PRUSHKA
FAST DEBT RECOVERY
NO RECOVERY – NO CHARGE

SUBMISSION TO THE HOUSE OF REPRESENTATIVE ECONOMICS COMMITTEE

Hearing date: August 10, 2007

Submission by: Roger Mendelson
(CEO of Prushka Fast Debt Recovery Pty Ltd)

MY BACKGROUND

1. As CEO of Prushka Fast Debt Recovery Pty Ltd, I have access to data from across the country which provides an early warning indicator of economic trends within the company.

2. The reason for this is that Prushka has over 38,000 clients across Australia, has 14 offices, a strong regional presence and collects overdue accounts for a wide variety of business. Analysing the data provides an excellent indicator of economic trends, which become apparent well before they hit the official figures.

3. In addition, as the commercial partner in a Melbourne Law Firm in the 1980's and until 1991, I was very actively involved in acting on behalf of a wide range of borrowers in dealing with financial institutions arising from issues with commercial property and business loans.

4. I have no political or commercial barrow to push here and welcome the opportunity to present views from an outside perspective.

CREDIT STANDARD

5. In the lead up to the 1990-1991 recession, the decline in lending standards had been basically within the commercial property sector and this is the sector which suffered a huge fall-out in 1990-1991. During that time, there was little real fall-out in the residential sector, except at the top end.

6. Lending criteria for business and commercial loans have been tight ever since and the decline in criteria has been solely within the residential sector, particularly at the lower end.

7. The driving factor has been the decline in the percentage of residential loans written directly by banks. It is estimated that banks now directly lend less than 60% of new residential loans.

8. The balance is now written largely through finance brokers, who invariably act as agents for either non-bank institutions or for banks. In those cases, banks which provide the funds are effectively a wholesaler provider of funds and have virtually no relationship with the borrower.

9. A complication factor is that loans from non-bank institutions, where the LVR ("Loan to Value Ratio") exceeds 75% to 80% are normally insured through Mortgage Insurers, of which they are only two major Mortgage Insurers in Australia.

10. I do not know the percentage of new loans which are "low-doc" and this in itself is a deficiency. It is estimated to be approximately 1 or 2% but it is a concern that the term itself is not unambiguously defined and that there is no consistent reporting on this figure.

11. Anecdotal evidence I have is that Prushka is approached virtually on a weekly basis by fringe lenders and brokers, seeking referrals of business by us for debtors who we are currently dealing with. That is, they wish us to refer debtors who have overdue accounts, to them, in order that they may provide them with a loan.

LOAN ARREARS AND MORTGAGE DEFAULTS

12. Various media commentators have reported on figures such as the annual figures for orders for possession from the Supreme Court of Victoria. This figure in fact shows an increase of approximately 500% over a five year period.

13. I believe that formal orders for possession from the Court represent only approximately 20% of the number of loans which are in arrears and result in a sale being effected "under pressure" from the lender.

14. A lender will normally try to "work through" a default situation with a borrower and if they are satisfied that they have sufficient equity to cover the loan principle, interest (at Penalty Rates) and costs and that the borrower is cooperative, they will normally arrange for the borrower to sell the property. This way, the property will normally achieve a higher price than if it is sold by Mortgagee. In this case, the institution does not appear to be "tough" and the result is achieved with much less trauma. Invariably, in that case, the estate agent will be obliged to not accept an offer for sale without firstly obtaining consent from the Lender.

15. My perception is that at present, serious loan defaults are largely confined to outlying areas of Sydney and Melbourne and this is certainly supported by anecdotal evidence. Example: areas of west Sydney such as Campbelltown and Craigieburn in Melbourne.

16. This is logical in that these two cities had the highest level of house price growth in the early stages, so that borrowers were forced to borrow more in order to buy into the market, at an earlier stage of the cycle than for other areas.

☙ TREATMENT BY LENDERS ❧

17. There are two areas of concern:

    (a) Loans where there is mortgage insurance and which fall in default will have a far greater chance of proceeding to mortgagee sale than a loan directly from a financial institution. The reason is that the lender is obliged, under the terms of the policy, to “crystallize” the loss first before making a claim on the policy cover, so the lender effectively has no real discretion in the matter;

    (b) There has been a growing disconnect between the people who approve the loan in the first place and the people who deal with administration of the loan and handle defaults. Up until about ten years ago, most residential borrowers would have had a relationship with the manager of their bank or building society, there would have been a track record and the manager would not normally recommend that a loan be approved unless he felt comfortable with the borrowers. This nexus has now largely been broken. In addition, some institutions now outsource the whole default process, so that there is no relationship whatsoever between the borrower and the people handling the default.

18. I believe that as a result of the above comments, a serious issue is emerging and one which has not been in existence in Australia previously.

19. I believe that borrowers from financial institutions which are not directly responsible for dealing with their own defaults are at a serious disadvantage compared to borrowers from institutions which handle their own default processes and are concerned about their brand and reputation.

☙ LONG TERM IMPLICATION ❧

20. I believe that a study should be undertaken of:

    (a) Percentage of housing loans which are sourced from a third party;

(b) Who these third parties are and what are their criteria?;

(c) What protection is there in the event where the third party provider goes into liquidation?;

(d) What percentage of housing loans are subject to mortgage insurance?;

21. The implications of a US style low-doc loan fall-out are likely to be limited to areas where these loans are common (largely, to the outer areas of the major cities).

22. It is unlikely to have a wider impact on the financial system or the regional or upper-end of the residential market. However, the impact on those areas at risk could be quite pronounced because there is likely to be a domino effect, resulting in a substantial fall in property prices in those areas, as a result of properties coming on to the market from mortgagee sales.

MORTGAGE DEFAULT REGISTER

23. I have previously called for the establishment of a National Mortgage Default Register because I believe that there is a real dearth of information for use by economic commentators and decision makers.

24. I suggest that the source of information come from real estate agents because 100% of mortgagee sales or mortgagee-influenced sales will be handled by estate agents.

25. It is imperative that the agents, when obtaining a listing, have an additional form to complete and that it lists whether or not a financial institution is involved in the decision-making in relation to the sale and whether the vendor is currently in arrears at the time of listing the property.

26. It would not be a difficult task to collate the information and this would then provide valuable data on emerging trends on both a national and regional basis.