

**CONFIDENTIAL****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.

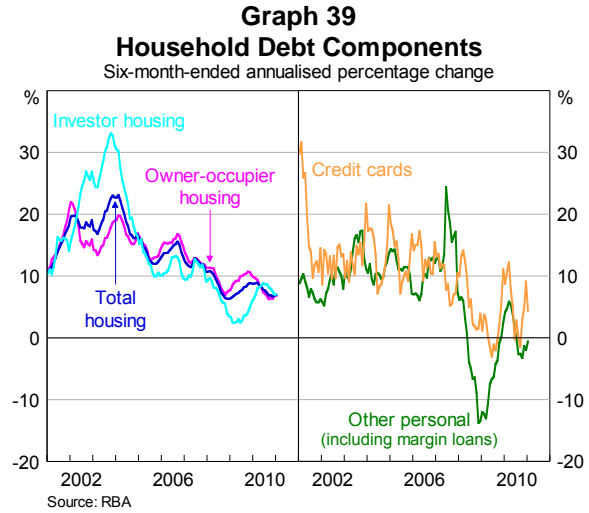
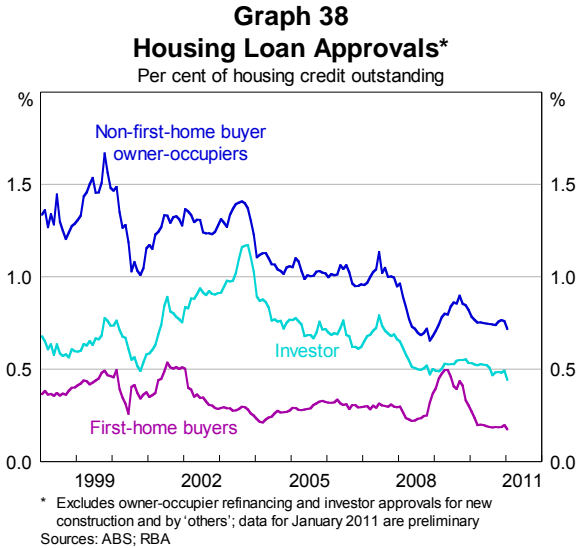
In contrast, a number of banks reported increasing their margins on housing loans in the December quarter 2010 following a two-year period of reported margin compression. This corresponds with the highly publicised move by most banks to raise their housing lending rates by more than the increase in the 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

# CONFIDENTIAL

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).

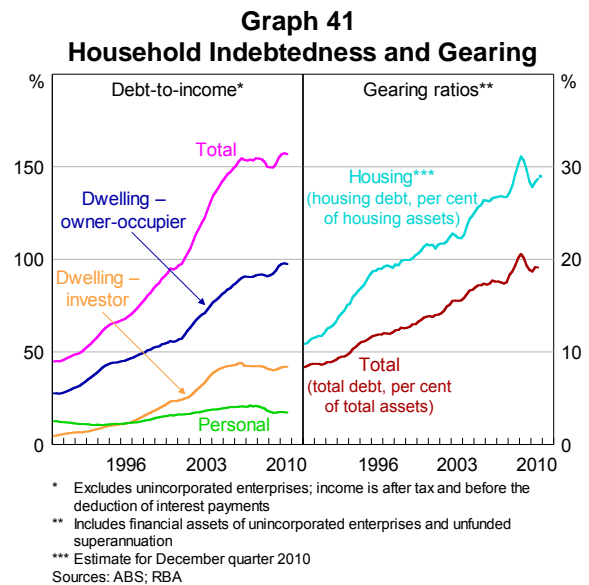
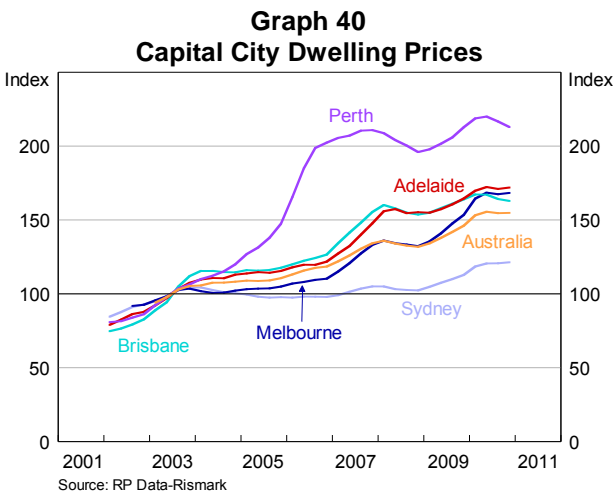
The responsible lending requirements of the National Consumer Credit Protection regime, which started for ADIs on 1 January 2011, should help limit any undue loosening in lending standards. This regime, which replaces (and largely replicates) the state-based Uniform Consumer Credit Code, places a strong 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.

