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Association of Building Societies and Credit Unions

Abacus
Australian Mutuals

2 April 2008

Mr John Hawkins
Secretary
Senate Select Committee on Housing Affordability in Australia
Parliament House
Canberra ACT 2600
By e-mail: housing.sen@aph.gov.au

Dear Mr Hawkins,

Thank you for your invitation to *Abacus – Australian Mutuals* to provide a submission to the Senate Select Committee on Housing Affordability in Australia.

Abacus is the industry association for credit unions and mutual building societies. This submission will focus on paragraphs (c) and (f) of the Committee's terms of reference: proposed assistance for first home buyers; and, the role of financial institutions in home lending.

MUTUAL ADIs

Credit unions and mutual building societies are customer-owned Authorised Deposit-taking institutions (mutual ADIs), licensed and supervised by the Australian Prudential Regulation Authority to engage in retail banking.

Mutual ADIs are companies and Australian Financial Services Licensees under the *Corporations Act 2001* and their consumer lending activity is subject to the Uniform Consumer Credit Code.

Collectively, mutual ADIs have around 12 per cent of the household deposits market (second only to the Commonwealth Bank) and around 7 per cent of the owner-occupied home lending market.

Abacus' membership comprises the largest and most diverse group of ADIs in the banking sector, with 145 lenders servicing a wide range of communities and occupational groups across Australia.

Mutual ADIs have 4.5 million members, total assets under management of $65 billion, more than 1,100 branches and an estimated 14,500 employees.

Credit unions and mutual building societies have a long tradition of responsible lending, excellent customer service and putting members first. This is reflected in the fact that credit unions and mutual building societies strongly outperform major banks in customer satisfaction surveys.

Building societies have been helping Australians into home ownership for well over 100 years. Credit unions have been providing financial services to Australians for more than 50 years.

Newcastle Permanent Building Society's origins date back to 2 February 1903: "A meeting held in Wickham (a Newcastle suburb) on that day saw a few visionary individuals determined to help low income families achieve the security and dignity that comes from home ownership. This goal was to be realised through the establishment of a building society."

Toowoomba-based Heritage Building Society's origins date back to 1875 and IMB was formed in 1880 "to provide housing finance and deposit account facilities for the growing population of the Illawarra region of NSW and has traded continuously since that time."

Australian's largest mutual ADI, Credit Union Australia, was established in 1966 by staff at Brisbane's GPO as the Queensland Postal Cooperative Credit Union. NSW Teachers Credit Union was also established in 1966 and Australian Defence Credit Union in 1959.

The benefits of competition and choice that mutual ADIs bring to the home lending market are highlighted in the current environment where funding costs for all lenders have spiked due to the impact of the United States sub-prime mortgage crisis.

Mutual ADIs are less reliant on wholesale markets for funding than banks and, unlike banks, mutual ADIs are not under pressure to put shareholders ahead of customers.

As indicated in the table below based on Cannex data on standard variable home loans, credit unions and mutual building societies have, on average, held rates at levels well below the banks.

1 April 2008	**Average**	**Min**	**Max**
Banks	9.38	9.32	9.47
Credit Unions	8.84	8.10	9.39
Building Societies	8.99	8.49	9.32

According to the RBA's March 2008 Financial Stability Review, credit unions and building societies remain well capitalised, with aggregate capital ratios of around 16 per cent and 13 per cent, respectively.

Credit unions and building societies are prudent and responsible lenders.

KPMG's latest annual survey of credit unions and building societies found that the sector achieved an "outstanding result" in asset quality, continuing to enjoy "historic lows in credit losses despite recent interest rate rises and early signs of financial stress in some sectors of the economy."[1]

