The RBA and APRA commented that 'there is a small proportion of borrowers whose finances are overextended.'[2]

---

1 RBA & APRA, *Submission no. 7*, p. 1.

2 RBA & APRA, *Submission no. 7*, p. 1.

Figure 3.1 Real disposable income per household (annual percent growth)



Source *RBA & APRA, Submission no. 7*, p. 4

3.6 The changed lending market, together with the buoyant economic conditions, has allowed more households to take on more debt. As debt levels increase it is likely that the number of people facing financial difficulty will also increase. The RBA has recently made comments to this effect:

> Expansion in the availability of credit has meant that for any given level of unemployment and interest rates, a higher share of loans could be expected to be in arrears.[3]

3.7 Recent media reports have suggested that declining lending standards have caused an increasing number of people to fall into 'mortgage stress'. However, the definition of stress that underlies this assertion—mortgage repayments of more than 30 per cent of gross income—appears to be questionable, particularly for higher income earners. Most lenders are now willing to lend well in excess of this level.

Loan arrears

3.8 Data on loan arrears give an indication of the number of people in 'absolute' mortgage stress—that is, the number of people who cannot make payment on their loans. Evidence to this inquiry has found agreement on two points with regard to recent loan arrears data:

- The level of loan arrears remains low by historical and international standards; and

3 RBA, *Financial Stability Review*, March 2007, p. 17.

- Notwithstanding this, there has been a steady increase in loans in arrears in recent years.

3.9 It is important to recognise that the upward trend in arrears rates does not amount to any sort of impending disaster. This point was made by Chairman elect of PMI Mortgage Insurance the Hon Nick Greiner:

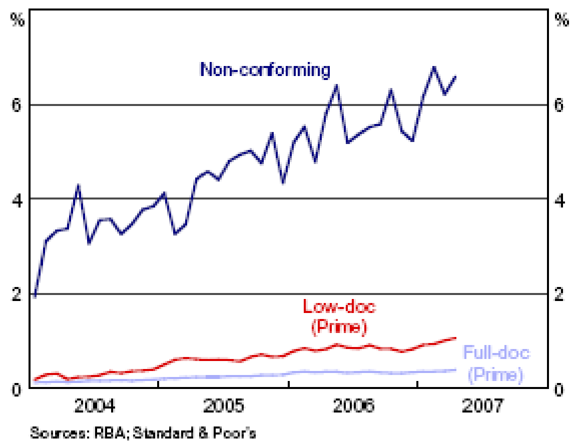
> The truth is that the stress in the current mortgage market is not a crisis … What is happening from PMI's perspective is that we are returning to a more normal loss experience.[4]

3.10 The RBA and APRA submission reported that '0.38 per cent of the value of the banks' domestic balance sheets were classified as non-performing.' They further noted that 'while this has increased since the low point in 2003, it remains lower than was typical in the past.'[5]

3.11 The figures available on securitised loans (this includes all types of lenders) show that as at April 2007, 0.47 per cent of loans were past due by 90 days or more, up from 0.16 per cent in early 2004.[6]

3.12 Arrears on securitised loans are also measured by loan type. These data show that 0.40 per cent of full doc prime loans, 1.07 per cent of low doc prime loans, and 6.5 per cent of non-conforming loans were in arrears (see figure 3.2 below).[7]

Figure 3.2 Securitised housing loan arrears (90+ days past due, per cent of outstanding)



Source *RBA & APRA, Submission no. 7*, p. 7.

4 Hon N Greiner, PMI Mortgage Insurance, *Transcript of evidence,* 10 August 2007, p. 7.
5 RBA & APRA, *Submission no. 7*, p. 6.
6 RBA & APRA, *Submission no. 7*, p. 1.
7 RBA & APRA, *Submission no. 7*, p. 1.

3.13 It is clear from these figures that riskier loan products—in particular non-conforming loans—have considerably higher arrears rates. This point was made by John Broadbent of the RBA during the roundtable. However, Mr Broadbent also noted that 'even on riskier loans … the vast majority of borrowers are servicing their mortgages.'[8]

3.14 Mortgage insurer Genworth Financial reported that while low doc loan products do have higher arrears rates, this is not necessarily because borrowers are facing financial difficulty:

> The higher arrears reflect the nature of the ultimate borrower of a low doc loan, who is typically self-employed and or a non-PAYG employee. This employment status typically results in the borrower having lumpy cash flow and a fluctuating ability to service the loan, particularly compared to a PAYG employee under a standard full documentation loan … This increased arrears has not translated into double the rate of claims when compared to an equivalent standard loan, as the arrears will more frequently 'cure' for a low doc loan than for a standard full documentation loan.[9]

3.15 Peter Hall, Chairman of Genworth, made further comments in this regard during the roundtable:

> We have been insuring these loans for eight years and we can categorically say the performance of these low doc loans has been impeccable and, in actual fact, have exceeded any expectations of what we thought would happen at day one.[10]

3.16 ANZ Bank's submission cites figures comparing arrears rates for bank and non-bank originators. These figures show that non-bank originators have loan arrears more than three times that of banks (see figure 3.3).

