

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.

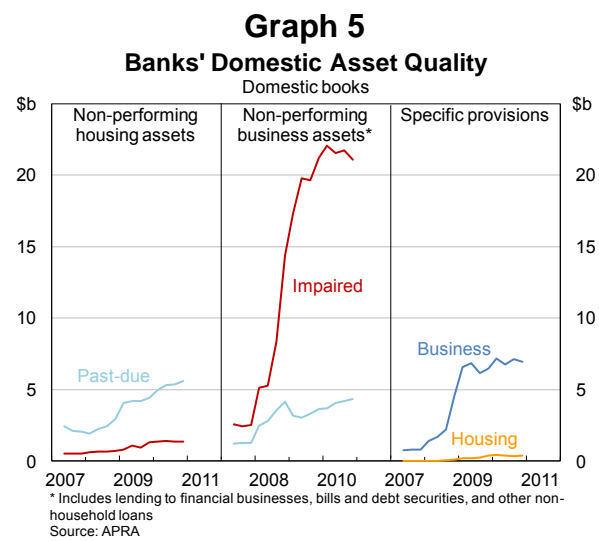
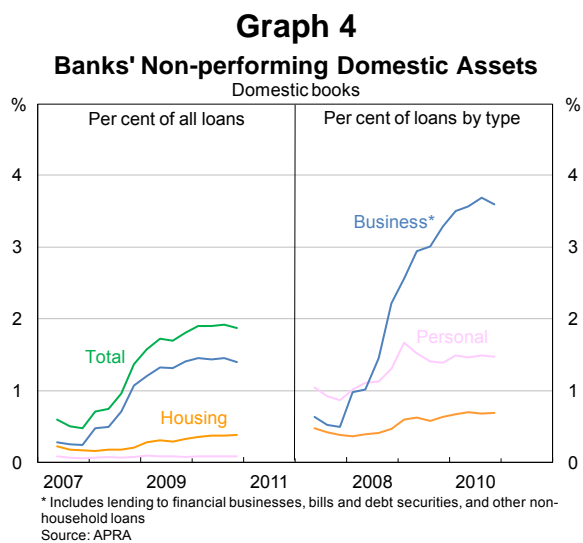


Table 1: Banks' Non-performing Domestic Assets
Domestic books

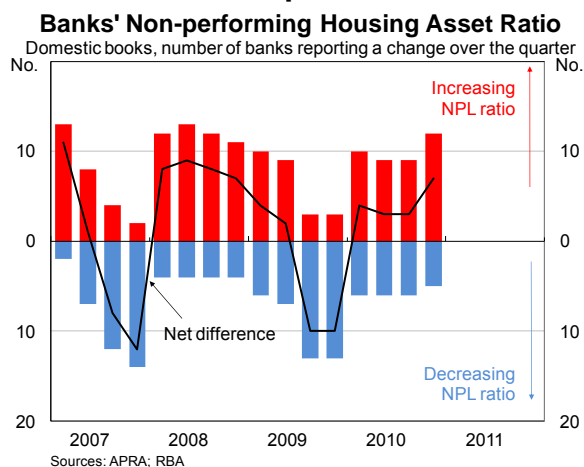
	Share by loan type*		Share of all loans*		Amount (\$ billions)		Memo: loan type as share of all loans* (per cent)	
	(per cent)		(per cent)				(per cent)	
	Dec 10	Sep 10	Dec 10	Sep 10	Dec 10	Sep 10	Dec 10	Sep 10
Housing	0.7	0.7	0.4	0.4	7.0	6.7	55	55
Owner-occupier	0.7	0.7	0.3	0.3	4.8	4.6	38	38
Investor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

* On-balance-sheet credit as at December 2010

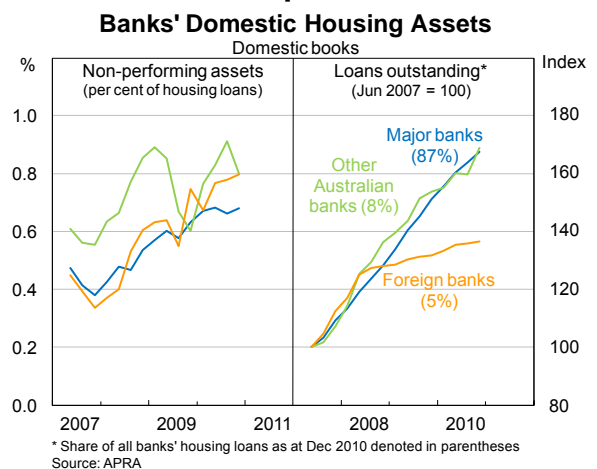
Domestic housing assets

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.

