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MEMORANDUM FOR THE BOARD **MARCH 2011 MEETING**

Financial Stability

The economic recovery is supporting the financial position of the household and business sectors in Australia, though they continue to exhibit a more cautious approach to their borrowing than prior to the crisis, which is evident in slower rates of credit growth in recent years. Even so, household indebtedness remains historically high, and recent increases in interest rates have lifted the aggregate debt-servicing requirement. While indicators of financial stress are relatively subdued, a continuation of the recent borrowing restraint by the household sector would be beneficial for building additional resilience into balance sheets.

The Australian Financial System

A challenge for the industry in coming years will be adjusting to a likely slower pace of credit growth compared with the previous few decades, which will limit their growth opportunities. As yet, there is little evidence that banks are actively loosening lending standards or taking on other risks in an attempt to sustain the earlier rates of growth. The slower rate of credit growth, in combination with ongoing strength in deposit growth, has eased the pressures on wholesale funding. Long-term wholesale markets remain sensitive to global investor sentiment, however, and access for smaller institutions is still limited. The banking sector is well placed to meet the more stringent Basel III capital requirements that will be phased in over the next few years.

The share of housing loans that are non-performing was broadly unchanged over 2010, at around 0.7 per cent.

Lending growth and credit standards

Banks have continued to expand their domestic loan books, though at a slower pace than in recent years as both households and businesses have been more cautious in their borrowing. Lending to households accounted for all of the growth in banks' books in the six months to January. . The major banks have reported that the 'battle for market share' in home lending has intensified as second-tier banks and credit unions and building societies (CUBS) have regained some pricing competitiveness.

Consistent with this, there is little sign that banks have been actively relaxing their lending standards in a bid to stimulate credit growth.

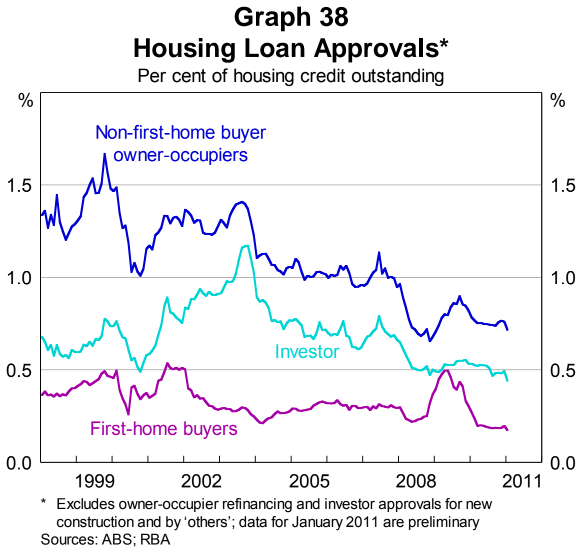
One or two banks also reported some easing in non-price lending criteria for wholesale borrowers. Margins in the smaller business loan segments, however, were reported to be little changed in the second half of 2010. There was no notable change in non-price criteria at the smaller end of the business loan market.

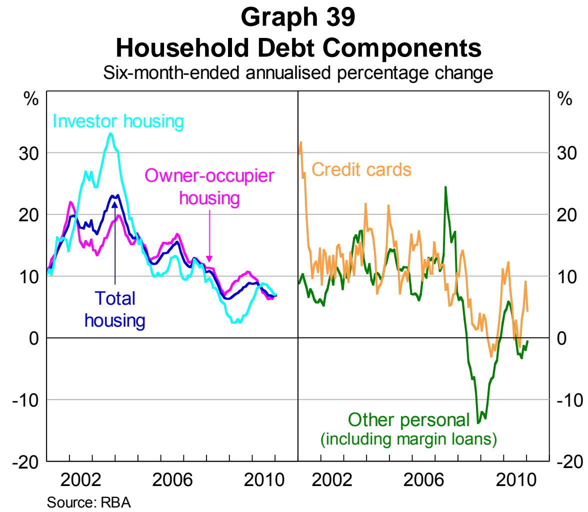
In contrast, a number of banks reported increasing their margins on housing loans in the December quarter 2010 following a two-year period of reported margin compression This corresponds with the highly publicised move by most banks to raise their housing lending rates by more than the increase in the target cash rate following the November Board meeting. Recently, there have been signs of increased competition on fees, with some banks abolishing exit fees on mortgages or offering to reimburse the exit fees incurred by customers switching from other banks. A few banks reported raising their maximum loan-to-valuation ratios (LVRs) on housing loans during 2010, though this follows a period in late 2008 and early 2009 when many banks were tightening these criteria. One bank tightened various other non-price lending conditions, including

debt-serviceability criteria, in the December quarter. Some banks also report that non-standard and line-of-credit loans are a declining share of new mortgage lending (although this could reflect weaker demand for such loans).

The responsible lending requirements of the National Consumer Credit Protection regime, which started for ADIs on 1 January 2011, should help limit any undue loosening in lending standards. This regime, which replaces (and largely replicates) the state-based Uniform Consumer Credit Code, places a strong onus on lenders to ensure that loans are suitable for borrowers' circumstances, notably their ability to repay. Banks are reportedly now requiring both their branch and broker channels to seek additional information from potential borrowers to determine the suitability of a product. Borrowers are also being required to provide more documentation in support of low-doc loans. Some banks report, for example, that what was formerly a 'low-doc' loan is now more like a 'mid-doc' loan.

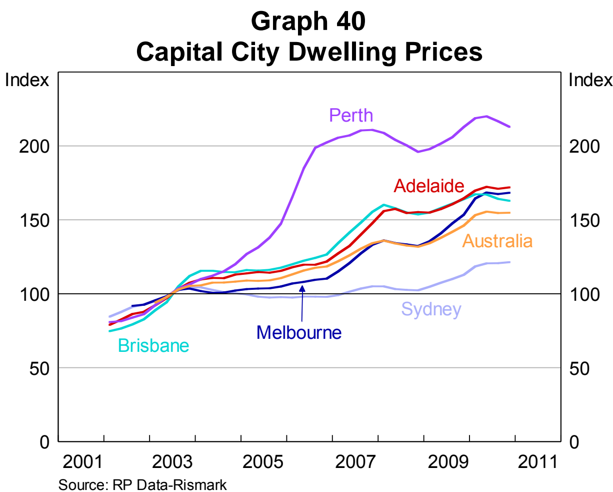
Other forms of borrowing by households are also relatively subdued; growth in credit card lending picked up in the second half of 2010 but has since declined and is well below the average pace of recent years, while the level of all other personal credit outstanding has recently been contracting.

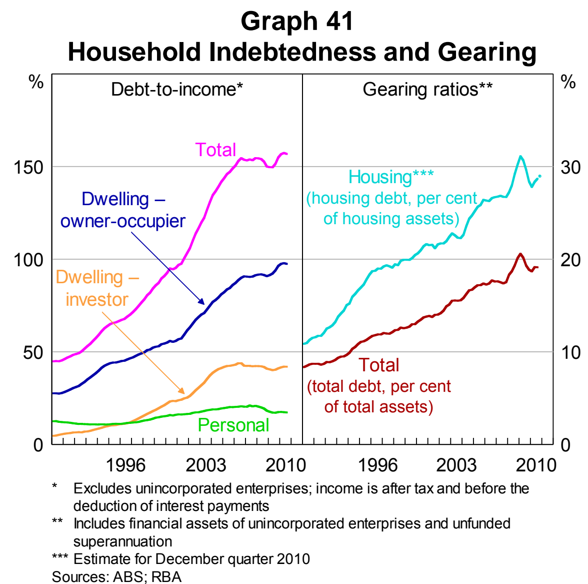




The moderation in demand for housing finance contributed to some cooling in the housing market in 2010. Nationwide housing prices rose 6 per cent over the year, compared with 11 per cent in 2009, and were fairly flat in the second half. The ratio of dwelling prices to income was broadly stable in 2010, at around the same level as in 2004. The increased propensity to pay down debt has also contributed to an increase in the rate of housing equity injection in the past few years.

Within the national average, though, there has been some regional divergence. Prices have been firmer in Sydney and Melbourne in 2010, but are drifting down in Perth and Brisbane (Graph 40). The strength in prices in Melbourne has occurred despite an apparently greater expansion in housing supply there than in the other cities, and is likely to have been driven by stronger than average growth in both population and loan approvals in Victoria.

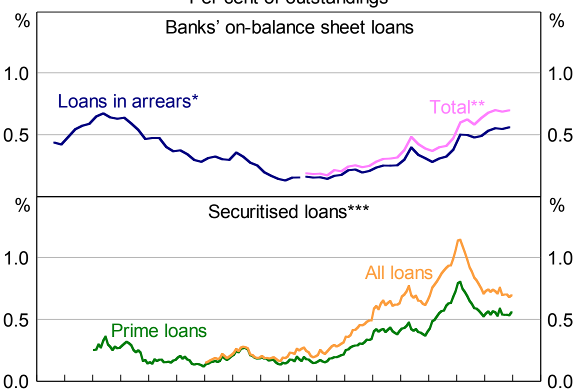




Even though the pace of debt accumulation has moderated in recent years, aggregate household indebtedness and gearing remain around historically high levels (Graph 41). This means some households could be exposed to shocks to their incomes and financial circumstances. A continuation of the recent borrowing restraint would thus be a welcome development, as it would add further resilience into household balance sheets and avoid a build-up of risk in the household financial position.

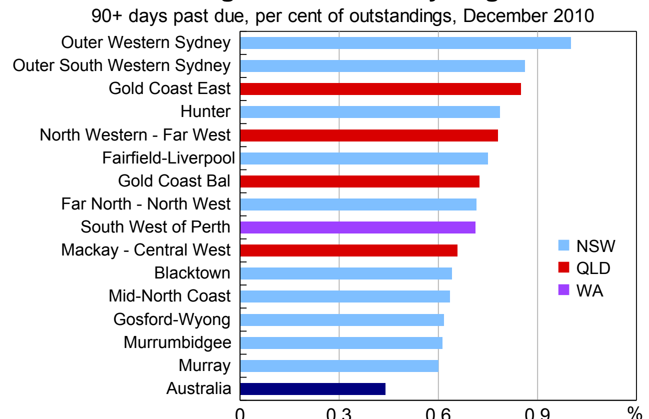
That said, a range of financial stress indicators show that the household sector is coping reasonably well with its debt levels and higher interest rates. While arrears rates on mortgage payments remain higher than average, they have levelled out recently, and remain low by international standards (Graph 42). By loan value, the share of non-performing housing loans on banks' balance sheets was around 0.7 per cent in December 2010, broadly unchanged since March, and up only 6 basis points from December 2009; the vast majority of these loans are well covered by collateral. Arrears on securitised housing loans were also stable in 2010, at about 0.7 per cent, though these data are becoming less representative of overall housing loan quality given the gradual decline in RMBS outstanding (down about 47 per cent from the peak in 2007). As for housing arrears, personal and credit card loan arrears have been little changed over the past year. As at December 2010, the non-performing rate for credit cards was 1.1 per cent, broadly unchanged since December 2007. The equivalent figure for other personal loans was 1.7 per cent in December, which was up a little over the year, but well down from the peak in early 2009.

