SUBMISSION 16

AUSTRALIAN PROPERTY INSTITUTE INC.

INQUIRY INTO
HOME LENDING PRACTICES AND PROCESSES

SUBMISSION TO THE HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

JULY 2007

INTRODUCTION

This submission responds to the document released by the House of Representatives Standing Committee on Economics, Finance and Public Administration in respect of the *Inquiry into Home Loan Lending Practices and Processes.*

This submission by the Australian Property Institute (API) is in response to an invitation by the Inquiry Secretary to the Institute dated 20 July 2007.

The Institute fully supports the inquiry by the Standing Committee into home loan lending practices and processes to address the following issues:

- *To what extent have credit standards declined in Australia in recent years?*
    - *Market share of non-conforming lenders; increase in low-doc products across the board.*
- *Have declining credit standards caused an increase in the number of loans in arrears and the number of repossessions?*
    - *Lack of accurate data on repossessions; 'agreed' sales hiding true rate of defaults.*
- *Are borrowers in financial difficulty being treated appropriately by lenders?*
    - *Obligations under CBP and/or UCCC; access to superannuation for repayments.*
- *Are declining credit standards likely to have any long-term implications for the Australian financial system?*
    - *Lessons from the current situation in the United States.*

The Institute is happy to discuss any of the matters raised in its submission or to provide any additional information required. Arrangements can be made by contacting Mr. Grant Warner, API National Director on telephone number (02) 6282 2411.

COMMENTS AND RECOMMENDATIONS

The following comments and recommendations have been framed to respond to the headings of the Standing Committee's letter of invitation

1. *To what extent have credit standards declined in Australia in recent years?*

1.1 The Institute notes that there has been an apparent decline in credit standards in recent years. The following examples evidence this decline in credit standards.

- An increase in equity loans to retirees with no need for repayments by the retirees. This results in a diminishing of the owners equity.
- The number of loans provided to borrowers without the requirement for the borrower to provide evidence of financial ability to make loan repayments.
- Ability of previously delinquent borrowers being able to access credit in spite of poor or faulty Credit Rating Authority ratings.
- Increasing number of debt consolidation loans (i.e. credit cards, personal loans etc) without requirement for borrower to reduce available credit results in an over extension of debt level by the borrower.
- Apparent limited checking or cross checking procedures of information/data provided by borrowers or borrowers agents for loan applications.
- Second and third private mortgages are provided at very high interest rates with no need for financial evidence to support ability to repay the loan.
- Loans of 100% to 110% on homes, with no deposit and no equity required from borrower are regularly being advertised.
- Loans on 80% of purchase price based on contracts only, with no valuation required to support the loan amount.
- Loans on Desktop Assessments with minimal checking procedures (Opposed to the Desktop Assessment model developed by the API).
- Loans provided to borrowers based on statistical assessments which utilize sales price averages in all suburbs with no requirement for a valuation to support the assessment.
- Loans (by some financial institutions) given on ex-bank managers drive-by assessment with no requirement for a valuation to support (or otherwise) home loan.

2. *Have declining credit standards caused an increase in the number of loans in arrears and the number of repossessions?*

2.1 The advent of declining credit standards has made borrowers more susceptible to changes in interest rates. While a borrower who defaults in a rising property market may meet their financial obligations, the opposite is likely to be the case in a falling property market.

2.2 Lending practices coupled with uncertainty (lack of documentary evidence at time of loan application) as to whether the borrower can afford to make repayments on the amount borrowed has further exacerbated the propensity for defaulting loans.

2.3 High rates of interest for 2^{nd} and 3^{rd} mortgages make borrowers more susceptible to fluctuations in interest rates.

2.4 The provision of Low–doc loans (loans provided to borrowers with no requirement for either a valuation of the property concerned or documentary evidence to support the borrowers ability to make loan repayments) at higher interest rates than standard home loans have made it easier for borrowers to access finance. At the same time any change in interest rate or the borrowers financial circumstances invariably leads to defaults in mortgage repayments and frequently repossession..

2.5 No equity on home loans allows no margin for error where the borrower has accessed the maximum loan available. E.g. If unemployed for short period or interest rates increase, could result in a default in mortgage repayments.

2.6 Where a borrower has financed 110% of the funds required to purchase the house and the property market declines, the house is subject to repossession if the borrower cannot meet repayments. Had the borrower an appropriate level of equity in the house the option to re-finance would be available.

3. *Are borrowers in financial difficulty being treated appropriately by lenders?*

3.1 The API cannot comment on this matter due to lack of information.

4. *Are declining credit standards likely to have any long-term implications for the Australian financial system?*

4.1 The Institute is of the view that declining credit standards will likely have long-term implications for the Australian financial system. This could be avoided through the instigation of the following measures.

- Review of lending standards to ensure future downturns do not have the 2003-2007 effect (high number of default loans and re-possessions).

- Loan to Valuation Ratio (LVR) should be re-introduced such as at 80% of purchase price, allowing a 20%buffer (owners equity) in times of rising interest rates, unemployment and market downturns.
- Increased requirement for supporting documentation to ensure borrower has the ability to make loan repayments at the current rate of interest as well as at a higher rate.
- Establishment of rules and guidelines (including checking procedures) covering mortgage brokers. Issues include broker introduce ed deals, ability for fraud, manipulation of borrowers financials to support loan application.
- The requirement for a valuation for every property purchase and refinance of residential property.

APPENDIX 1 AUSTRALIAN PROPERTY INSTITUTE INC.

The Australian Property Institute, (formerly known as the Australian Institute of Valuers and Land Economists), has enjoyed a long and proud history.

Originally formed over eighty years ago in 1926, the Institute today represents the interests of approximately 8,000 property experts throughout Australia. As the peek professional property organisation the API has been pivotal in providing factual and dispassionate advice on a broad range of property issues addressed by the Commonwealth and State/Territory governments since the Institute was formed.

In addition, the Institute's advice has increasingly been sought by overseas bodies such as the United Nations, the World Bank and the International Valuation Standards Committee, evidencing a level of expertise within the API and its membership which is recognised globally.

However, as a professional organisation the primary role of the Australian Property Institute is to set and maintain the highest standards of professional practice, education, ethics and discipline for its members.

Institute members are engaged in all facets of the property industry including valuation, property development and management, property financing and trusts, professional property consultancy, plant and machinery valuation, town planning consultancy, property law, and architecture. Membership of the Australian Property Institute has become synonymous with traits and qualities such as professional integrity and client service, industry experience, specialist expertise, together with tertiary level education and life long continuing professional development.

Members are the Institute's greatest asset, and the Australian Property Institute is committed to maintaining a strong base for the future of the property profession through the broadening of the expertise, and knowledge of the membership.

Integrity

The Membership of the Australian Property Institute is bound by:
- A Code of Ethics and
- Rules of Conduct