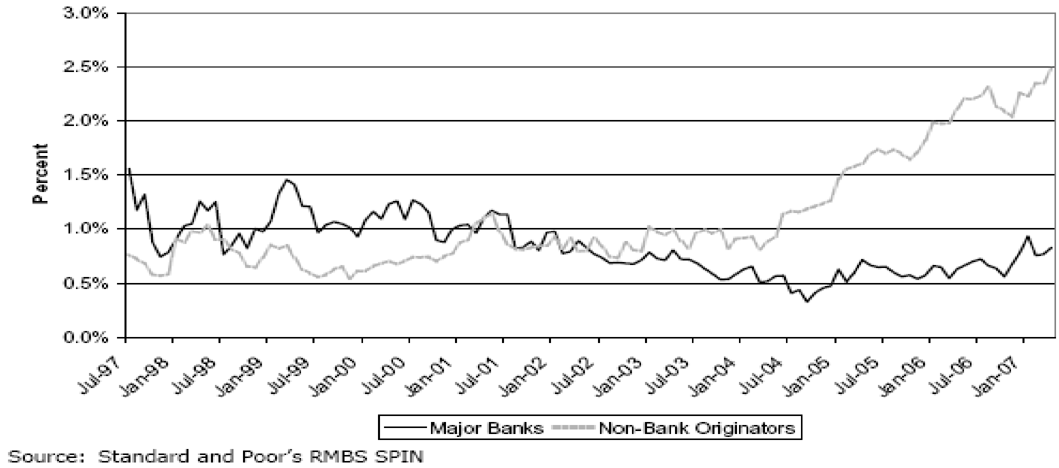
---

8 Mr J Broadbent, RBA, *Transcript of evidence,* 10 August 2007, p. 26.

9 Genworth Financial, *Submission no. 6,* p. 5.

10 Mr P Hall, Genworth Financial, *Transcript of evidence,* p. 9.

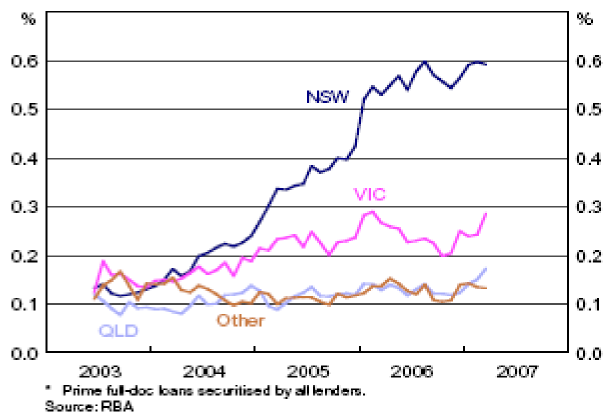
Figure 3.3 Australian prime securitised loans, bank and non-bank originators (30+ days past due, per cent of outstanding)



Source *ANZ Bank, Submission no. 12, p. 5.*

3.17 As might be expected there are substantial differences in arrears rates across the country. Arrears in New South Wales—where economic growth has been slower and house price growth has been negative in some areas—are considerably above other states (see figure 3.4 below).

Figure 3.4 Housing loan arrears by state (90+ days past due, per cent of outstanding)



Source *RBA & APRA, Submission no. 7,* p. 7.