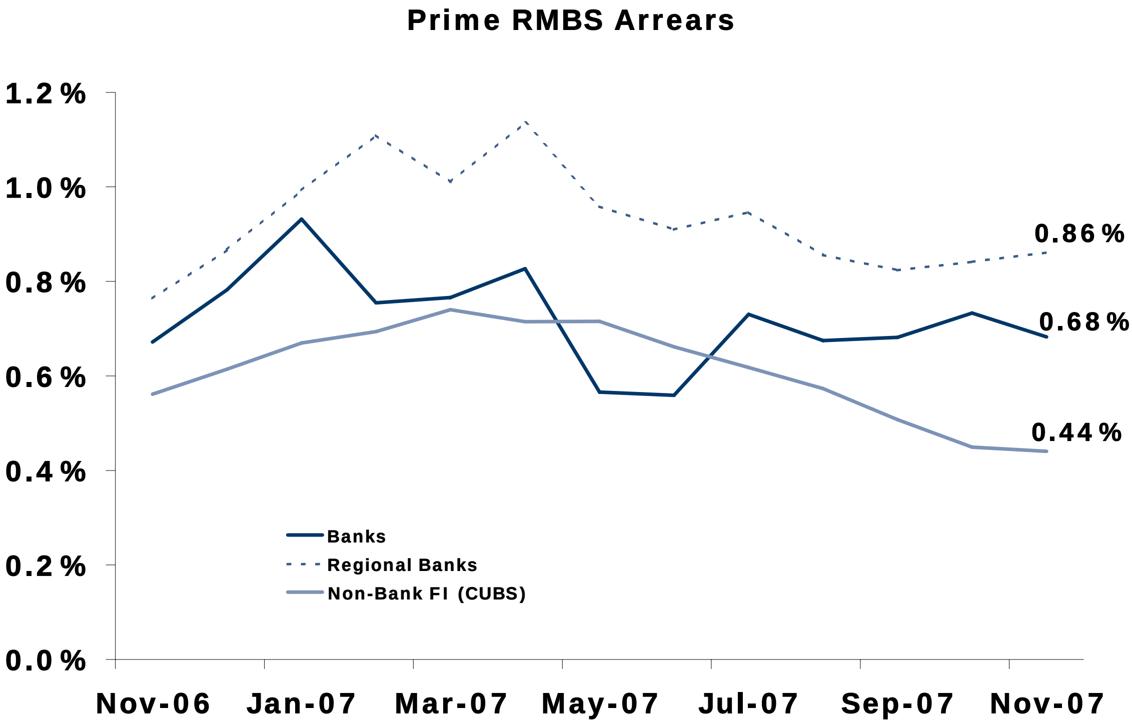
A further indicator of the prudent and responsible approach taken by credit unions is provided by Standard & Poor's data on arrears on loans underlying Prime Residential Mortgage Backed Securities (RMBS).

According to Standard & Poor's (see chart below), credit union and building society (CUBS) Prime RMBS arrears has recorded a consistent downward trend to 0.44%. This compares

[1] KPMG Financial Institutions Performance Survey 2007 Building Societies and Credit Unions, November 2007.

with the higher arrears recorded by major banks and regional banks at 0.68% and 0.86% respectively.

Even when the credit crunch first hit last year, credit unions and building societies consistently reported lower arrears as major bank and the regional bank arrears edged upwards.



(Source: Standard & Poor's)

The competition and choice provided by mutual ADIs against banks in the home loan market has become even more important as competitive pressure from non-ADI lenders has, for the time being, diminished dramatically.

Non-ADI lenders have been severely affected by the impact of the "global repricing of risk" on the mortgage securitisation market.[2]

> "The largest banks, however, make relatively little use of securitisation, with their outstanding securitised loans accounting for only around 6 per cent of total housing loans outstanding. The reliance on these markets varies considerably across the other Australian-owned banks, with some of these banks financing more than half of their loans through securitisation prior to the recent turmoil.
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> "Reflecting the differences in funding patterns, non-ADI lenders were among the first to raise their interest rates as funding costs rose, and have increased their advertised standard variable interest rates by an average of 40 basis points more than the increase in the cash rate since July 2007. While most other lenders have also increased their advertised rates by more than the cash rate, access to alternative sources of funding, including deposits, has meant that their funding costs have not risen by as much.

[2] Financial Stability Review, March 2008. Reserve Bank of Australia.

> "The effect of the changed competitive environment in the mortgage market is evident in recent changes in market shares, with data on housing loan approvals showing that the share of owner-occupier loan approvals by wholesale lenders (mainly mortgage originators) fell to around 6½ per cent in January 2008, compared with around 12 per cent for the previous few years. Conversely, the share of new loans approved by the five largest banks has risen in the past few months. In addition, with mortgage margins under downward pressure, many lenders have re-examined their use of brokers and the commissions that they pay to these brokers."

Unless and until investor confidence returns to the securitisation market, or alternative sources of competitively-priced funding can be found, non-ADI lenders will have limited capacity to apply home loan pricing pressure to banks.