Graph 42
Non-performing Housing Loans
Per cent of outstandings



* Loans that are 90+ days past-due but otherwise well secured by collateral
** Includes 'impaired' loans that are in arrears (or are otherwise doubtful) and not well secured by collateral
*** Loans securitised by all lenders, 90+ days past-due
Sources: APRA; Perpetual; RBA; Standard & Poor's

Graph 43
Housing Loan Arrears by Region*
90+ days past due, per cent of outstandings, December 2010



* Prime loans securitised by all lenders; includes 'self-securitisations'
Sources: ABS; Perpetual; RBA

That housing loan arrears stabilised in 2010 despite further increases in interest rates reflects a number of factors. On top of the decline in unemployment, the strength in the property market in recent years provided home-owners with a buffer of equity, allowing them to sell readily rather than default should they get into financial difficulty. A large share of borrowers also repay ahead of schedule. Recent liaison with banks indicates that many borrowers have been able to absorb the recent increases in interest rates by reducing their prepayment rates without lifting their overall repayment by much, if at all. Recently some borrowers have also been looking to reduce their interest-rate exposure by shifting to fixed-rate loans: the share of new owner-occupier loans at fixed rates rose to about 9 per cent in December 2010, up from a low of about 2 per cent in early 2010.

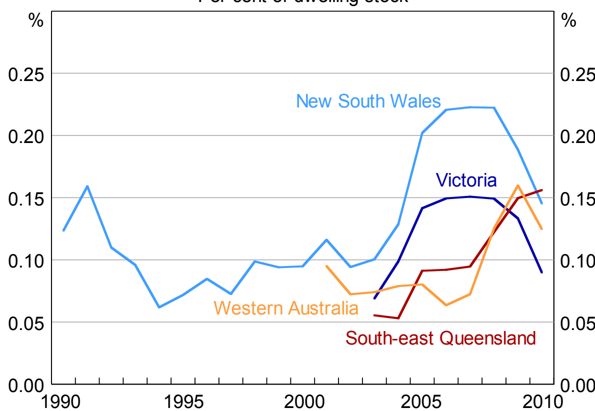
Based on securitised loans, the housing loan arrears rate remains higher in New South Wales than in the other states, but it was broadly unchanged over the year to December; in contrast, the arrears rates in Western Australia and Queensland increased further. Similar trends are evident at the regional level. While a small number of regions in Western Sydney remain among the most affected by housing loan stress, Queensland has become more heavily represented. As at December 2010, four regions in Queensland were among the 15 regions nationwide that had the highest rates of housing loan arrears, compared with just one in 2009 (Graph 43).

The pick-up in arrears in Queensland, even before the onset of the recent floods, was a common theme of our recent discussions with the major banks, and is consistent with the higher-than-average unemployment rate and weaker property market in the state. In response to the floods, many banks have put in place hardship relief packages, including temporary repayment holidays, to help affected borrowers. While banks have reported a large initial uptake in this hardship assistance, the floods are unlikely to cause a major increase in housing arrears to the extent borrowers remain in employment.

Other indicators of financial stress confirm that household financial circumstances are, in aggregate, relatively strong. Rates of mortgagees' applications for property possession picked up in most states in the first half of 2010, but generally declined in the second half of the year; for the year as a whole, these rates were below those seen in recent years (Graph 44). The exception was south-east Queensland (data are not available for the entire state), where the rate of mortgagees' applications for property possession has continued to increase over the past few years. The nationwide rate of bankruptcies and other personal administrations declined further in the second half of 2010, and is now well below the peak in 2009.

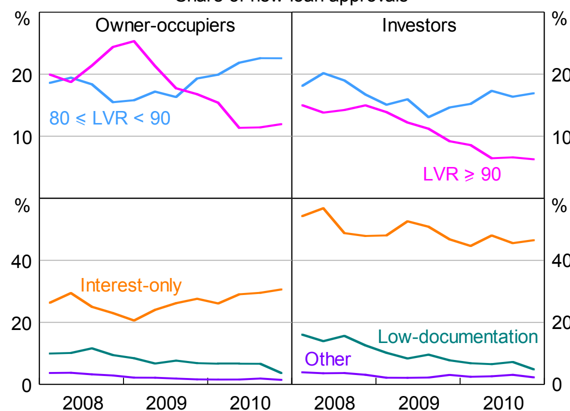
The relatively benign picture painted by these aggregate indicators of financial stress is consistent with household surveys, which show that only a small proportion of borrowers are highly geared. The latest HILDA survey, for 2009 (before most of the recent increase in interest rates took place), showed a sharp decline in the share of households considered most vulnerable, that is, with both high debt-servicing ratios (DSRs) and high loan-to-valuation ratios (LVRs). As well, less than 5 per cent of owner-occupier households in 2009 were in the lowest two income quintiles and had DSRs above 50 per cent. Even with the increase in interest rates since 2009, our estimates suggest that the share of such vulnerable households would still only be about 6 per cent.

Graph 44
Applications for Property Possession*
Per cent of dwelling stock



* Includes applications for possession of some commercial, as well as residential, properties
Sources: ABS; state Supreme Courts

Graph 45
Banks' Housing Loan Characteristics*
Share of new loan approvals



* LVR = loan-to-valuation ratio; 'Other' includes loans approved outside normal policies, and other non-standard loans; 'Interest-only' includes mortgages with 100 per cent offset accounts
Source: APRA

The risk profile of mortgage lending has also benefited from tighter lending standards in recent years. The share of new housing loans approved by banks with LVRs above 90 per cent was stable in the second half of 2010 after declining over the previous few years. The proportion of low-documentation loans has continued to trend lower; these loans accounted for 4.1 per cent of banks' new housing loans in the December quarter 2010, down from 13 per cent in 2008 (Graph 45). While the share of new investor housing loans that are interest-only has always been relatively high, reflecting tax considerations, recently there has been an increase in the share of owner-occupier loans that are interest-only. Liaison with banks indicates that these loans are popular because of the repayment flexibility they offer, but the majority of borrowers continue to make principal repayments either directly into the loan or into a linked offset account; their repayment behaviour is not much different from those with standard principal-and-interest loans. Moreover, most lenders assess debt serviceability on the basis of principal and interest payments, not just interest payments.

The performance of the 2009 cohort of first-home buyers (FHBs) is of particular interest given it has a high share of lower-income borrowers who made their home purchase during a period of relatively low interest rates and at relatively high LVRs. Despite the increase in interest rates since 2009, liaison with major banks indicates that the 2009 cohort of FHBs is performing no worse, and in some cases better, than earlier cohorts. These FHBs are likely to have reduced their LVRs since they purchased their homes, and to a similar extent as earlier FHB cohorts had done after a year, given that they have made some principal repayments and housing prices have risen.

Financial Stability Department
24 February 2011

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MAJOR BANK LIAISON – MARCH 2011 FSR

*During the first week of February, staff from FS and DM met with the major banks in preparation for the March 2011 FSR. Discussion focused on ,
developments in lending to households and businesses and the impact of the recent natural disasters.*

The banks reported that there had been little change in either price or non-price lending conditions for households in the past six months.

Asset quality is generally stabilising, although higher interest rates may put upward pressure on arrears rates. Queensland was singled out as an area of concern for asset quality, even prior to the floods and Cyclone Yasi. The recent natural disasters are expected to have little effect on asset quality, although they will affect some of the banks' insurance operations.

Lending to households

The banks do not expect housing **credit growth** to rise from its current annual rate of around 6 to 7 per cent. They largely attributed this to households continuing with a more cautious approach to borrowing. noted there had been a little more interest from investors in the residential housing market in recent months.

The banks indicated there had been no major change to their housing **lending standards**,

. Banks have not materially changed the interest rate buffers embedded in their serviceability calculators over the past six months, even though they increased these buffers during 2009 in anticipation of official interest rate increases that have now occurred. The average current threshold rate is about 9 per cent, compared with an average discounted indicator rate of 7.15 per cent.

Overall, the banks expected that **housing loan arrears** could tick up in the early part of this year due to normal seasonal effects and higher official interest rates. They also thought the recent flooding and other natural disasters would put some modest upward pressure on arrears in the near term. In part this could be due to the temporary cessation in collections activity in the affected parts of Queensland, which could see some borrowers fall behind. Some banks commented that higher arrears were also being driven by higher official interest rates. Losses from properties taken into possession are not tending to increase, however, because properties are selling well. Queensland was an area of concern for asset quality, even prior to the floods, particularly the south-east part of the state.

The banks noted they are having some difficulties selling properties in south-east Queensland on which they have foreclosed.

In regard to **first-home buyers**, there is no discernible difference in their arrears performance relative to other owner-occupiers. If anything, the 2009 cohort of first-home buyers were performing better. This was attributed to a tightening of banks' lending standards at the time of the first-home buyer incentives in 2009.

The new Consumer Credit laws are expected to have, at most, only a marginal effect on the major banks' credit policies.

The majors thought that the new Consumer Credit policies might add to the consolidation pressures within the **broker sector**, although not necessarily leading to a reduction in the overall market share for brokers.

Bernadette Donovan, Chris Stewart and Chris Thompson
Financial Stability and Domestic Markets Department
28 February 2011

DOMESTIC MARKETS REVIEW: FEBRUARY 2011

Market Developments

Westpac offers greater mortgage discounts and a waiver of its establishment fee

Westpac has begun to offer greater discounts on its mortgage products. The banks is offering a discount of 75 basis points for loans between $250 000 and $500 000, and a discount of 80 basis points for larger loans. This compares with an advertised discount of around 70 basis points on all loans of $250 000 and above, through its Premier Advantage package. Westpac has also reportedly waived the first $395 annual fee and the $600 establishment fee on these packages. Furthermore, the bank has reportedly waived its requirement that customers obtain mortgage insurance on loans with a loan-to-valuation ratio of 80 to 85 per cent.

Domestic Markets Department

PRESSURES ON THE MORTGAGE BROKING INDUSTRY

Mortgage brokers have seen their market share decline considerably over the past couple of years. This has been driven by banks originating more of their loans amid tighter standards of lending, particularly in the low-doc segment.

2. Lending standards

Tighter lending standards are likely to have contributed to the fall in brokers' market share over the past couple of years. This is most apparent in the low-doc mortgage segment, where it appears that the general tightening in bank lending standards was particularly pronounced for applications coming via brokers.