Graph 11

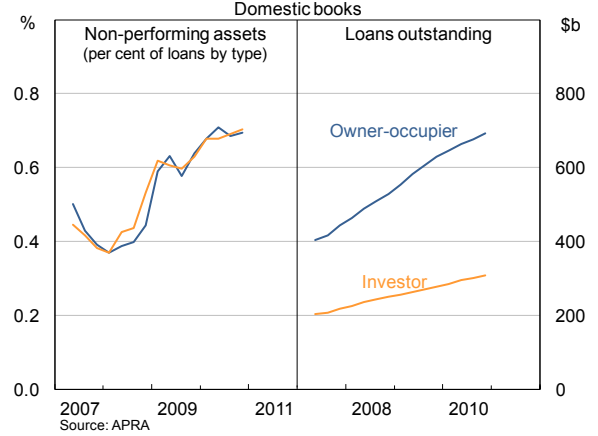


Graph 12



Graph 13

Banks' Domestic Housing Assets



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).

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.

FS NOTE

CONFIDENTIAL

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

26

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)

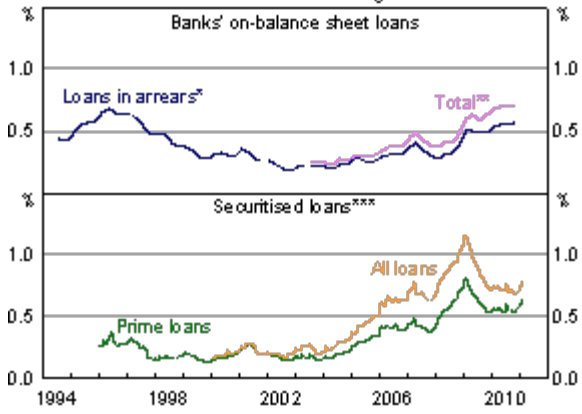
Despite the increase in interest rates since 2009, liaison with major banks indicates that the 2009 cohort of FHBs is performing no worse, and in some cases better, than earlier cohorts.

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.

Non-performing Housing Loans

Per cent of outstandings



1994 1998 2002 2006 2010

* Loans that are 90+ days past due, but otherwise well secured by collateral
 ** Includes 'impaired' loans that are in arrears (or are otherwise delinquent) and not well secured by collateral
 *** Loans securitised by all lenders, 90+ days past due; excludes 'securitisation'

Sources: APRA; Peppercorn; RBA; Standard & Poor's

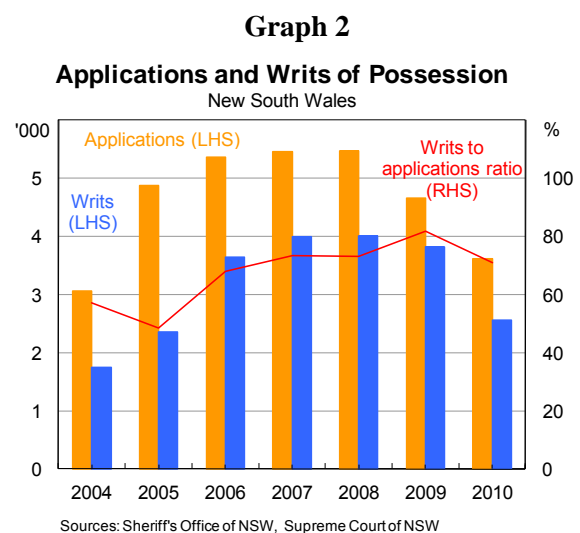
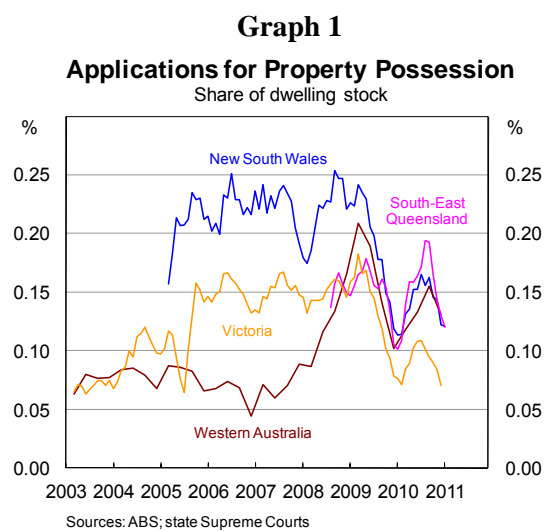
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PROPERTY POSSESSIONS: RECENT TRENDS AND OUTLOOK