Although it is a constant challenge for credit unions and mutual building societies to take on the scale, large distribution networks and marketing muscle of the major banks, mutual ADIs have a long and successful track record. Consistent with their core responsibility to all members (borrowers and savers) to operate prudently and for the long term, mutual ADIs will continue to provide competition, choice and diversity in the home lending market.

HOUSING AFFORDABILITY

A recent AMP/NATSEM report[3] says Australia has one of the least affordable housing markets in the developed world.

> "Younger generations today are likely to confront a more challenging housing market than people of the same age in the past. The amount required to purchase a house has increased at a greater rate than incomes for all age groups, and the proportion of people paying more than 30 per cent of their income on housing increased between 1995-96 and 2005-06.
>
> "The prospect of purchasing a house for those marginalised in our community (the unemployed, the poor, sole parent families) is very low. Purchasing a house for these groups in 2005-06 is much more difficult than it was in 1995-96. The housing boom appears to have hit these people particularly hard."

The AMP/NATSEM report says Australians have not given up on their great housing dream but the "mortgage noose" now remains around the household neck for much longer periods of time.

Home ownership among 25-39 year olds - typically the age when people first enter into home-ownership - has fallen from around 65 per cent in 1986 to 58 per cent in 2006, according to the RBA.[4]

The RBA says housing will never be "as 'affordable' as we might like" and to a large extent the decline in affordability reflects market outcomes, especially factors which have boosted demand for housing.

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[3] Trends in housing affordability and housing stress, 1995-96 to 2005-06. AMP/NATSEM Income and Wealth Report, Issue 19 - March 2008.
[4] *Some Observations on the Cost of Housing in Australia* Anthony Richards, Head of Economic Analysis Department, Reserve Bank of Australia, 27 March 2008.

> "However, various commentators and industry groups have argued that there are also some factors on the supply side that have boosted the price of new housing and limited the expansion of housing supply that could have moderated the worsening in affordability. Overall, it seems likely that developments in housing prices close to CBDs mostly reflect demand-side factors, but that supply-side factors might have materially affected housing prices near the fringes of our major cities.
>
> "As the [2004 Productivity Commission report on first home ownership noted] 'there is limited scope for governments to improve affordability for first (and other) homebuyers in the short term. … However, governments do have an important role to play in facilitating efficient housing outcomes. In particular, policy initiatives to address any structural factors that encourage excessive demand for housing, or that unnecessarily reduce the responsiveness of supply to increases in demand, will reduce 'average' house prices over future cycles and could provide enduring affordability benefits to both home buyers and renters.' The discussion in this paper suggests that those observations in the Productivity Commission report remain valid. On the demand side, it is now widely accepted that policies that simply give people more money to spend on housing are likely to be capitalised into higher housing prices. On the supply side, efforts to improve housing affordability should be focussed on policies regarding land use and on improving efficiency in the supply of land and housing."

The Commonwealth, State and Territory Governments have announced steps to address some of the housing supply issues.

The March 2008 Council of Australian Governments Meeting[5] identified the decline in housing affordability as a pressing issue for Australians and recognised that improving affordability is critical to addressing financial stress and disadvantage, including for Indigenous communities.

> "COAG agreed to implement five key housing initiatives: to facilitate improved housing supply through identifying surplus government land suitable for housing development; provide incentives to construct affordable rental housing; lower the burden of infrastructure and regulatory costs built into the purchase price of a new home; improve the evidence base for housing policy and program development; and, support the most needy in society through joint Commonwealth-State investment in 600 houses and units for homeless people.
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> "COAG agreed to the distribution of $150 million to deliver new homes for homeless people. These funds will be distributed with reference to the number of homeless people in each jurisdiction, with a guarantee for smaller jurisdictions that no State or Territory will receive less than $1 million per annum.
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> "COAG welcomed the decision of the Commonwealth to provide $30 million from the Housing Affordability Fund for the roll out of electronic Development Applications in local government with a priority focus on high growth areas. COAG requested the Local Government and Planning Ministers' Council to make the implementation of this work a priority."

Abacus welcomes measures to remove impediments to housing supply.

[5] Council of Australian Governments' Meeting, 26 March 2008, Communiqué.

The Productivity Commission's 2004 report[6] on first home ownership found that house prices are the result of the interaction of many influences on the supply and demand sides of the market and it is not possible to be precise about the contribution of specific developments such as cheaper and more available finance.