5. Outlook

Looking ahead, while brokers' loan volumes may pick up, several factors are likely to weigh on brokers' market share, including:

- Some banks have recently tightened requirements of brokers in terms of assessing borrower suitability.

Cameron Deans / Institutional Markets Section / Domestic Markets Department / 10 March 2011

INNOVATION AND COMPETITION IN THE MORTGAGE MARKET

Earlier this week, I attended the Australian Banking and Finance Mortgage Innovation Forum. More than 300 industry delegates attended, with panellists and presenters from each of the main lender types alongside other industry experts.

1. Recent developments in lending standards

Participants spanning both large and small institutions noted the heightened level of competition in the mortgage market in recent months. While these competitive pressures have generally revolved around loan pricing, several participants raised concerns that there has been a mild loosening in lending standards. This follows recent moves by the major banks to increase their maximum loan-to- valuation ratios for new customers to 95 per cent – their highest levels since late 2008 Any weakening in lending standards was viewed as particularly concerning as some industry experts stated that the culture of sales teams had not improved following the crisis (despite institutions materially tightening 'top-level' credit risk strategies).

Opinions differed as to whether the new National Consumer Credit Protection (NCCP) legislation would assist in aligning sales teams' incentives with risk management practices, or whether it just represents "another layer of costs". Most panellists thought that the NCCP would have a manageable effect on low-doc lending, in contrast to concerns that credit to the self-employed would be curtailed. This relaxed attitude towards the NCCP included low-doc applications coming via brokers – which became relatively scarce after the financial crisis.

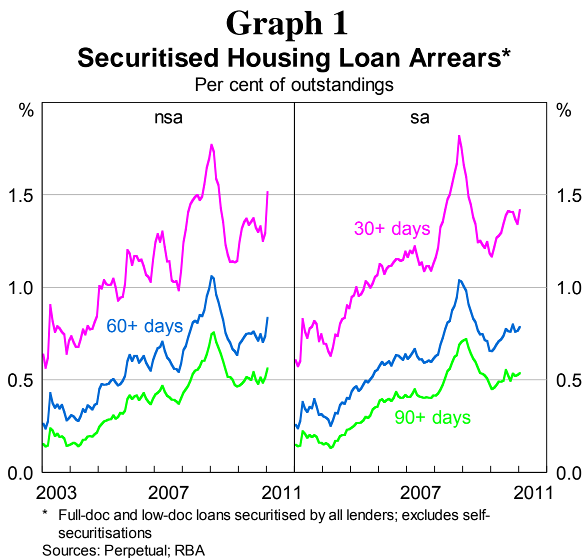
Cameron Deans
Institutional Markets Section
Domestic Markets Department
18 March 2011

SECURITISED HOUSING LOAN ARREARS – JANUARY 2011[1]

Key Points

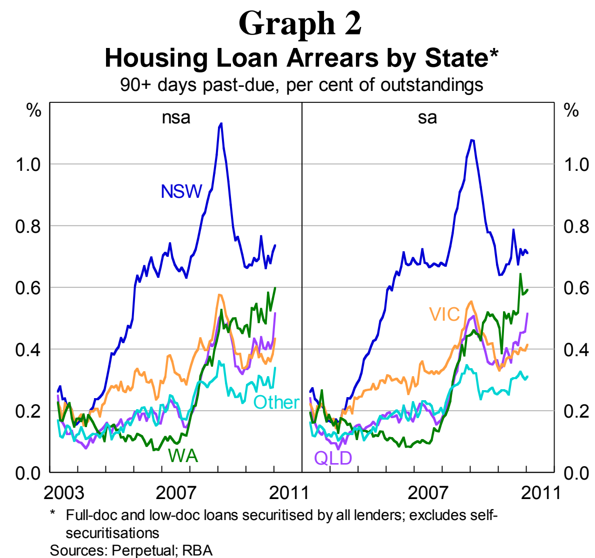
- The arrears rate on securitised housing loans increased sharply in January 2011, particularly at lower arrears durations (Graph 1). This was largely due to seasonal factors, although the seasonally adjusted arrears rate trended up at all durations over the year to January 2011.
- All states experienced a sharp increase in their 90+ day arrears rate in January prior to seasonal adjustment (Graph 2). Most of this increase appears to be seasonal, with only Queensland exhibiting an unusually large increase over the month on a seasonally adjusted basis.
- The 90+ days arrears rate trended up for all states over the year to January 2011, with the largest increases being in Queensland and Western Australia. The arrears rate remains highest in NSW.
- The arrears rate on low-documentation loans, which account for around 8 per cent of the securitised prime loan pool, increased by 72 basis points over the year to January 2011 (Graph 3). The arrears rate on full-documentation loans increased by 6 basis points over the same period.
- Both investor and owner-occupier arrears rates increased by around 10 basis points over the year to January 2011 (Table 1).

Graph 1
Securitised Housing Loan Arrears*
Per cent of outstandings



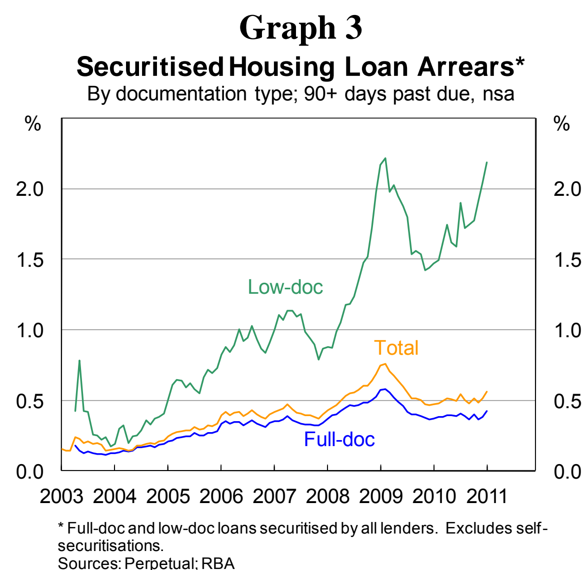
* Full-doc and low-doc loans securitised by all lenders; excludes self-securitisations
Sources: Perpetual; RBA

Graph 2
Housing Loan Arrears by State*
90+ days past-due, per cent of outstandings



* Full-doc and low-doc loans securitised by all lenders; excludes self-securitisations
Sources: Perpetual; RBA

Graph 3
Securitised Housing Loan Arrears*
By documentation type; 90+ days past due, nsa



* Full-doc and low-doc loans securitised by all lenders. Excludes self-securitisations.
Sources: Perpetual; RBA

Table 1: Securitised RMBS 90+ Days Arrears Rates
Per cent of prime outstandings[(a)], not seasonally adjusted

	January 2011	December 2010	November 2010	January 2010
Loan documentation type				
Conforming loans	0.56	0.51	0.49	0.47
Full-doc	0.43	0.38	0.37	0.37
Low-doc	2.19	2.04	1.91	1.47
State				
NSW	0.74	0.72	0.68	0.66
Vic	0.43	0.38	0.36	0.34
Qld	0.52	0.42	0.40	0.33
WA	0.60	0.56	0.53	0.48
Other	0.34	0.28	0.27	0.28
Interest type				
Variable	0.60	0.55	0.52	0.52
Fixed	0.29	0.28	0.27	0.25
Loan type				
Owner-occupier	0.56	0.51	0.48	0.46
Investor	0.59	0.54	0.51	0.49

(a) Excludes self-securitisations
Sources: Perpetual; RBA

Rob Johnson (x8546)
Financial Stability Department, 21 March 2011

[1] This note examines Perpetual securitised arrears data, excluding self-securitisations. Because RMBS sold on the market account for a declining share of total housing loans, their representativeness of the broader market may be poor.

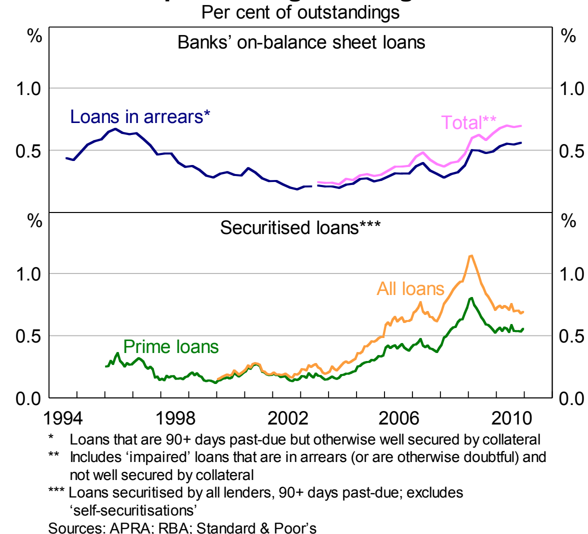
DIFFICULTIES IN USING SECURITISED HOUSING LOAN DATA AS A MEASURE OF WIDER MORTGAGE QUALITY

The trends of RMBS arrears and banks on-balance sheet arrears have diverged since 2009. RMBS arrears had previously provided a more timely indicator of likely developments in the quality of banks' on-balance sheet housing loans. They have also been used as an indicator of developments at a disaggregated level. The recent divergence between the two measures of arrears has been partly driven by an aging of the RMBS pool, caused by limited market issuance since the onset of the global financial crisis. This pushed up the RMBS arrears rate, as RMBS arrears typically peak around two to five years after origination. Widening the pool of RMBS to include self-securitised loans can reduce the aging of the RMBS pool, but creates a structural break in the series, making it difficult to identify recent changes in the underlying trend. For disaggregated analysis, the diminished pool size may lead to greater volatility in the measures of arrears. These developments suggest that measures of RMBS arrears should be treated with caution for the time being.

Introduction

FS has traditionally presented banks' on-balance sheet non-performing loans (NPLs) alongside arrears on securitised housing loans (Graph 1).[1] While these measures are not entirely comparable,[2] they displayed broadly similar trends prior to 2009. However, they have since diverged; the RMBS arrears rate fell sharply over 2009, while the rate of on-balance sheet NPLs rose.

Graph 1
Non-performing Housing Loans
Per cent of outstandings



This divergence suggests that the RMBS arrears rate is less representative of wider mortgage quality than previously. In the past, FS has used monthly RMBS arrears data as a more timely indicator of likely developments in the quality of banks' on-balance sheet housing loans (comparable data for on-balance sheet loan performance are only available quarterly). RMBS data have also been used to examine arrears at a disaggregated level, including by:

- borrower type;
- lender type;
- interest rate type;
- geographical location;
- loan documentation type;
- origination year;
- arrears duration; and
- size of loan.