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 preceded 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.



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

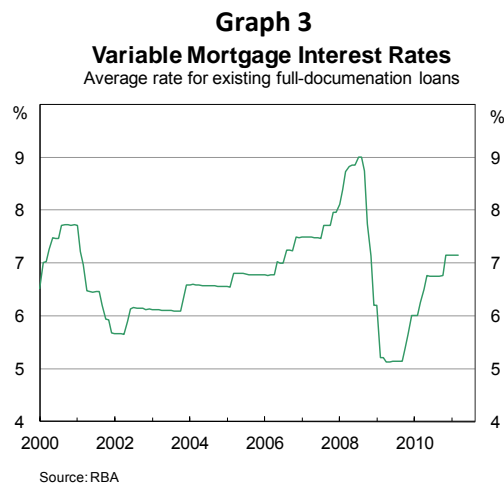
¹ Although the property possessions data mainly relate to residential properties, they will also capture commercial properties where the lender has applied for possession of the land. Recent discussions with the Supreme Court of NSW suggest that because the land is often the most valuable part of the 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 options 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.



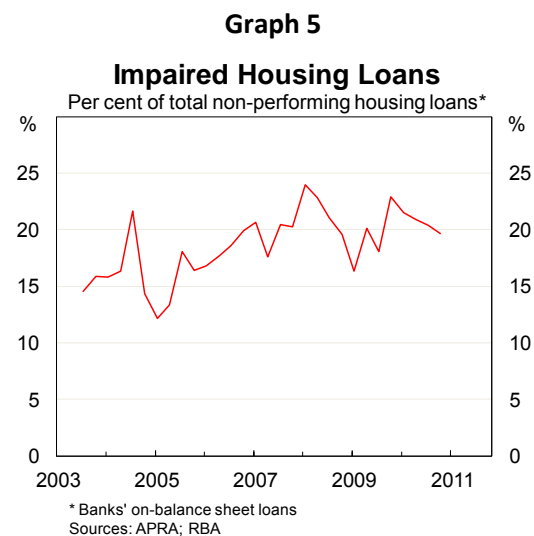
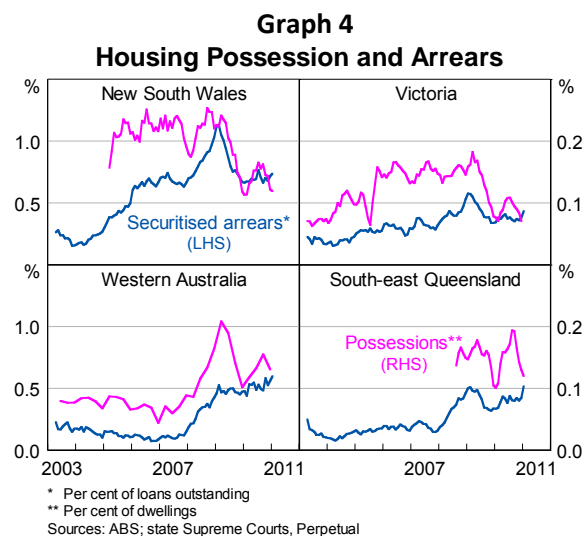
Applications for possession have declined since mid-2010, despite mortgage interest rates remaining around 7 per cent. Liaison with repossession agents suggests that this may be a consequence of tighter lending conditions and bank forbearance (e.g. loan modifications or extensions), which have resulted 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

⁴ It could also be the case that most borrowers that were unable to cope with mortgage 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

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.

