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Shona Batge
Committee Secretary
Parliamentary Joint Committee on Corporations
and Financial Services
Department of the Senate
PO Box 6100 Parliament House
CANBERRA ACT 2600

Dear Madam,

Re: Inquiry into Financial Products and Services in Australia

Please find below the Australian Property Institute's (API) response to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the issues associated with recent financial product and services provider collapses, such as Storm Financial, Opes Prime and other similar collapses.

The Institute, in particular, wishes to comment on the additional term of reference agreed to by the Senate on 16 March 2009, which is as follows:

> ***The committee will investigate the involvement of the banking and finance industry in providing finance for investors in and through Storm Financial, Opes Prime and other similar businesses, and the practices of banks and other financial institutions in relation to margin lending associated with those businesses.***

There has been significant media coverage as a result of the collapse of Storm Financial, including the use of "valuations" as part of the process by the relevant lending institutions and Storm Financial.

The issue from an API perspective is whether prudent lending practices were adopted to protect the shareholders of the lending institutions as well as the financial position of the borrower.

The Institute has for some time been concerned about the lowering of valuation standards adopted by the lending institutions when compared to the API's mortgage valuation standards and the perception of the acceptance of such diminished standards by the Australian Prudential Regulation Authority (APRA). APRA being the regulator responsible for Authorised Deposit-taking Institutions (ADI's - banks, building societies and credit unions) within Australia.

It is an issue of **Risk** for the regulator and the lending institutions. Unfortunately, when the inevitable downturn occurs, the party which bears the brunt of losses suffered is the individual investor.

Members of the Australian Property Institute undertake valuations for mortgage purposes for ADI's in accordance with instructions from the relevant lender. Instructions may require an internal inspection of the property by the valuer; a restricted valuation of the property based on a "kerbside inspection" (no internal inspection); or a desktop assessment which does not encompass any inspection at all. The lower the level of inspection, the greater the lending risk. It should be noted the average fee for a residential valuation report encompassing an internal inspection of a median priced home for mortgage lending purposes is around $200.

The impact of Lenders instructing Valuers to undertake less rigorous "valuation" investigations is that greater lending risk occurs.

Valuers undertaking work for lending institutions will have adequate Professional Indemnity Insurance for valuations which encompass an internal inspection, however, for a restricted valuation or desktop assessment, the risk will normally reside with the lender.

Furthermore, some lenders adopt an automated valuation model which is a statistically computer generated figure, or the actual purchase price as being acceptable for lending purposes. The Institute's view is that an AVM does not constitute a valuation.

From media reports it would appear that the Commonwealth Bank of Australia (CBA) was, in effect, undertaking internal "valuations" using its own computer based valuation program known as VAS. This activity, or abuse of procedures, may (or may not) have been restricted to the Aitkenvale branch of the CBA in Townsville, Queensland, however, it reflects the real cost to the consumer should valuation standards be lowered and or misused.

In Queensland, New South Wales and Western Australia the valuation of real property may only be undertaken by a licensed valuer who is registered under the relevant Act. The API argues that any desktop assessment is not a valuation and indeed the use of the word "valuation" when talking about a desktop assessment, or figure produced by a statistically computer generated program is both false and misleading.

It should also be noted that in Queensland legislation is in place which requires a Warning Statement (see attached) to be made available for all residential purchases in that State (other than by auction). Perhaps it is something required for the lending industry when it comes to margin lending and or home equity loans.

The API seeks that legislation or appropriate action by APRA which ensures the use of restricted valuations and desktop assessments are only ever considered in relevant risk adverse situations. The use of Automated Valuation Models (in itself a misleading description) should be a tool to assist lenders and their mortgage insurers, not something which determines value.

In 2005 APRA published Survey Results from a Review of Residential Valuation Practices by ADI's and Lenders Mortgage Insurers. The document included the following extract:-

> "The surveys have identified that residential valuation practices have undergone a significant change over recent years, particularly for the larger ADIs. Whereas previously a full external valuation, including an internal inspection of the property, was the most common valuation technique, this is now not the case; some institutions physically inspect less than 50 per cent of their security properties.

> Alternative valuation methodologies can pose additional risks since they do not typically involve an internal inspection of the property by an appropriately qualified valuer. APRA is conscious of the pressures on ADIs to reduce valuation expenses and that this could, in turn, see a further reduction in the number of properties subject to external valuation. APRA is concerned that these new methodologies have not been tested during a period of property price declines and it will be closely monitoring developments in residential valuation practices. In particular, APRA will be assessing how the new valuation methods were researched, and subsequently monitored, in the regular visits to ADIs and LMIs."

We are now in a market where APRA should be testing new methodologies and whether they have contributed to the losses suffered by investors.

The moral and ethical questions (or lack thereof) associated with Storm Financial and its "friendly lenders" is one for the Joint Committee and the Boards of those lenders to consider.

Yours faithfully

D. B. Moore

David Moore
National President
Australian Property Institute