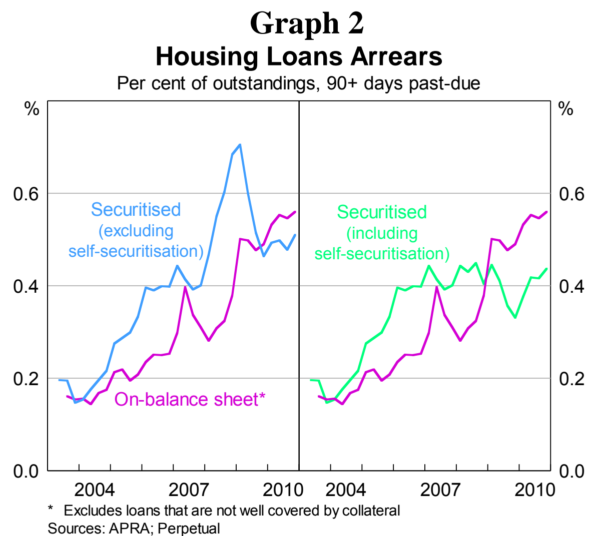
Disaggregated information is more limited for banks' on-balance sheet lending, with only borrower type, lender type and interest rate type being available. RMBS arrears data also

[1] Self-securitised loans are typically excluded from this analysis, as they are already included in on-balance sheet loan performance measures.
[2] For example, on-balance sheet data record both past-due loans that are well collateralised and loans that are considered to be impaired, whereas securitised arrears cover all loans past due (regardless of whether the loans are well collateralised). For more details, see Box B in the September 2009 FSR.

provide a useful measure of the performance of housing loans outside the traditional banking sector.

Comparing on and off-balance sheet mortgage performance

The on-balance sheet 90+ days arrears rate for well-collateralised housing loans and the 90+ days arrears rate for prime securitised loans provide the closest match in terms of underlying housing loan composition. The securitised arrears rate has traditionally been higher than the on-balance sheet arrears rate, reflecting the greater representation of non-traditional lenders and non-standard loans in the RMBS pool.[3] Excluding self-securitisations, the gap between the RMBS arrears rate and the on-balance sheet arrears rate widened over 2008, then converged again in 2009 as the RMBS arrears rate fell while the on-balance sheet arrears rate was broadly stable (Graph 2, lhs). In contrast, the RMBS arrears rate including self-securitisations was broadly stable over 2008, before declining in 2009 (Graph 2, rhs). Over 2010, both measures of RMBS arrears have followed a similar trend to on-balance sheet loans, although it is too early to tell whether this represents a true convergence between the different arrears rate measures.



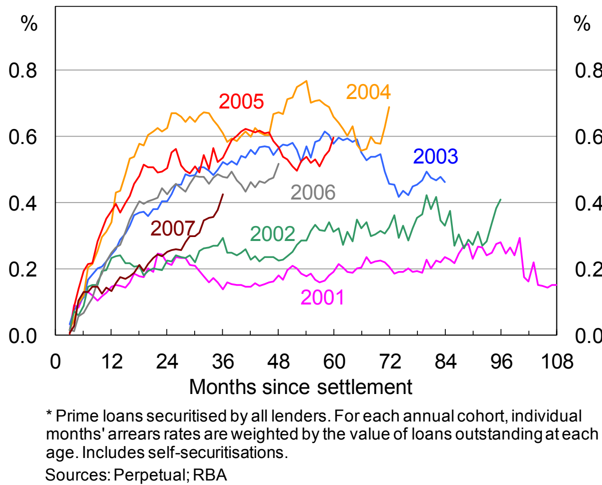
What drove the divergence between these measures of loan performance in 2008 and 2009?

The divergence between the measures of the RMBS arrears rate and the on-balance sheet arrears rate has been partially driven by changes in the composition of the RMBS pool. Since the onset of the global financial crisis, there has been limited public RMBS issuance. Banks also started to self-securitise their housing loans. In mid-2007, securitised loans accounted for around 18 per cent of all outstanding housing lending by value. Excluding self-securitisations, they currently account for around 7 per cent of all outstanding housing loans. The pool size including self-securitisations has fallen far less, to 15 per cent of all outstanding housing loans. Self-securitisations now make up 53 per cent of all outstanding securitised loans by value, having not existed prior to 2008.

These developments have resulted in an older securitised mortgage pool, which may have initially pushed up the RMBS arrears rate. This is because securitised mortgage loan arrears typically peak two to five years after settlement (Graph 3). This aging effect is particularly acute for measures of RMBS arrears excluding self-securitisations. The average age of outstanding RMBS loans has increased from 36 months at mid-2007 to 51 months in May 2010 when self-securitisations are included, and 60 months excluding self-securitisations. As the securitised loan pool has continued to age, this effect may have been unwinding. This may help to explain why the RMBS arrears rate excluding self-securitisations has subsequently fallen below the on-balance sheet arrears rate. To the extent that pre-crisis loans had looser lending criteria, the impact of aging on the RMBS arrears rate will be amplified, particularly when self-securitisations are excluded (Graph 4).

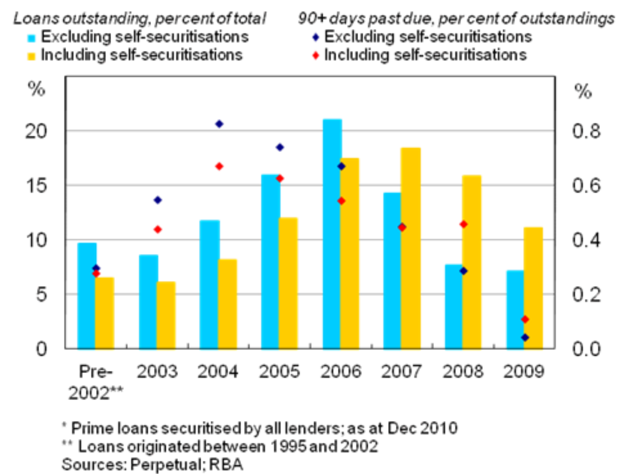
[3] The securitised arrears pool also includes loans which are not well-collateralised. In general, higher loan-to-valuation ratios are associated with riskier lending.

Graph 3
Housing Loan Arrears by Cohort*
90+ days past due



* Prime loans securitised by all lenders. For each annual cohort, individual months' arrears rates are weighted by the value of loans outstanding at each age. Includes self-securitisations.
Sources: Perpetual; RBA

Graph 4
Housing Loans Outstanding & Arrears
By origination year*

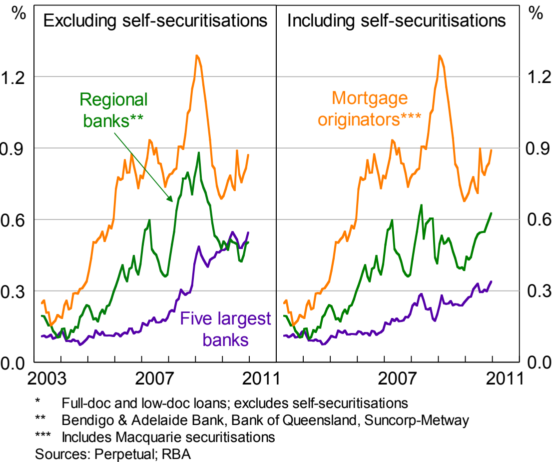


* Prime loans securitised by all lenders; as at Dec 2010
** Loans originated between 1995 and 2002
Sources: Perpetual; RBA

The limited public RMBS issuance since the onset of the global financial crisis means that the RMBS arrears rate excluding self-securitisations will not adequately capture trends in new loan performance. This may explain some of the divergence in 2008 between this measure and on-balance sheet arrears, where the latter has been tempered by tighter lending standards since the onset of the global financial crisis. The divergence may also reflect the underlying poorer average quality of the RMBS pool, which will naturally lead to greater variation in the RMBS arrears rate in comparison to the on-balance sheet arrears rate.

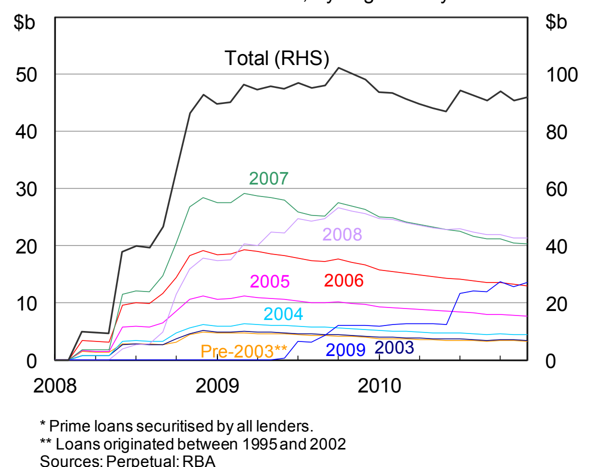
Examining the RMBS arrears rate including self-securitisations solves some of the problems associated with the aging of the pool of market-issued securitised loans, but results in other distortions. By including self-securitisations, more recent mortgages are included, but the arrears rates for mortgages are lower for all origination years prior to 2008 (Graph 4). The latter effect is a result of most self-securitisations being carried out by the major banks, which have lower arrears rates in general, but especially for their self-securitised loans (Graph 5).[4] Inclusion of self-securitisations therefore results in a structural break in the arrears rate series, making it difficult to identify changes in the underlying trend.

Graph 5
Housing Loan Arrears by Originator*
90+ days past due, per cent of outstandings



* Full-doc and low-doc loans; excludes self-securitisations
** Bendigo & Adelaide Bank, Bank of Queensland, Suncorp-Metway
*** Includes Macquarie securitisations
Sources: Perpetual; RBA

Graph 6
Housing Loans Outstanding*
Self-securitisations, by origination year



* Prime loans securitised by all lenders.
** Loans originated between 1995 and 2002
Sources: Perpetual; RBA

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[4] Self-securitised loans are held on-balance sheet and reported as part of banks' on-balance sheet loans. There may therefore be an incentive for banks to self-securitise their highest quality loans in order to achieve the highest ratings for the self-securitisation and ensure its eligibility in repo operations.

Although including self-securitisations does improve the representation of more recent loans, most self-securitisation occurred in 2008, with the last self-securitisation being in February 2009. Furthermore, a large portion of self-securitised loans were written in earlier years (Graph 6). Neither measure of securitised arrears is therefore likely to adequately capture recent trends in new loan performance.

Which measure of securitised arrears is most appropriate?

FS analysis of securitised loan arrears has typically excluded self-securitisations. This was done to make it easier to identify recent changes in the trend. But, continuing to exclude self-securitised loans from the pool results in a pool that only accounts for 7 per cent of the outstanding value of loans as of December 2010. Furthermore, as self-securitised loans mature, an arrears measure including these loans may provide a better indicator of wider housing loan quality (once the underlying trend becomes less obscured by the structural break in the series). The recent convergence in the securitised and on-balance sheet measures may indicate that the structural break has now passed, although it continues to make historical comparisons difficult when using the measure including self-securitisations.