However, the PC did conclude that cheaper and more accessible finance was an important driver of increased housing demand and rising house prices in the eight years from 1996 to 2004.

The PC said:

- since interest rates peaked in 1990, reductions in nominal interest rates have roughly doubled the amount that households can borrow for housing from a given income;
- innovations in home lending have simultaneously made it easier for many households to access finance; and
- lower real interest rates have made both owner-occupied and rental housing more attractive as an investment and thereby increased the incentive to borrow.

"However, there is no mechanistic relationship between the cost and availability of finance, levels of housing-related borrowing and house prices. A range of other demand-side factors have also increased the capacity and/or incentive for households to borrow for housing," the PC said.

These other demand-side factors include:

- higher incomes and more jobs — in short, economic growth;
- population growth and the propensity of people to form households; and
- two "booster" factors:
  - The First Home Owner Scheme introduced as compensation for the GST; and
  - The 1999 change to capital gains taxation.

ROLE OF FINANCIAL INSTITUTIONS

The role of financial institutions in home lending is to participate in a competitive market that meets the needs of borrowers, including first home buyers.

Building societies were established for the specific purpose of home lending. Mutual building societies continue to focus on member benefit rather than maximising profits for shareholders. Credit unions were originally oriented towards personal loans rather than housing loans but have since become important participants in the home loan market.

One way that mutual ADIs address housing affordability is to tailor home loan products specifically for first home buyers.

Some mutual ADIs, including Savings & Loans Credit Union and Police & Nurses Credit Society, offer 40 year home loans to help lower repayments. Savings & Loans Credit Union offers a "Family Guarantee option to get your foot in the door by having a member of your immediate family guarantee a portion of their home for your loan."

Many mutual ADIs offer to assist first home buyers in applying for the First Home Owner Grant.

[6] *First Home Ownership* Productivity Commission Inquiry Report, March 2004.

Maritime Workers of Australia Credit Union offers first home buyers the opportunity to borrow up to 95 per cent of property value and reduced set-up costs. NSW Teachers Credit Union offers to absorb the cost of some loan processing fees and allows first home buyers to apply to temporarily stop repayments. Similarly, Victorian credit union mecu offers first home buyers a loan repayment pause feature enabling borrowers to cut repayments by 50 per cent for six months during maternity/paternity leave.

A competitive home loan market ensures that home buyers can obtain finance at the lowest possible price, within the framework of official monetary policy and pricing in wholesale credit markets.

The 2007 inquiry by the House of Representatives Economics Committee into home loan lending[7] noted substantial changes to the housing lending market over the last 10 to 15 years, including a huge increase in the number of lenders.

The Committee concluded that competition in the lending market has provided great benefits to consumers, including lower interest rate margins and new products.

> "The overall change to lending practices concerns some people, who argue that credit is being provided irresponsibly. Lenders, of course, deny this and maintain that credit is only provided to people who can afford it.
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> "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.
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> "There is no universal consensus on what constitutes an 'appropriate' loan. Different institutions—both ADIs and non-ADIs—are willing to take on different levels of risk. One lender's appropriate lending practices will be different to the next. While there are big differences between the most aggressive and least aggressive lenders, given that the RBA estimates only 0.22 per cent of loans are in arrears, it is fair to say that in the vast majority of cases 'appropriate' lending practices have been undertaken.
>
> "Not discounting the incidence of predatory lending, in most cases of mortgage default it is likely that the lender was *not* at fault. Unfortunate events like job loss, marital breakdown and family deaths do occur. These events have a material effect on a person's ability to make mortgage repayments."

The Committee recommended that the Commonwealth should regulate credit products and advice, including mortgage brokers and non-bank lenders.

At the March 2008 COAG Meeting, Commonwealth, State and Territory Governments agreed "in principle" to the Commonwealth assuming responsibility for regulating mortgage credit and advice, including mortgage brokers, for the purpose of protecting consumers.

COAG also agreed "in principle" to the Commonwealth assuming responsibility for regulating lending by non-deposit taking institutions and for regulating margin lending.

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[7] *Home loan lending* House of Representatives Economics Committee, September 2007.

States will retain interim responsibility to regulate mortgage credit and advice and mortgage broker activities until the Commonwealth completes its assumption of responsibility.