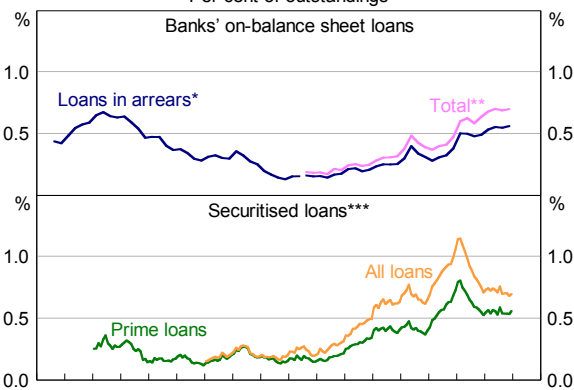
Within the national average, though, there has been some regional divergence. Prices have been firmer in Sydney and Melbourne in 2010, but are drifting down in Perth and Brisbane (Graph 40). The strength in prices in Melbourne has occurred despite an apparently greater expansion in housing supply there 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.

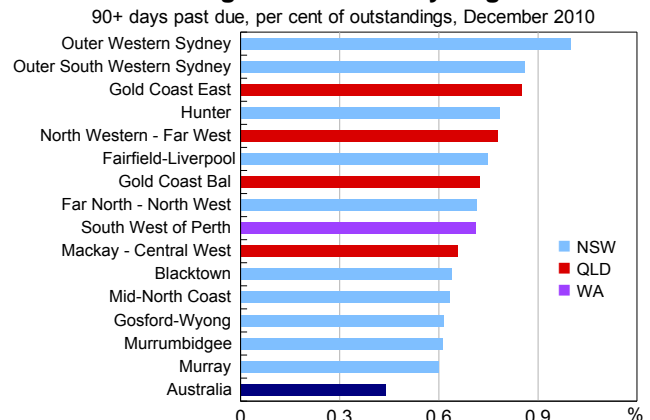
That said, a range of financial stress indicators show that the household sector is coping reasonably well with its debt levels and higher interest rates. While arrears rates on mortgage payments remain higher than average, they have levelled out recently, and remain low by international standards (Graph 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.



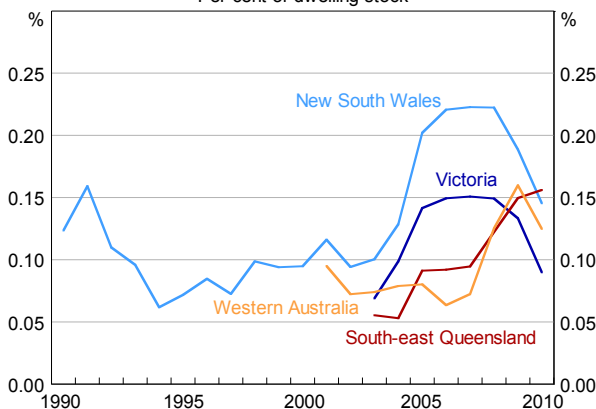
Based on securitised loans, the housing loan arrears rate remains higher in New South Wales than in the other states, but it was broadly unchanged over the year to December; in contrast, the arrears rates in Western Australia and Queensland increased further. Similar trends are evident at the regional 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.

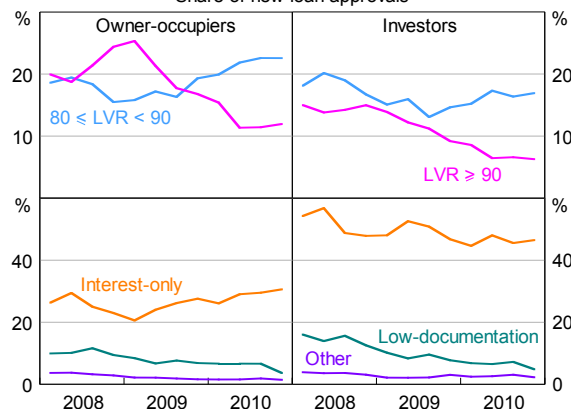
The relatively benign picture painted by these aggregate indicators of financial stress is consistent with household surveys, which show that only a small proportion of borrowers are highly geared. The latest HILDA survey, for 2009 (before most of the recent increase in interest rates took place), showed 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

# CONFIDENTIAL

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.