For the time being, both measures of RMBS arrears should be treated with caution, as the problems described above significantly reduce the reliability of these measures. Even taking into account these problems, it is difficult to explain the sharp reduction in the measures of the securitised arrears rates relative to the on-balance sheet arrears rate over 2009. If RMBS markets were to reopen in a form similar to pre-crisis, the composition of the pool would shift back towards its pre-crisis structure. Over time, RMBS measures may therefore become more reliable once again.

Disaggregated analysis of securitised housing loan arrears

Disaggregated analysis magnifies the impact of the reduced sample size when self-securitised loans are excluded from the pool. The Appendix contains a table that illustrates the impact on the pool size of various common disaggregations of the Perpetual securitised loan data. Although these typically leave a large number of loans in each sub-division, multiple disaggregations are likely to leave too few loans in each category to make reliable inferences. Furthermore, because only a small percentage of loans fall into arrears, the number of loans in arrears in each of the disaggregations is relatively small. As a result, as the pool size falls, the volatility of the disaggregated arrears rates could increase substantially.

The size of the RMBS pool including self-securitisations has also fallen since the wave of self-securitisations in 2008. These data have been used in earlier FSRs to present regions with the highest arrears rates, subject to each region having at least 2,500 loans. It is conceivable that regions we have identified in the past will contain too few loans to be included in this measure in the future if the pool size continues to shrink. Under FS's new approach to aggregating mortgage arrears into regions, only two of the worst performing regions contain fewer than 4,000 loans (Table 1).[5] This is a significant improvement on the old approach, where seven regions were close to this cut-off point (Table 2).

[5] See Pendle (2011), *Arrears By Region – A New Approach.*

Table 1 Regions with highest 90+ day arrears rates – December 2010, new approach*

	State	Arrears rate	Number of loans
Outer Western Sydney	NSW	1.00	16,308
Outer South Western Sydney	NSW	0.86	12,820
Gold Coast East	QLD	0.85	11,927
Hunter	NSW	0.79	20,591
North Western - Far West	NSW	0.78	3,260
Fairfield-Liverpool	NSW	0.75	16,931
Gold Coast Bal	QLD	0.72	22,563
Far North - North West	QLD	0.71	12,850
South West of Perth	WA	0.71	11,295
Mackay - Central West	QLD	0.66	7,526
Blacktown	NSW	0.64	14,839
Mid-North Coast	NSW	0.63	8,829
Gosford-Wyong	NSW	0.61	15,160
Murrumbidgee	NSW	0.61	4,793
Murray	NSW	0.60	3,783

* Only includes regions with at least 2,500 loans outstanding
Sources: ABS; Perpetual; RBS

Table 2 Regions with highest 90+ day arrears rates – December 2010, old approach*

	State	Arrears rate	Number of loans
Mackay SD Bal	QLD	1.20	3,063
Outer Western Sydney	NSW	1.00	16,308
Hervey Bay City Part A	QLD	0.99	2,671
Mandurah	WA	0.96	3,593
Outer South Western Sydney	NSW	0.86	12,820
Gold Coast East	QLD	0.85	11,927
Gold Coast North	QLD	0.83	3,648
Newcastle	NSW	0.82	17,563
Hastings (excl. Port Macquarie)	NSW	0.81	2,879
Cairns City Part A	QLD	0.75	8,614
Fairfield-Liverpool	NSW	0.75	16,931
Gold Coast West	QLD	0.71	17,974
Lower South Coast	NSW	0.66	2,566
North Goulburn	VIC	0.66	2,699
Blacktown	NSW	0.64	14,839

* Only includes regions with at least 2,500 loans outstanding
Sources: ABS; Perpetual; RBS

Rob Johnson
Financial Stability Department
22 March 2011

APPENDIX

Securitised RMBS Pool

Number of prime loans

	Including self-securitisations				Excluding self-securitisations			
	December 2010	**December 2009**	**December 2008**	**December 2007**	**December 2010**	**December 2009**	**December 2008**	**December 2007**
Lender type								
5 largest banks (a)	476,785	531,497	561,404	301,870	146,039	174,371	228,657	301,870
Regional banks	160,361	160,316	167,925	93,777	89,234	78,899	87,892	93,777
Other banks	129,102	144,211	146,865	136,295	113,795	125,277	127,134	136,295
Mortgage originator (b)	124,707	147,194	185,123	226,582	124,707	147,194	185,123	226,582
Other	93,976	69,592	69,051	50,428	62,585	37,795	40,056	50,428
Documentation								
Full-doc	925,914	986,599	1,046,756	737,855	539,998	562,041	651,635	737,855
Low-doc	57,441	66,175	83,546	71,097	36,605	43,733	60,481	71,097
State								
NSW	291,590	312,730	372,556	284,910	169,304	187,216	242,493	284,910
Vic	236,156	250,079	248,419	180,060	129,399	139,958	148,064	180,060
Qld	231,686	235,804	254,074	165,050	121,526	123,924	143,775	165,050
WA	95,660	102,008	110,326	75,057	49,066	52,817	62,384	75,057
Other	129,880	131,308	144,875	103,817	80,168	79,401	87,591	103,817
Cohort								
2009	82,149	38,764	NA	NA	30,567	14,002	NA	NA
2008	129,342	136,739	94,531	NA	35,163	25,291	18,126	NA
2007	161,013	177,920	179,599	32,692	65,358	56,365	52,834	32,692
2006	166,143	193,833	224,930	151,460	98,721	109,625	131,602	151,460
2005	124,322	151,382	178,800	150,544	81,266	98,689	120,909	150,544
2004	91,921	113,180	140,255	131,797	64,554	80,981	104,676	131,797
2003	77,414	92,988	122,768	118,774	52,996	64,136	89,856	118,774
Pre-2003	190,980	229,960	298,991	324,274	138,189	167,867	227,867	324,274
Interest type								
Variable	863,990	879,939	907,501	663,689	470,238	478,938	542,978	663,689
Fixed	119,557	159,772	185,833	142,755	64,723	79,105	107,933	142,755
Other	1,430	13,157	37,055	2,508	1,416	5,509	17,972	2,508
Loan type								
Owner-occupier	737,266	795,356	839,578	550,530	385,082	403,447	480,049	550,530
Investor	219,180	225,634	248,282	191,845	125,409	132,410	161,817	191,845
Other (incl unknown)	28,531	31,878	42,529	66,577	25,886	27,695	27,017	66,577
Arrears duration								
30+ days	8,299	7,081	9,366	5,919	4,571	4,148	7,004	5,919
60+ days	4,467	3,674	4,702	3,059	2,552	2,294	3,964	3,059
90+ days	2,992	2,451	3,023	2,048	1,779	1,655	2,734	2,048
Memo item								
Non-conforming	5,549	8,188	12,293	16,301	5,549	8,188	12,293	16,301

(a) Includes Bankwest for all dates
(b) Includes Macquarie securitisation
Sources: Perpetual; RBA

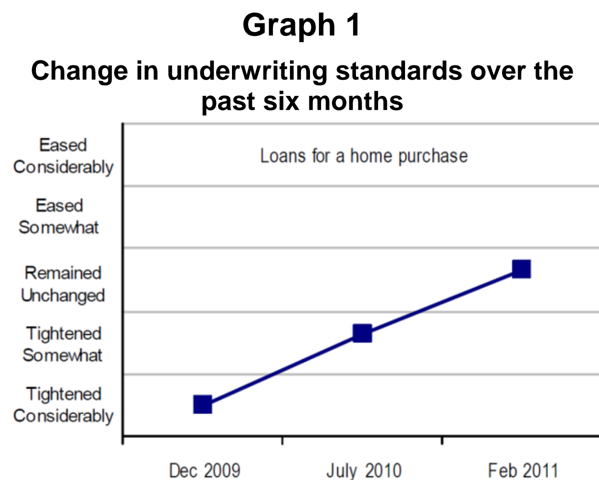
UBS LOAN OFFICER SURVEY – FEBRUARY 2011

Banks reported that their underwriting standards were little changed for household loans and most corporate loans following a period of tightening, and that the demand for credit remained subdued. Banks indicated that they plan to ease underwriting standards in the period ahead, yet they also expect credit demand to remain subdued for both household and business borrowers.

Household lending

Supply conditions

On balance, banks reported that their 'credit underwriting standards' have stopped tightening over the six months for housing and other personal loans (Graph 1). This is largely consistent with the December 2010 APRA Credit Conditions Survey. Within this result, UBS noted that 'several respondents' reported an easing in underwriting standards, consistent with banks' recent increases to maximum LVRs and larger discounting for housing loans. Banks claimed that industry competition was not a factor in these developments. Banks also claimed that while their more cautious outlook on the housing market pushed standards towards tightening, easing concerns about the labour market and cost of funds worked in the other direction.



Source: UBS

There was little change to margins on balance, but responses were mixed: an equal number of banks reported a widening as those reporting a narrowing. UBS noted that this likely reflects a combination of the recent increase in competition – which includes heavier discounting – and banks' rate increases in late 2010, which were larger than the increase in the cash rate. Banks reported an easing in non-interest fees charged, consistent with the majors' recent marketing campaigns. Non-price criteria were reported to be little changed.

Demand

Banks reported a softening in demand for housing loans over the six months to February, which they attributed to a combination of worsening housing market prospects, higher interest rates, and lower consumer confidence. Banks reported little change in the demand for other personal loans.

Expectations

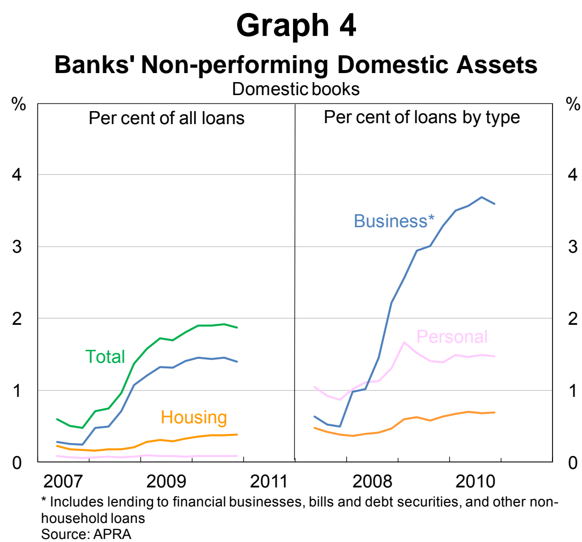
Banks expect housing credit demand to soften slightly over the six months to August but also that they will ease underwriting standards. This suggests that banks themselves recognise that much of their planned loan book growth will be a search for market share in an environment of subdued credit growth, rather than an expansion in the size of the market.

BANKS' NON-PERFORMING ASSETS – DECEMBER QUARTER 2010

Across all banks, there was little change to the non-performing rate for loans to households.