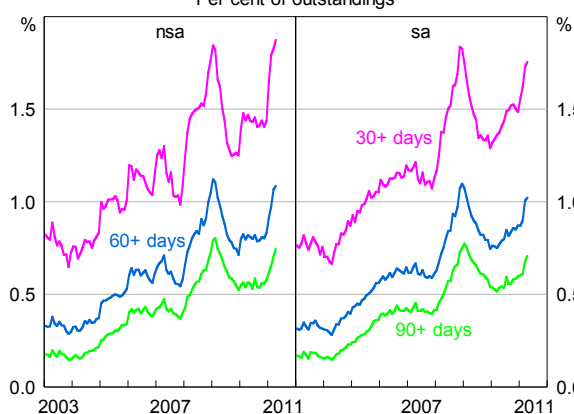
Sophie Stone
Institutional Markets Section
31 May 2011

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

Graph 1
Securitized Housing Loan Arrears*
Per cent of outstandings



* Full-doc and low-doc loans securitised by all lenders; excludes self-securitisations
Sources: Perpetual; RBA; Standard & Poor's

Table 1: Securitized 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

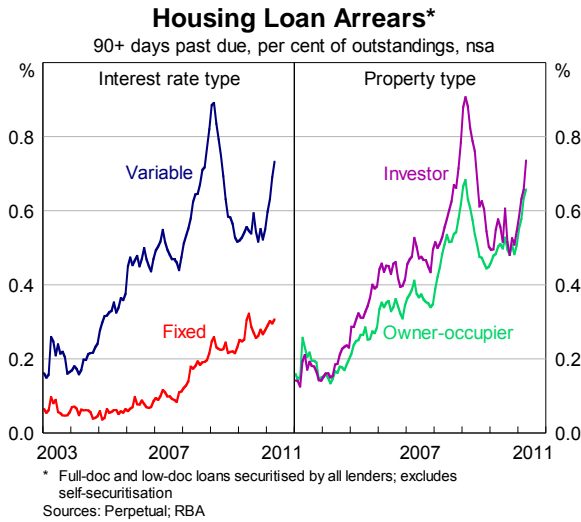
(a) Excludes self-securitisations
Sources: Perpetual; RBA

- 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

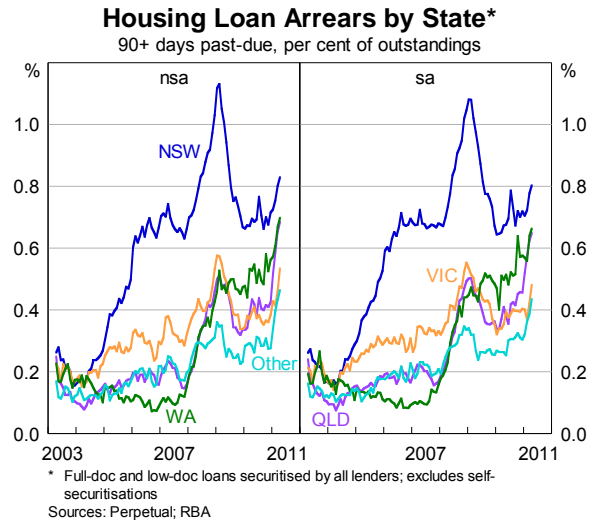
liaison, indicated that their investor arrears rates were double those of owner-occupiers.

- 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

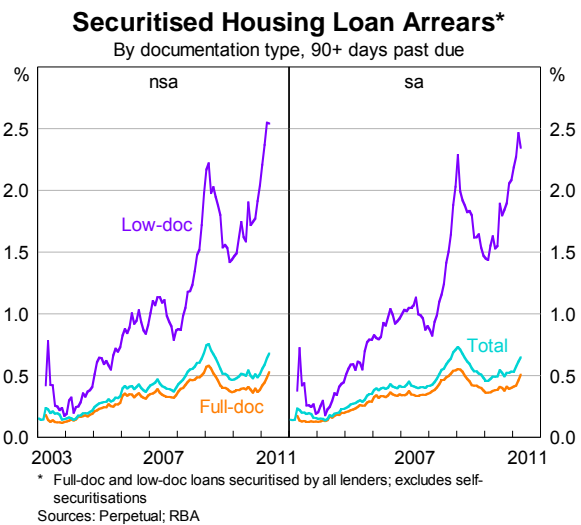


Graph 3



- 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