**CONFIDENTIAL**

Financial Stability Department  
24 February 2011

**CONFIDENTIAL****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

\$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.

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

Westpac has begun to offer greater discounts on its mortgage products. The bank 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

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.

## 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.

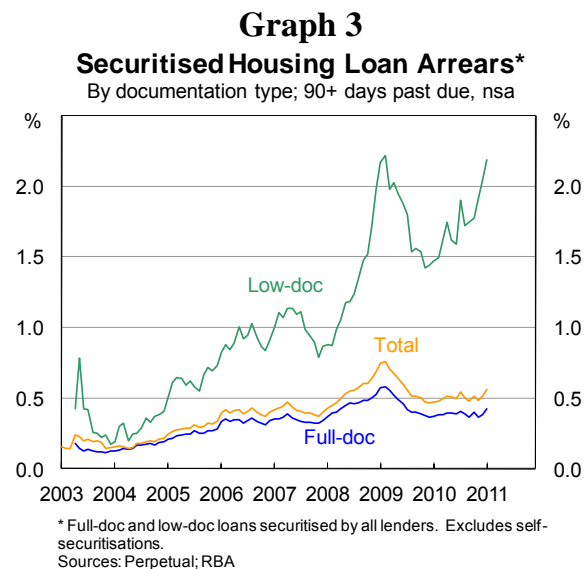
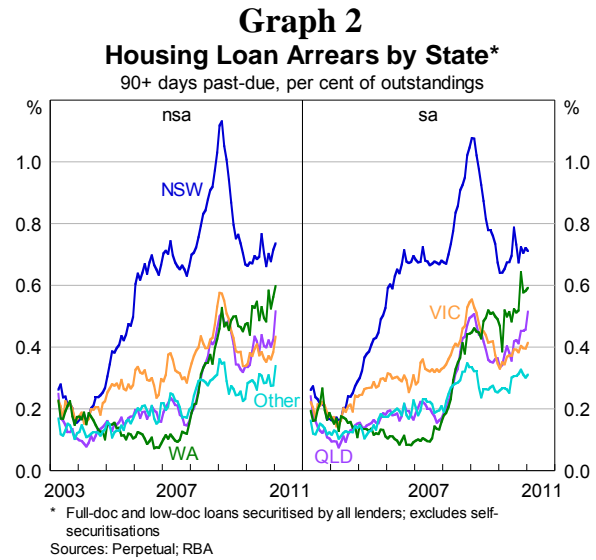
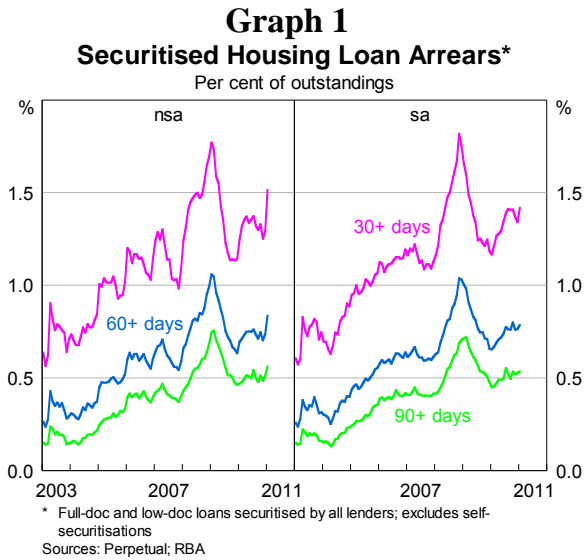
Cameron Deans  
Institutional Markets Section  
Domestic Markets Department  
18 March 2011



## SECURITISED HOUSING LOAN ARREARS – JANUARY 2011<sup>1</sup>

### 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).



**Table 1: Securitized RMBS 90+ Days Arrears Rates**  
Per cent of prime outstandings<sup>(a)</sup>, not seasonally adjusted

|                                | January 2011 | December 2010 | November 2010 | January 2010 |
|--------------------------------|--------------|---------------|---------------|--------------|
| <b>Loan documentation type</b> |              |               |               |              |
| 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         |
| <b>State</b>                   |              |               |               |              |
| 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         |
| <b>Interest type</b>           |              |               |               |              |
| Variable                       | 0.60         | 0.55          | 0.52          | 0.52         |
| Fixed                          | 0.29         | 0.28          | 0.27          | 0.25         |
| <b>Loan type</b>               |              |               |               |              |
| 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

<sup>1</sup> 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).<sup>1</sup> While these measures are not entirely comparable,<sup>2</sup> 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.

