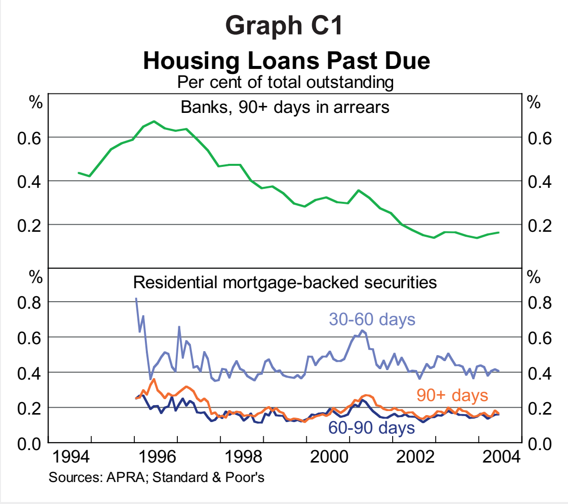
Box C: Measures of Housing Loan Quality

Two commonly used measures of housing loan quality are housing loans past due and claims on mortgage insurers. Both measures show that Australian mortgages have historically been of very high credit quality.

Housing loans past due data measure the share of housing loans, by value, for which payments are overdue. The most representative series, compiled by APRA, covers banks' housing loans for which payments are late by 90 days or more. Data on loans past due are also available from rating agencies for the home loans underlying residential mortgage-backed securities (RMBS). RMBS currently account for around 20 per cent of outstanding housing loans, up from less than 5 per cent in the mid 1990s.[1]



Aggregate data from APRA are available from the mid 1990s, over which time the environment for housing loans has been highly favourable. Since 1994, the ratio of bank housing loans past due to total housing loans has averaged 0.38 per cent, although over the past couple of years, the ratio has been less than half this level (Graph C1). The ratio for RMBS housing loans 90 days or more in arrears is currently at a similarly low level, although there is less evidence of a downward trend in the series over the 1990s. This largely reflects the requirement that only housing loans free of payment difficulties are used for new RMBS issues. The RMBS data also show that the ratio of loans 30 to 60 days in arrears is higher than the ratio of loans more than 60 days overdue, suggesting that many households overcome their initial debt-servicing difficulties.

Banks do not automatically foreclose on housing loans with payments in arrears. In recent years it has not been uncommon for write offs to be less than a tenth of housing loans 90 days or more past due, as lenders work with customers to overcome difficulties. In a less benign environment, the write-off rate could be considerably higher.

Claims on mortgage insurers are a narrower measure than housing loans past due, as claims are primarily triggered when there is both an inability to service the debt and insufficient

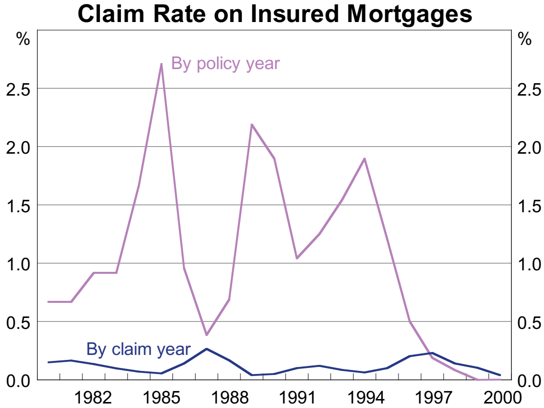
1 *Battellino, R (2004), 'Some Comments on Securitisation', Reserve Bank of Australia* Bulletin, *August, pp 62-67.*

collateral. The extent to which loans past due result in insurance claims varies with economic conditions: partial industry data suggest that the share of insured mortgages 90 days or more past due that become insurance claims each year has varied between 5 per cent and 30 per cent over the past decade.

Historically, the subset of mortgages that is covered by lenders' mortgage insurance may not be representative of the banks' mortgage portfolio as a whole. This reflects the tendency for banks to require mortgage insurance only for higher-risk loans, most notably those with high loan-to-valuation ratios. Over recent times, however, the pool of insured mortgages is likely to have become more representative, as loans are often insured prior to being securitised.

Claims data, which in the past have been provided by the Insurance Council of Australia, are available on two bases. The first is the claim rate by *policy year*. This measures the proportion of loans written in any given year on which a claim is eventually made. The second is the claim rate by *claim year*. This measures the share of insured loans in any given year on which there is a claim in that year. This latter measure is more useful when analysing the quality of overall outstanding mortgages through time. Unfortunately, data have not been published for either measure since 2000. For the two decades to then, on average, around 1 per cent of insured mortgages ultimately defaulted (Graph C2). In any given year, the share of insured mortgages that defaulted has averaged around 0.1 per cent, with the worst year being 1987 when 0.27 per cent of total insured loans recorded a claim.

Graph C2
Claim Rate on Insured Mortgages



Source: Insurance Council of Australia