Credit unions and mutual building societies are currently finalising a new code of practice, including new provisions on credit assessment and use of brokers.

Section 15.1 of the existing Credit Union Code of Practice says:

> In considering whether to provide a Credit Union Product or Service involving the provision of credit to a Member, a Credit Union will take into account the range of factors it considers are relevant to the Member and the Credit Union Product or Service to establish whether, in the Credit Union's view, the Member has or may have in the future the capacity to repay the credit. These factors may include:
>
> > (i) the Member's income and expenditure;
> > (ii) the purpose for which the Credit Union Product or Service is to be used;
> > (iii) credit scoring (being a scoring method used by the Credit Union to assess whether a credit applicant is an acceptable risk); and
> > (iv) the Member's assets and liabilities.

FIRST HOME SAVER ACCOUNTS

Under paragraph (c) of the Committee's terms of reference, the Committee is to inquire into and report on proposed assistance for first home buyers by state, territory and the Commonwealth governments and their effectiveness in the absence of increased supply.

The measure of proposed assistance for first home buyers of most interest to mutual ADIs is the Commonwealth's First Home Saver Account (FHSA) program.

Encouraging and assisting first home buyers to save a deposit not only directly benefits borrowers, but lowers risk for borrowers and lenders.

Instilling a savings habit in a prospective borrower is valuable preparation for servicing a loan and any equity for a first home borrower via a deposit provides a buffer against a fall in house values. (While a fall in house values would increase housing affordability for new first home buyers, it would not be welcomed by existing home buyers and owners or by their lenders who have secured loans against prevailing property values.)

Depending on the size of the deposit, the borrower may be able to avoid the additional cost of lenders' mortgage insurance (LMI). A deposit of 15 to 20 per cent or more will enable the borrower to avoid this cost that brings no direct benefit to the borrower and is in fact a benefit to the lender.

Abacus strongly welcomes the FHSA initiative and we have provided two submissions to Treasury on design issues and the regulatory framework for FHSAs.

We seek a regulatory framework that maximises competition and choice for savers, particularly risk-averse savers, and that minimises entry barriers for providers. Optimising the FHSA initiative will require FHSA products that are attractive to, and understood by, young people. Each additional layer of complexity in the regulatory framework will reduce returns to savers, dampen competition and choice, and slow the arrival of FHSA products to market.

The FHSA regulatory framework will need to reflect the distinction between deposit products offered by ADIs and market linked FHSA products. While FHSAs are similar to superannuation in taxation treatment and in restrictions on withdrawals, FHSAs do not have the purpose of providing retirement income and are not intended to be a long term investment vehicle. The FHSA regulatory framework should be proportionate to the complexity and risk of different FHSA products.

Many first home buyers are young people and, according to research by the Australian Government's Financial Literacy Foundation, 77 per cent of young people "would not consider risk when choosing an investment."

Relying on disclosure documentation to protect savers is questionable given evidence that a large proportion of adult Australians do not understand such documents. According to the Australian Bureau of Statistics, 46 per cent of Australians aged 15 to 74 years do not have the minimum level of "prose literacy" that is "required for individuals to meet the complex demands of everyday life and work in the emerging knowledge-based economy."

FHSAs & housing supply

It is axiomatic in any market that action to increase demand in the absence of increased supply will drive up prices. As noted above, governments are addressing issues of housing supply.

We have argued that, rather than putting significant upward pressure on house prices, over the medium term FHSAs could have a smoothing effect on house prices.[8]

> "During the first four years of the new policy's operation, flows of funds associated with the new FHSAs will all be in the one direction - namely inwards into the accounts. Some portion of the aggregate inflows would probably, in the absence of the new policy, have gone into additional consumer spending. In this way the new policy will make some positive contribution to the containment of private sector aggregate demand for goods and services in Australia over the period immediately ahead, thus contributing positively to the task of inflation containment.
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> "In the medium term, when the FHSA system is 'mature', and there are flows of funds outwards from the accounts as well as inwards into them, there is also a good prospect of macroeconomic positives in terms of some *smoothing* effects on price cycles in housing assets. The present system of disadvantaged taxation treatment of the accumulation of the first home deposit is likely to encourage impatience at those times when house prices are rising most rapidly. When the aspiring first home-owners can see that in after-tax terms their house deposit accumulations are growing at a healthy annual rate, they might be expected to act with greater patience during periods of *over heating* in house prices generally. By this means the First Home Saver Policy would then be expected to have some positive 'smoothing' effect in terms of new residential construction spending and construction activity across the Australian economy."