Apart from the improvement in business assets, there was little change to the aggregate performance of other domestic assets (Graph 4, Table 1). A slight uptick in the dollar value of non-performing housing assets was largely commensurate with the expansion in banks' housing loan books. Past-due assets continued to account for most non-performing housing loans

Despite the improvement in the overall performance of banks' domestic assets, the stock of specific provisions held against impaired assets remained little changed.



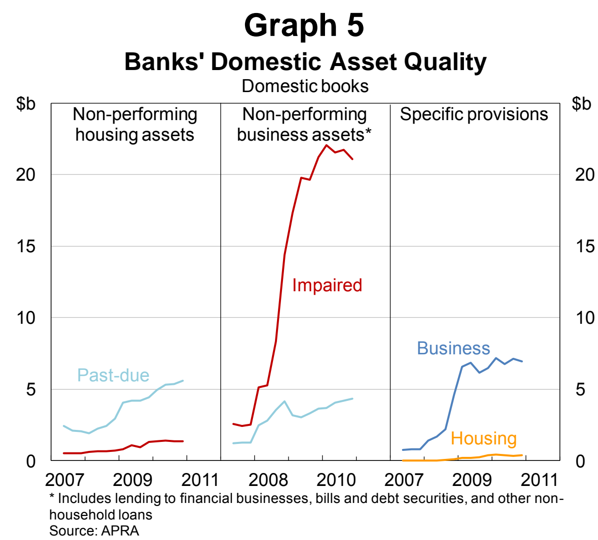


Table 1: Banks' Non-performing Domestic Assets

Domestic books

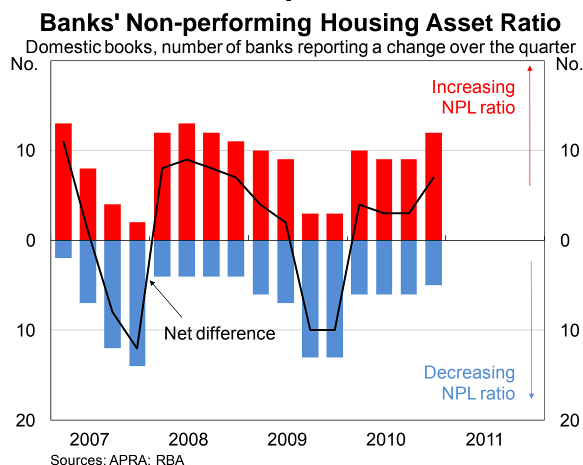
	Share by loan type* (per cent)		Share of all loans* (per cent)		Amount ($ billions)		*Memo: loan type as share of all loans* (per cent)*	
	Dec 10	Sep 10	Dec 10	Sep 10	Dec 10	Sep 10	*Dec 10*	*Sep 10*
Housing	**0.7**	**0.7**	**0.4**	**0.4**	**7.0**	**6.7**	***55***	***55***
Owner-occupier	0.7	0.7	0.3	0.3	4.8	4.6	*38*	*38*
Investor	0.7	0.7	0.1	0.1	2.2	2.1	*17*	*17*

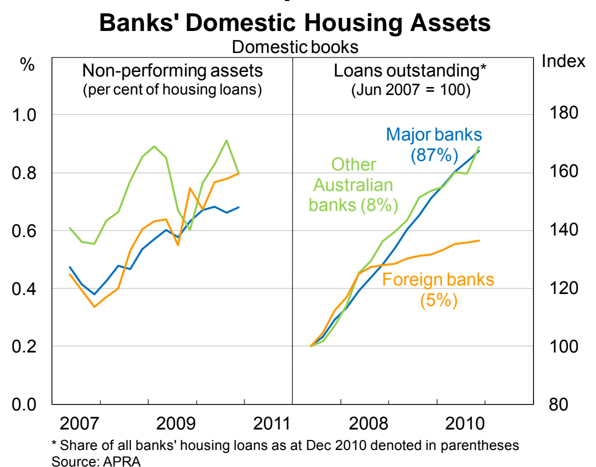
* On-balance-sheet credit as at December 2010

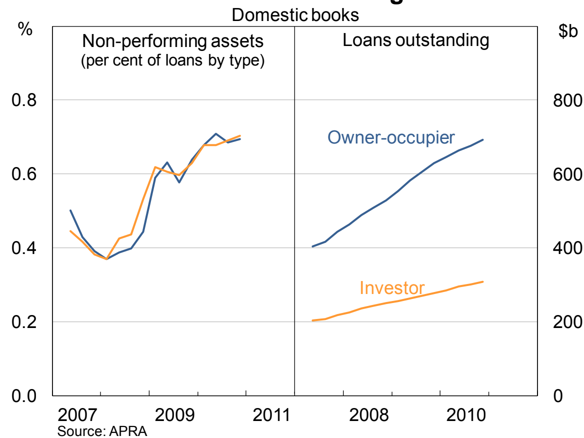
Sources: APRA; RBA

Domestic housing assets

As a share of housing loans, banks' aggregate non-performing housing assets were little changed in the December quarter (Graph 4). The housing NPA ratio remained at 0.7 per cent of housing loans despite more banks reporting an increase in their ratio than those reporting a decrease (Graph 11). By bank type, a slight rise in the housing NPA ratios of the major and foreign banks was offset by a decline for the smaller Australian banks, which was from both a fall in the smaller Australian banks' stock of non-performing housing assets, and the relatively fast quarterly growth in their housing loan books (Graph 12). The latter development is consistent with a re-entry of second-tier bank lenders into the housing market.







By borrower type, there was little difference between the performance of mortgages extended to owner-occupiers and to investors, with the NPA ratio for both remaining at 0.7 per cent of housing loans (Graph 13).

Iris Chan
Australian Financial System, Financial Stability
22 March 2011

DOMESTIC MARKETS REVIEW: MARCH 2011

- Most **variable indicator rates** were unchanged over the month. However, **competition** in the mortgage market appears to have picked up further, with a number of new product offerings and an increase in maximum loan-to-valuation ratios.

Developments by Product Type

Housing loans

It appears that competitive pressures have also led to an easing in some lending criteria, with each of the major banks raising their maximum loan-to-valuation ratios (LVRs) on full-doc housing loans to *new* customers. At 95 per cent, the maximum LVRs currently allowed by most banks are the highest since late 2008; although at that time several lenders would approve loans with an LVR of between 95 and 100 per cent.

Westpac has also increased the threshold for mortgage insurance from a LVR of 80 per cent to 85 per cent. Furthermore, according to its online calculator, Westpac has raised the potential borrowing capacity of households for a given level of income.

COMPETITION IN BANKING

Yesterday, I attended a panel discussion regarding competition in the banking industry. The panel comprised NAB Deputy CEO Michael Ullmer, ACCC Chairman Graeme Samuel, Professor Ian Harper of Deloitte Access Economics, and the Australian Bankers' Association (ABA) Chief Executive Steven Münchenberg.

1. Competition and reform

The panellists noted the heightened level of competition in the mortgage market at present. Ullmer expected competition to intensify further, in part because some lenders may have been surprised by the weakness in demand for credit (especially from business borrowers). Münchenberg raised the concern that these competitive pressures may lead some smaller lenders to adopt inappropriately risky lending practices.

Cameron Deans
Institutional Markets Section
15 April 2011

DOMESTIC MARKETS REVIEW: APRIL 2011

Developments by Product Type

Housing loans

While variable indicator rates have been steady over recent months, banks have been competing more intensely in the mortgage market in various other ways; competitive actions have included offers to pay customers' switching costs, lower fees, larger discounts and higher maximum LVRs.

APRA CREDIT CONDITIONS SURVEY – MARCH QUARTER 2011

In the March credit conditions survey, banks reported pressure to relax lending standards and housing loans, in an environment of strong competition.

Some banks noted an increase in their loan-to-valuation ratios (LVRs) in housing lending, in line with a perceived industry trend. Housing lending asset quality conditions seem to have slightly weakened with increases in mortgages-in-possession and claims on lenders' mortgage insurers. Half of the banks in the sample expect housing lending delinquency rates and write-offs to increase over the next quarter.

Housing lending

Banks reported some easing of lending standards in housing lending over the March quarter.

Although reported an effective loosening of *loan-to-valuation ratios* (LVRs), all the banks in the sample believe that there is an industry-wide easing, with greater competition in the high LVR market. This is consistent with the recent moves by a few banks to begin offering 95 per cent LVR housing loans again.

Ed Tellez
Financial Stability Department
10 May 2011

CBA
Trading Update – March Quarter 2011

CBA today released its trading update for the March 2011 quarter.

Consumer **credit quality** remains sound, although CBA noted a modest increase in home loan arrears over the quarter. The small rise was attributed to the recent natural disasters, post-Christmas seasonal factors and the elevated volume of lending from 2008 starting to flow through to arrears. CBA also noted improvements in credit quality for their corporate and business portfolios.

Luke Van Uffelen and Luke Cayanan
Financial Stability and Domestic Markets Departments
11 May 2011

From: STIEHM, Susan
Sent: Wednesday, 18 May 2011 09:57
To: THOMPSON, Chris
Subject: Arrears, FHBs and regional sentiment

Hey Chris, here are the summaries regarding both the 2009 first homebuyer cohort as well as WA and Queensland households from industry reports, liaison meetings and HILDA. I've also included the arrears graph below. The most recent data point for the securitised loans portion is an estimate based on Perpetual data.

Veda Advantage

According to the most recent data, the average credit score (as calculated by Veda) of the FHOB cohort (14 October 2008 to 14 October 2009) as at the end of 2010 was virtually identical to that of the non-FHOB cohort as at the end of 2009.

By state, credit scores of the FHOB cohort are lowest (most risky) for FHBs in Western Australia and South Australia and are also the only ones where the FHOB cohort is viewed as slightly less creditworthy than the non-FHOB cohort – whereas in the other states, scores are either virtually identical or higher.

Genworth Homebuyer Confidence Index

Genworth found FHB households to be less likely to experience mortgage stress than other households, but more pessimistic about the future. 17 per cent of FHBs ran into repayment difficulties in the previous year, compared with the overall figure of 21 per cent. Looking ahead, 24 per cent of FHB households surveyed by Genworth expect to run into repayment difficulties in the next 12 months, compared with 19 per cent of all borrowers. According to Genworth, this pessimism is driven by the threat of further interest rate rises, which affect FHB borrowers more because they are more heavily geared.
Households in WA were the most pessimistic about the property market in the coming year, followed by Queensland. By state, households in WA and Queensland were the most likely to experience 'difficulty' meeting their repayments, although Genworth does not define what this means. In contrast, 40 per cent of Queenslanders and 49 per cent of WA residents believe that now is a good time to buy a home, compared with the national average of 38 per cent.