Repossessions

3.18 When a mortgage is in default for an extended period a lender may choose to foreclose and seek repossession of the property. Figures on court applications for repossession give some indication as to how often this occurs. The RBA and APRA reported that court applications have risen in recent times:

> In New South Wales and Victoria, the number of applications increased by around 50 per cent in 2005 compared with the previous year, and by about 10 per cent in 2006. Some more recent data are available for Victoria, and these suggest that there has not been a further increase in the number of applications in 2007.[11]

3.19 However, the usefulness of these figures in determining the extent of mortgage stress is questionable. The Australian Bankers Association (ABA), among others, made this point:

> Given a lack of disaggregated data from the various Supreme Courts relating to applications for repossession of land, it is difficult to make detailed comments about repossession activity and its causes … Applications for repossession relate to a variety of real property and include family homes, investment properties, vacant land, holiday homes, properties owned commercially and other land … The plaintiffs who initiate repossession applications vary considerably and include all types of financial institutions (e.g. banks, building societies, credit unions, finance companies, and non-conforming lenders), businesses, trusts, solicitors, family members and other persons.[12]

3.20 Care Financial Counselling Service and the Consumer Credit Law Centre argued that the collection of repossession data could be improved to provide more useful insights:

> Information from the various state and territory Supreme Courts regarding mortgage foreclosure activity is already collected. It is not however coordinated, or easy to access. Further, it is not broken down into categories of loan type or lender, which can make it difficult to identify the source of apparent trends.[13]

3.21 These sentiments were echoed by the ABA who states 'more detailed information from the Courts should be available to better inform the public debate on this matter.'[14] These sentiments were also echoed during the roundtable.

3.22 The Finance Sector Union argued that the obligation should be on lenders to provide detailed figures on repossessions:

---

11 RBA & APRA, *Submission no. 7*, p. 1.

12 ABA, *Submission no. 9*, p. 4.

13 Care Financial Counselling Service & the Consumer Credit Legal Centre, *Submission no. 4*, p. 4.

14 ABA, *Submission no. 9*, p. 7.

> One possibility could be to require all lending institutions to report the number of repossessions and foreclosures each year to increase transparency in this area and encourage a public commitment to minimising such events.[15]

3.23 David Wakeley of Virgin Money made similar comments to the roundtable:

> Virgin is an absolute supporter of strong data and surely we would want this data to be published by a lender. That is absolutely what we have to have. It is a wall of shame that actually goes back to the lenders who are not acting responsibly because at the end of the day this is all about consumers and it is about lenders who are lending to consumers in a way that is not responsible.[16]

Bankruptcies

3.24 Data are also available on personal administrations (mainly bankruptcies and personal debt agreements). While these figures have increased recently, with New South Wales once again showing an above average rise, the RBA and APRA warn that this is not an accurate indicator of mortgage difficulty:

> Caution needs to be exercised in interpreting these trends given that a reasonable large proportion of personal administrations probably relate to personal credit problems rather mortgages directly.[17]

Committee conclusions

3.25 The level of loan arrears has increased in recent times but remains low by international and historical standards. The increased availability of credit for housing has not, at this stage, resulted in substantial increases in mortgage defaults.

3.26 Arrears on low doc and non-conforming loans are higher than full doc loans, reflecting the increased risk involved in such products. Evidence suggests that while low doc loans have a higher arrears rate, these arrears

15 Finance Sector Union, *Submission no. 17,* p. 4.

16 Mr D Wakeley, Virgin Money, *Transcript of evidence,* 10 August 2007, p. 46.

17 RBA & APRA, *Submission no. 7,* p. 8.

are more likely to self-cure. This is indicative of the lumpy cash flow of the holders of these loans, who are primarily self-employed.

3.27 The level of arrears on non-conforming loans is high and is rising. This is not surprising given the profile of such borrowers, and non-conforming lenders charge much higher interest rates to cover any losses. The non-conforming market is only a fraction of the total housing lending market (about 1 per cent), so the higher arrears rates do not pose significant macro-economic concerns. Predatory lending practices are almost exclusively associated with the non-conforming sector. Higher arrears rates in this sector may also be reflective of this fact.

3.28 While from an aggregate perspective the level of loan arrears remains low, it must be remembered that there are an increasing number of people who are struggling to pay their mortgage. This may not cause concerns for the stability of the economy or the financial system, but it does cause great concern for the individuals involved. The following chapters will look at why people are getting into to trouble, how they are treated by their lenders when this occurs, and the regulatory frameworks in place to offer consumer protection to borrowers.

3.29 A consistent theme in submissions and at the roundtable was the need to get better information on housing repossessions. The committee believes this should occur so that public debate on housing lending can be better informed. The most obvious agency to collect national data would be the Australian Bureau of Statistics. Sources of the data could include lenders and state and territory supreme courts.

Recommendation 1

3.30 **The committee recommends that the Australian Bureau of Statistics begin collecting and publishing annual data on housing repossessions. The data should be disaggregated to include, as a minimum, breakdowns by loan type, lender type, primary cause, and location (local government area or postcode).**