To the extent that there is any house price inflationary impact from the FHSA initiative, this is dampened because FHSAs are, by definition, not available for buyers of investment properties or for second or third home buyers.

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[8] *First Home Saver Accounts* Report for Abacus by SA Centre for Economic Studies, January 2008.

The Government has announced that eligibility for FHSAs will be based around the qualifying criteria for the First Home Owner Grant scheme. This utilises existing systems and infrastructure. The 2004 PC inquiry into first home ownership found that the First Home Owner Scheme was “relatively simple and cheap to administer.” The PC inquiry concluded that “while the First Home Owner Scheme has brought forward some housing demand and thereby contributed to increased prices in the short term, the effect has been small.”

OTHER MATTERS

Abacus draws to the Committee’s attention two other policy issues that could affect housing affordability at the margin:

- the capacity for lenders to make better lending decisions if they have access to more information about borrowers’ existing credit commitments; and
- the introduction of electronic conveyancing to lower costs in home buying transactions.

Credit reporting

The House Economics Committee noted that unsecured consumer debt is an underplayed factor in debates about home lending practices.

> “People have an increasing propensity to take on debt to purchase expensive consumer items. If not paid in a timely manner, some of these forms of debt involve large fees and penalty interest rates. Where a person seeks to consolidate unsecured debt into their mortgage, evidence suggests that mortgage defaults become far more likely.
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> “Some lenders have argued that the problem of excessive consumer debt could in part be addressed by introducing positive credit reporting. This would give lenders more detailed and accurate information with which to assess potential borrowers’ creditworthiness. However, there are a range of privacy concerns surrounding positive credit reporting. The committee notes that the Australian Law Reform Commission is currently reviewing credit reporting arrangements as part of its broader review of the Privacy Act.”[9]

Abacus supports reform of credit reporting laws to promote better informed lending decisions. The Law Reform Commission is due to deliver its report to the Attorney General on 30 May 2008.

E-conveyancing

Abacus welcomes agreement by COAG to the development of a national electronic conveyancing system to “provide a single electronic system for completing real property transactions and lodging land title dealings for registration in Australia.”

Introduction of e-conveyancing has been delayed by interstate rivalries and conservative stakeholders. Abacus supports the implementation of an e-conveyancing system as soon as possible to reduce costs to property buyers and sellers and remove the need for paper cheques.

Victoria is the only Australian jurisdiction with an operating e-conveyancing system. Victoria says the benefits of e-conveyancing include: reduction in time spent arranging and attending settlement; equity of access for rural and regional Victorians; reduced costs to industry and

[9] *Home loan lending* House of Representatives Economics Committee, September 2007.

community by up to $70 million a year by 2012; and, savings of an estimated $235 to $395 per four party settlement.[10]

COAG will consider advice on appropriate governance arrangements and system implementation processes for e-conveyancing by June 2008.

CONCLUSION

The main points we have sought to make in this submission are:

- Mutual ADIs are an important force in the home loan market, are prudent and responsible lenders, and their role in providing competition and choice to Australian borrowers has become more significant with the decline of non-ADI lenders;
- Recent analysis indicates:
    - Australia has one of the least affordable housing markets in the developed world;
    - home ownership among 25-39 year olds has fallen; and
    - the decline in housing affordability reflects market outcomes, especially demand-side factors.
- Commonwealth, State and Territory Governments have announced steps to address housing supply issues;
- Cheaper and more accessible finance has been an important driver of increasing housing demand, along with several other factors;
- The role of financial institutions in home lending is to participate in a competitive market that meets the needs of borrowers, including first home buyers, and ensures they can obtain finance at the lowest possible price within the framework of official monetary policy and pricing in wholesale credit markets; and
- Abacus welcomes the Commonwealth Government’s First Home Saver Accounts initiative and seeks a regulatory framework for FHSAs that recognises the needs of young people.

Please don’t hesitate to contact me on 02 8299 9053 or Luke Lawler in our Canberra office on 02 6232 6666 to discuss any aspect of this submission.

Yours sincerely,

MARK DEGOTARDI
Head of Public Affairs

[10] http://www.landexchange.vic.gov.au/ec/about/benefits.html