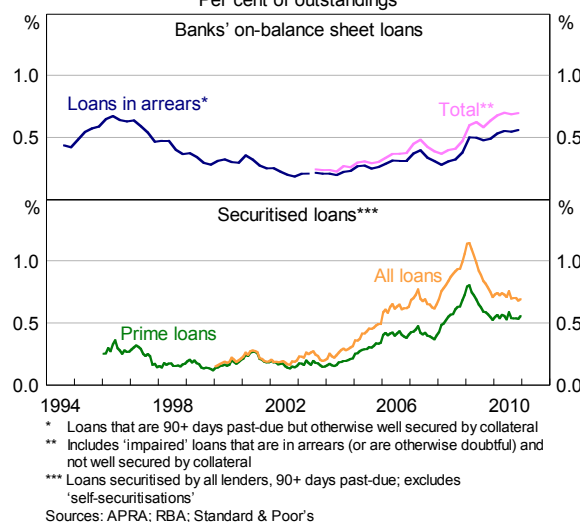
This divergence suggests that the RMBS arrears rate is less representative of wider mortgage quality than previously. In the past, FS has used monthly RMBS arrears data as a more timely indicator of likely developments in the quality of banks' on-balance sheet

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

**Graph 1**  
**Non-performing Housing Loans**  
Per cent of outstandings



<sup>1</sup> Self-securitised loans are typically excluded from this analysis, as they are already included in on-balance sheet loan performance measures.

<sup>2</sup> 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

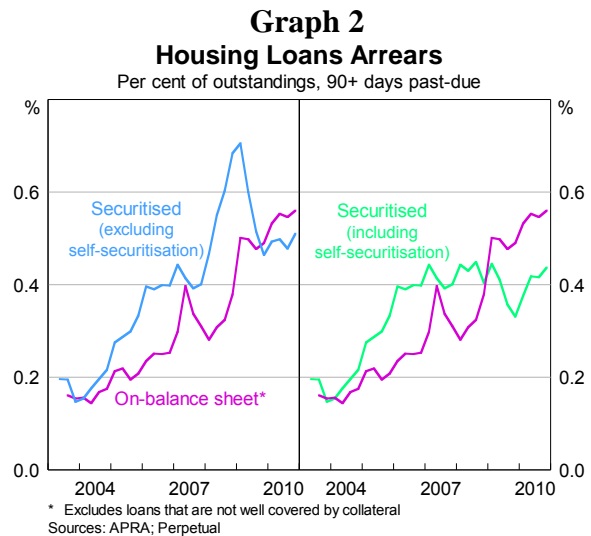
The on-balance sheet 90+ days arrears rate for well-collateralised housing loans and the 90+ days arrears rate for prime securitised loans provide the closest match in terms of underlying housing loan composition. The securitised arrears rate has traditionally been higher than the on-balance sheet arrears rate, reflecting the greater representation of non-traditional lenders and non-standard loans in the RMBS pool.<sup>3</sup> 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?

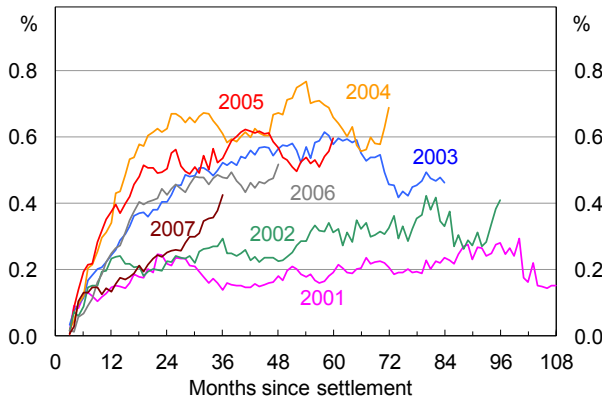
The divergence between the measures of the RMBS arrears rate and the on-balance sheet arrears rate has been partially driven by changes in the composition of the RMBS pool. Since the onset of the global financial crisis, there has been limited public RMBS issuance. Banks also started to self-securitise 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).