LMI Barometer (Does not provide relevant info on FHBs as they are defined as those that *intend* to purchase their first property in the next 5 years)

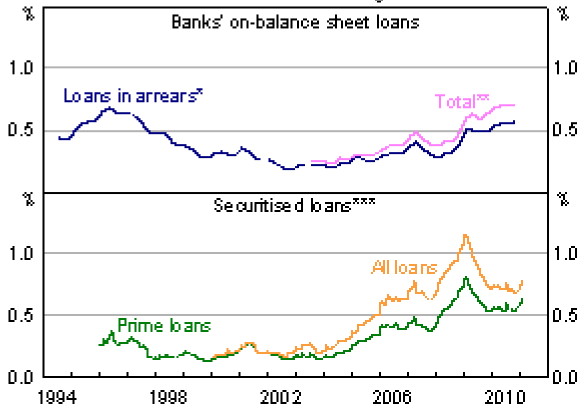
Respondents from Queensland and WA have the highest incidence of self-reported mortgage stress; they are also the most pessimistic about the likely path of property prices in 2011.

Liaison meetings (as published in the FSR)

Despite the increase in interest rates since 2009, liaison with major banks indicates that the 2009 cohort of FHBs is performing no worse, and in some cases better, than earlier cohorts.

HILDA

The 2009 FHB cohort does not appear to be particularly vulnerable relative to previous cohorts. However, the percentage of FHB households in the lowest two income quintiles has increased relative to previous cohorts, and forecast increases in debt-servicing costs are likely to have the greatest impact on these households.



Susan Stiehm | Senior Manager | Financial Stability
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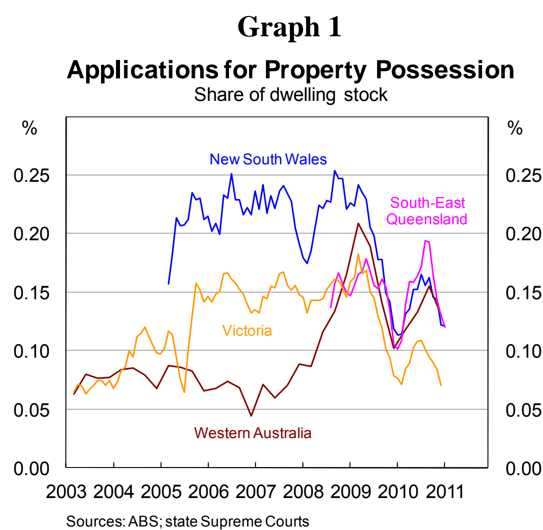
PROPERTY POSSESSIONS: RECENT TRENDS AND OUTLOOK

Mortgagees' applications for property possession as a share of the dwelling stock declined in all states during the second half of 2010, having increased in the first half. This reduction was proceeded by increasing arrears rates and interest rates, which would normally be associated with higher applications for possession. Liaison suggests that this breakdown in the relationship between arrears and possessions may be partly attributed to forbearance by banks, although it is difficult to verify this in the data.

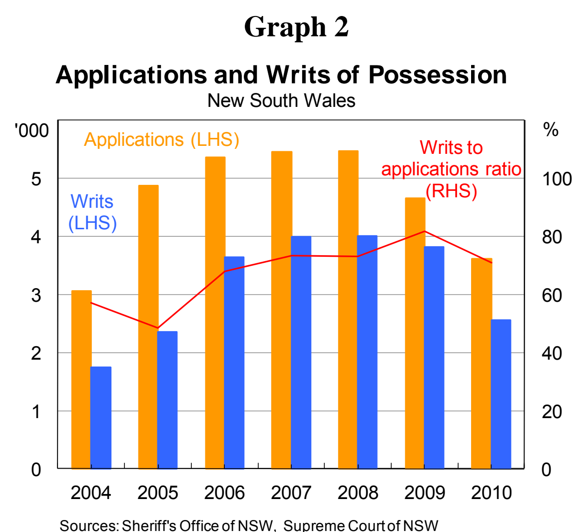
Recent trends

Applications for property possessions have been volatile as a share of the dwelling stock in recent years (Graph 1).[1] They generally increased in 2008, fell sharply in 2009 and then picked up over 2010. More recently applications for possession have been falling as a share of the dwelling stock in all states for which we have data. With the exception of South-East Queensland, the peak in 2010 was lower than in 2008.

Graph 1



Graph 2



In order to understand the trends in possessions it is worth recapping the possessions process. This process starts when the lender seeks an 'Application for Property Possession', which typically occurs after the borrower has failed to service the debt for a number of months. The next step is to obtain a 'Writ of Possession' which allows the lender to evict the borrower. After executing the Writ of Possession the lender is able to sell the property to repay the loan. If the property sale does not cover the loan, the lender can choose to pursue bankruptcy proceedings against the borrower to recover any shortfall. The entire possessions process typically takes between 6 to 13 months to complete after a loan falls into arrears.[2]

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[1] Although the property possessions data mainly relate to residential properties, they will also capture commercial properties where the lender has applied for possession of the land. Recent discussions with the Supreme Court of NSW suggest that because the land is often the most valuable part of the collateral the commercial property lenders have access to, lenders will in most cases seek an application for possession in the event that the loan becomes distressed. The alternatives for the lender are to pursue the borrower's debt through Common Law or through the Commercial List, although the numbers of commercial property cases going through these routes are thought to be small.

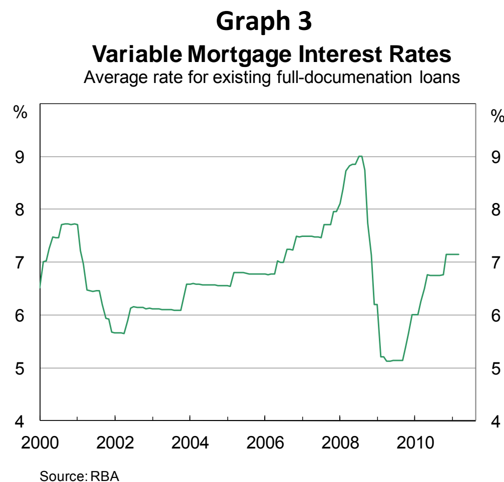
[2] For more information on the possessions process, see Property Repossession in New South Wales

It is also worth noting that the possessions data only capture a fraction of household loans that are in distress. This is because at each stage of the possessions process the borrower may have the option of voluntarily selling the property or refinancing the loan (although these option may not be available for borrowers in negative equity), or voluntarily allowing possession. Previous work by FS suggests that between 10 and 25 per cent of borrowers that are 90+ days in arrears ultimately sell the property themselves, and a large proportion of loans self-cure without the need to refinance or possess the property. However, in a downturn that is accompanied by falling house prices, lenders may have an incentive to foreclose on borrowers more quickly to prevent further losses, or because they view loans as being less likely to self-cure. This is supported by data from New South Wales, which shows that the ratio of Writs of Possession to Applications for Property Possession was elevated in 2009 following a period of weak house price growth (Graph 2).

What has driven the recent trends in possessions?

The initial increase in the rate of applications for possession began in 2007 for Western Australia and in 2008 for most other states, before falling over 2009. These trends are consistent with an increase in the share of households experiencing repayment problems as mortgage rates increased from 6 per cent in 2006 to around 9 per cent in 2008, before falling sharply to around 5 per cent in the second half of 2008 (Graph 3). The more recent pick-up in the rate of applications for possession in 2010 is again consistent with rising mortgage rates over this period, which increased to around 7 per cent by the end of 2010.

Graph 3



Applications for possession have declined since mid-2010, despite mortgage interest rates remaining around 7 per cent. Liaison with repossession agents suggests that this may be a consequence of tighter lending conditions and bank forbearance (e.g. loan modifications or extensions), which have resulted in a large drop in defaults among first home buyers.[4] An improvement in lending standards is consistent with other data sources: APRA data indicates that lenders have been originating fewer loans with high LVRs or low documentation, and Veda Advantage data suggest that the credit quality of borrowers that received the First Home Owners Boost between 2008 and 2009 was no worse than

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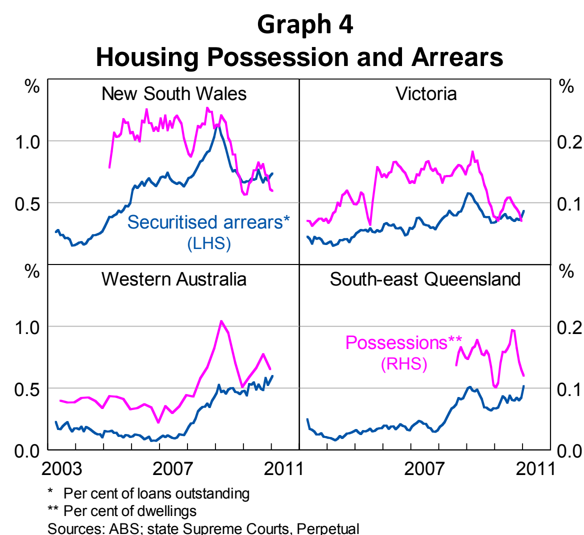
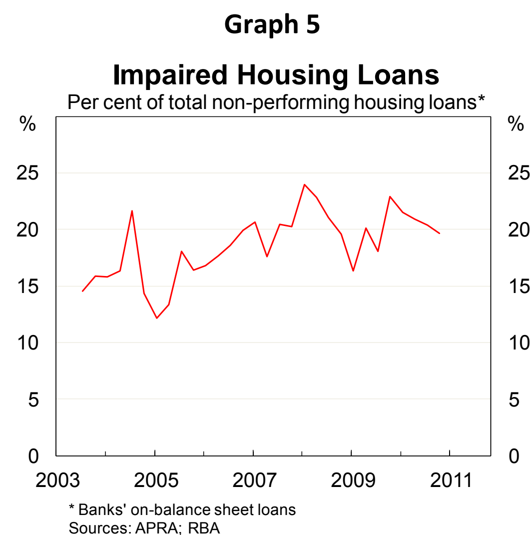
[4] It could also be the case that most borrowers that were unable to cope with mortgages rates around 7 per cent have sold their homes or had them repossessed. Further increases in interest rates might lead to additional repossessions from borrowers that were just managing their loans at the previous level of interest rates.

the previous cohort of first home buyers. Liaison also suggests that investors and second homeowners account for a large proportion of current properties undergoing possession.

Outlook for possessions

Possessions are a lagged indicator of household distress, with applications for possession being initiated some time after the loan has fallen into arrears. Arrears therefore potentially give us a leading indicator of possessions. Prior to mid-2010 there was a strong correlation between arrears and applications for possession, with 90+ day arrears leading applications for possession by up to six months (Graph 4). However, this relationship appears to have broken down in the second half of 2010 when applications for possession fell sharply and securitised arrears increased (similarly the on-balance sheet arrears rate has increased since 2010). This may be a result of the lender forbearance mentioned above. In the absence of this forbearance we might expect applications for possession to have continued to increase in line with the trend in arrears. This suggests that applications for property possession could pick up in the future if banks show less forbearance to troubled residential mortgage borrowers, particularly if loans that have been shown forbearance remain in difficulty.





