

Box D: Estimates of Borrowing Capacity from Banks' Online Housing Loan Calculators

When assessing a housing loan application, the maximum amount that a bank will lend is generally determined by the size of the borrower's upfront deposit and the borrower's ability to service the loan. In the past, a common rule of thumb on servicing was that loans would not be extended where the required debt-servicing ratio – the ratio of interest and principal repayments to gross income – exceeded 30 per cent. Over time, however, this limit has been relaxed. An indication of this is provided by the housing loan calculators that many banks make available on their websites to help potential borrowers estimate their borrowing capacity.

Generally, these online calculators require potential borrowers to specify their income, household size (e.g. single or couple, number of dependants) and existing loan commitments, from which they estimate the maximum amount that can be borrowed. In most cases the calculators do not ask the potential borrower to quantify their living expenses, relying instead on built-in estimates of average living expenses for each type of household. A number of lenders base these estimates on the Henderson Poverty Line (HPL), an estimate of income below which households are considered to be living in 'poverty'. In the September quarter 2004, the HPL, excluding housing costs, for a single individual with no dependants was \$213.75 per week, and \$310.75 for a couple (Table D1). Use of the HPL differs from lender to lender, with some using it as a direct estimate of living expenses, while others use a multiple of the HPL, or add some buffer.

Table D1: Henderson Poverty Line
Excluding housing costs, September 2004

Income unit ^(a)	\$ per week
Couple – no dependants	310.75
Couple + 1	386.27
Couple + 2	461.80
Couple + 3	537.32
Single person – no dependants	213.75
Single + 1	293.57
Single + 2	369.09
Single + 3	444.61

(a) With household head employed
Source: Melbourne Institute

Online calculators can be used to estimate maximum allowable loan sizes. The numbers presented below were derived from the calculators on eight banks' websites, and were estimated for a single borrower with no other loan commitments (including credit card debt) and whose sole income is from wages and salary. The calculations also assume that borrowing is for the purchase of an owner-occupied property and that the loan has a term of 25 years and an interest rate of 7.30 per cent, which is the major banks' current average standard variable rate. Given the prevalence of discounting, many borrowers pay a lower rate, allowing them to borrow somewhat more than suggested by these calculations.

Graph D1 shows the debt-servicing ratios implied by the maximum loan sizes for various income levels. The banks' loan calculators appear to regard the bulk of income after tax and living expenses as being available for debt servicing. Over the lower range of incomes, the maximum

permissible debt-servicing ratios rise as household income rises. This reflects the assumption that living expenses do not increase proportionately with income. At higher income levels, however, this effect is offset by the fact that tax payments rise more than proportionately with income, causing the maximum permissible debt-servicing ratios to level out and eventually fall slightly.

The maximum permissible ratios rise through to incomes of around \$60 000 per annum. At that income the maximum debt-servicing ratios lie in a range of 43 to 49 per cent, with a median outcome of around 47 per cent, well above the 30 per cent benchmark used in the past. Based on the assumptions above, a debt-servicing ratio of 47 per cent of gross income corresponds to an initial loan size of nearly 5½ times gross annual income (Graph D2).

Despite their apparently high borrowing capacity, most borrowers take out loans with debt-servicing requirements well below the maximum implied by estimates from online calculators. Discussions with banks confirm that customers with high debt-servicing requirements are typically those with high, and often diversified sources of, income. Nonetheless, given the availability of loans with high debt-servicing ratios, there is the possibility that some borrowers could overextend themselves and be at greater risk of default if there was an adverse change in their economic circumstances, including a loss of income due to unemployment.