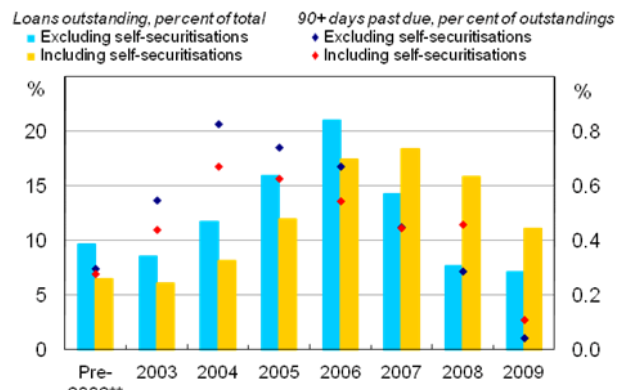
<sup>3</sup> The securitised arrears pool also includes loans which are not well-collateralised. In general, higher loan-to-valuation ratios are associated with riskier lending.

**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\*

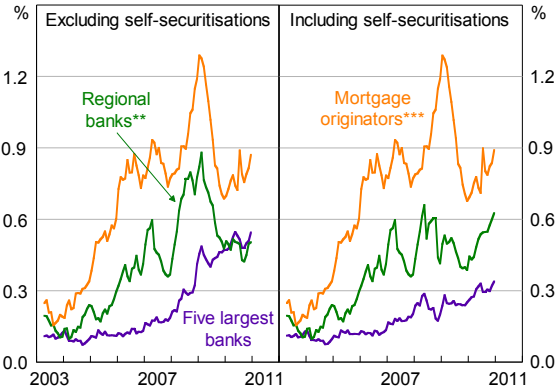


\* Prime loans securitised by all lenders; as at Dec 2010  
\*\* Loans originated between 1995 and 2002  
Sources: Perpetual; RBA

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.

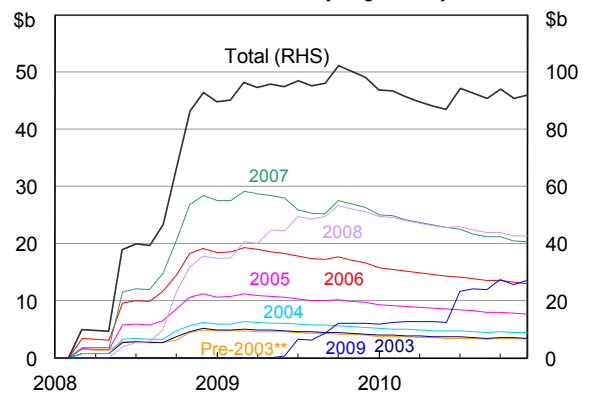
Examining the RMBS arrears rate including self-securitisations solves some of the problems associated with the aging of the pool of market-issued securitised loans, but results in other distortions. By including self-securitisations, more recent mortgages are included, but the arrears rates for mortgages 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).<sup>4</sup> 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

<sup>4</sup> 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).<sup>5</sup> This is a significant improvement on the old approach, where seven regions were close to this cut-off point (Table 2).

---

<sup>5</sup> 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 |
| <b>Lender type</b>      |                                |               |               |               |                                |               |               |               |
| 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        |
| <b>Documentation</b>    |                                |               |               |               |                                |               |               |               |
| 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        |
| <b>State</b>            |                                |               |               |               |                                |               |               |               |
| 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       |
| <b>Cohort</b>           |                                |               |               |               |                                |               |               |               |
| 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       |
| <b>Interest type</b>    |                                |               |               |               |                                |               |               |               |
| 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         |
| <b>Loan type</b>        |                                |               |               |               |                                |               |               |               |
| 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        |
| <b>Arrears duration</b> |                                |               |               |               |                                |               |               |               |
| 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         |
| <b>Memo item</b>        |                                |               |               |               |                                |               |               |               |
| 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



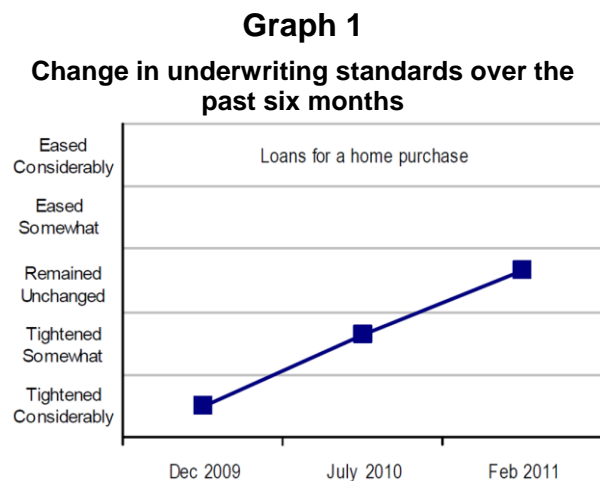
## UBS LOAN OFFICER SURVEY – FEBRUARY 2011

*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.



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.