The value of banks' impaired loans as a percentage of their total non-performing loans was elevated around the start of 2008 and 2010, suggesting that these were periods of greater than usual forbearance (Graph 5).[6] Although impaired loans remained high as a percentage of total non-performing loans during 2010, they trended down over the course of the year. The data therefore only provide weak support that forbearance limited possessions during the second half of 2010.

Although the possessions data largely consist of residential properties, the outlook for commercial properties will also have a bearing, as lenders may pursue foreclosure on distressed commercial property loans by making an application for possession. A recent report by Colliers International suggests that lenders held off selling distressed commercial distressed property assets during 2008

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[6] Under international accounting regulations banks should take into account forbearance actions when making impairment provisions. Loans that were previously in arrears whose terms have been renegotiated may therefore move to the impairment component of non-performing loans. However, evidence from the UK suggests that lenders do not always adequately account for loans that have been shown forbearance when calculating their impairment provisions: http://www.fsa.gov.uk/pubs/guidance/gc11_10.pdf

and 2009, but were more willing to do so in 2010 as asset prices recovered.[7] This suggests that lenders' willingness to take possession of a property is affected by selling conditions and may help to explain the sharp reduction in the rate of possessions in 2009 and the subsequent pick-up in 2010.

The RICS Q4 2010 *Global Distressed Monitor Report* pointed to an expected increase in the number of distressed commercial properties coming onto the market in Australia, supporting the idea that commercial property possessions have recently been tempered by lender forbearance.[8] Around 35 per cent of respondents expected the number of distressed commercial properties to increase in Q1 2011 compared to Q4 2010, up from around 28 per cent that expected an increase in Q4 compared to Q3 2010. This is based on a survey of 410 retail, office and industrial property real estate companies.

Rob Johnson
Financial Stability Department
23 May 2011

[7] See Colliers International - Trends in Distressed Property Asset Sales for more details.

[8] A distressed property is defined as one that is under foreclosure or is advertised for sale by its mortgagee. Distressed property usually fetches a price below its market value.

Meetings with Mortgage Brokers

Staff from Domestic Markets, Economic Analysis and Financial Stability recently met with mortgage brokers:

The discussions focused on and developments in the housing finance market.

Lending standards

In response to recent increases in lenders' maximum loan-to-valuation ratios (LVRs), commented that there has been some evidence of a recent tightening in interest serviceability calculations.

Sophie Stone
Institutional Markets Section
31 May 2011

SECURITISED HOUSING LOAN ARREARS – MARCH AND APRIL 2011

Key points:

- Arrears rates on securitised housing loans moved higher in March and April (Graph 1). While upwards movements in arrears at the beginning of the year largely reflected seasonality (with the exception of Queensland), arrears rates are now trending higher even after adjusting for seasonal effects.
- The increase in arrears has been fairly similar across all durations, with the 30+ day arrears rate rising by 8 basis points over March and April, compared to a rise of 9 basis points in the 90+ day arrears rate. The 90+ day arrears rate is now only 6 basis points below the series high of February 2009; however this comparison is complicated by the ongoing upwards pressure on the arrears rate exerted by the aging of the securitised loans pool.[1]

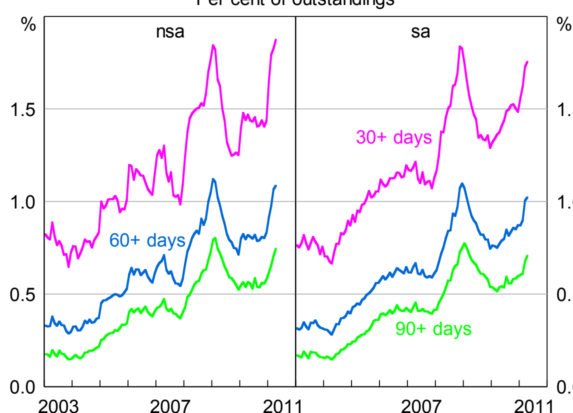


Table 1: Securitised RMBS 90+ Days Arrears Rates
Per cent of prime outstandings[(a)], not seasonally adjusted

	April 2011	March 2011	February 2011	April 2010
Loan documentation type				
Conforming loans	0.68	0.64	0.59	0.51
Full-doc	0.53	0.48	0.44	0.39
Low-doc	2.54	2.55	2.37	1.74
State				
NSW	0.83	0.80	0.75	0.69
Vic	0.53	0.46	0.41	0.39
Qld	0.69	0.65	0.58	0.43
WA	0.70	0.67	0.61	0.53
Other	0.46	0.43	0.40	0.28
Interest type				
Variable	0.73	0.69	0.63	0.56
Fixed	0.31	0.30	0.30	0.30
Loan type				
Owner-occupier	0.66	0.63	0.58	0.50
Investor	0.74	0.66	0.63	0.58
Loan size				
Less than 250k	0.47	0.42	0.39	0.33
250k to 500k	0.71	0.67	0.63	0.54
More than 500k	1.61	1.62	1.55	1.30

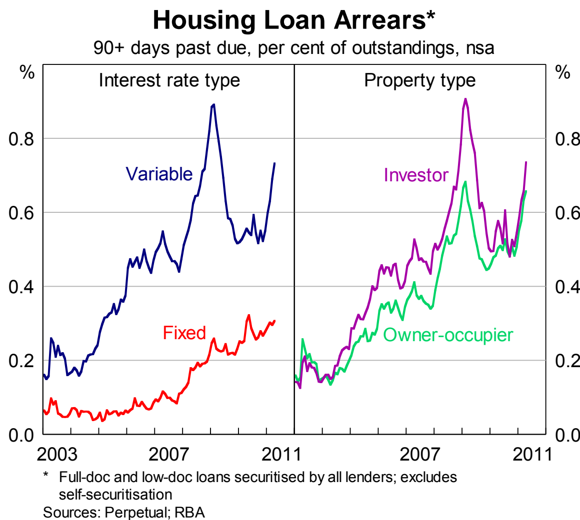
(a) Excludes self-securitisations
Sources: Perpetual; RBA

- Comparison of the arrears rates on variable and fixed-rate loans suggests that rising interest rates have been a significant driver of the deterioration in arrears. The 90+ day arrears rate on variable-rate loans has risen by 18 basis points since December 2010, in comparison to a 3 basis point increase in the equivalent rate for fixed-rate loans (Graph 2, Table 1). The difference between these arrears rates was at its widest since January 2009, with the gap marginally wider after adjusting for seasonality.
- As was evident in the previous period of stress, the data suggests that investor loans continue to underperform owner-occupier loans. The difference in the 90+ day arrears rate on investor and owner-occupier loans rose in April 2011, to be 8 basis points, even after accounting for seasonality. This is consistent with recent

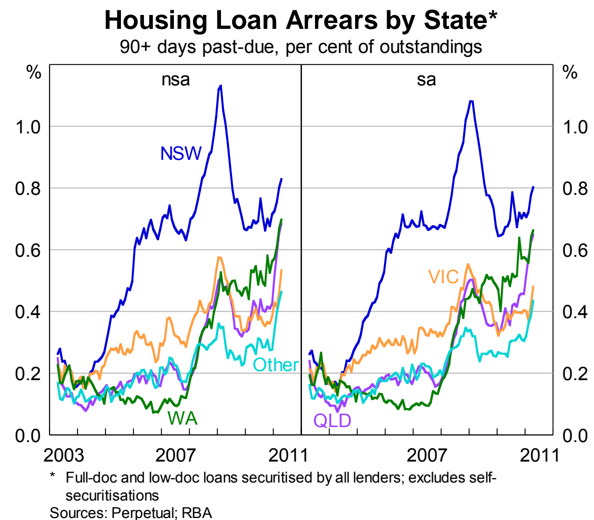
liaison, indicated that their investor arrears rates were double those of owner-occupiers.

- Across all states the 90+ day arrears rate rose in April, with the rise sharpest for Victoria, in seasonally and non-seasonally adjusted terms (Graph 3). However, over the year to April, the rise in the arrears rate was most pronounced in Queensland. New South Wales continued to have the highest arrears rate, although the difference has generally narrowed since early 2009.

Graph 2

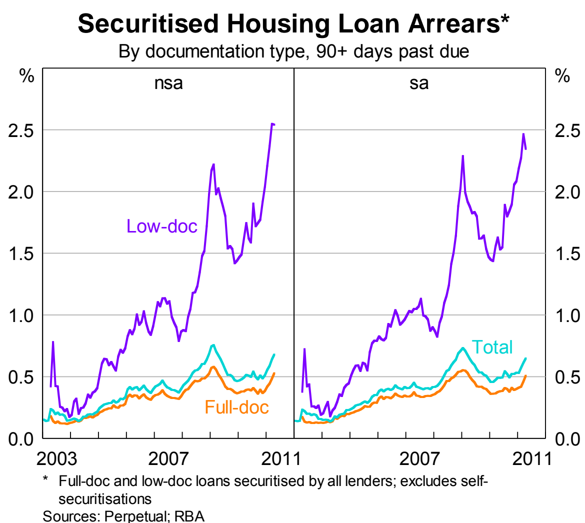


Graph 3

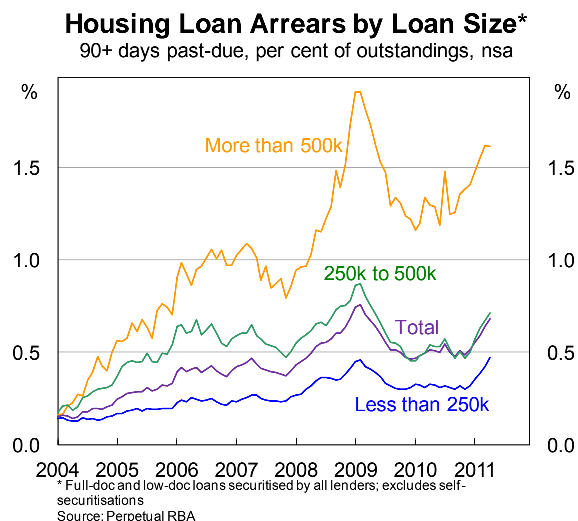


- The 90+ day arrears rate on low-doc loans (which represented at most 8 per cent of the prime securitised mortgage pool) remains around its highest level, despite falling slightly over April 2011 in seasonally and non-seasonally adjusted terms (Graph 4).
- The 90+ day arrears rate on larger loans (those over $500 000) has risen more sharply than for smaller loans over the year to April (Graph 5). However, in April 2011 the 90+ day arrears rate on loans under $250 000 increased by 4 basis points and that for loans over $500 000 fell by 1 basis point.

Graph 4



Graph 5



Tom Bilston/Financial Stability Department/9 June 2011