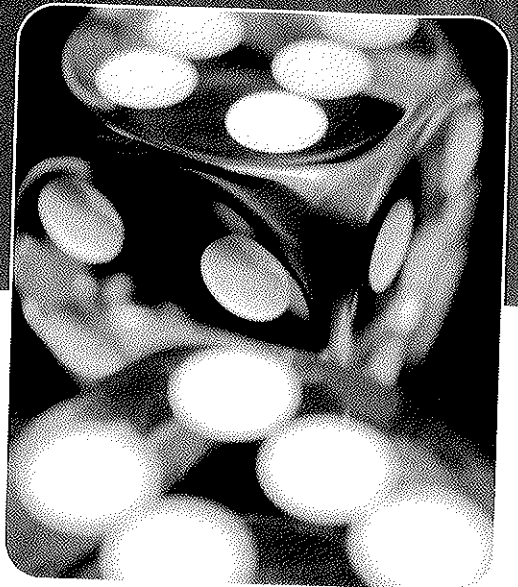


Riskier lending drives growth



An increased willingness by Australian borrowers to take on risk has driven a rebound in housing loan growth during 2006, according to an industry report. **story Matthew Liddy**

THE UP-TICK IN MORTGAGE loan growth in the first nine months of the year was driven by borrowers using higher loan to valuation ratios (LVRs), rather than new construction or renovation activity, the *Australian Mortgage Industry Report* found.

"Australian mortgage loan outstandings surged to 16 per cent on an annualised three-month rolling basis to \$785.4 billion in July 2006," said Brian Johnson, banking analyst with JP Morgan, which published the report along with Fujitsu Consulting.

"This reflects a modest upswing in national housing prices – stable in Sydney but growing in every other capital city – and the continued willingness of borrowers to take on more risk," he added.

The LVR on new lending is estimated at 60 per cent and perhaps as high as 70 per cent through brokers, the report said. Given that 85 per cent of Australian home loans are at variable rates, households rather than banks wear most of the added risk, Johnson said.

"Each 25 basis point increase in interest rates increases the interest burden on home loan borrowers by an estimated \$1.6 billion," he said. "However, this is balanced somewhat by the fact that those households that took on debt to enter the housing market in the last decade were the households best placed to service the debt."

The 35 per cent of households with a mortgage earn a disproportionate 46 per cent share of the household sector income, the report said.

The increase in LVRs has been especially pronounced in New South Wales, where the average LVR has climbed

from 51 per cent in 2003 to 78 per cent this year. In Queensland, by comparison, the average LVR was 46 per cent in 2003, climbing to 65 per cent in 2006.

"The combination of high LVRs, rising interest rates, stalling house prices in some sectors and a doubling of repossessions over the past two years in NSW indicates there are inherent risks in NSW property portfolios," said Martin North, the managing consulting director of Fujitsu Australia and New Zealand.

The percentage of home loans organised through mortgage brokers continued to rise, topping 37 per cent "despite recent efforts by the major banks to reinvigorate internal channels", the report said.

Not only were banks reopening branches but they were also starting to offer cheaper loans through their own channels to compete against brokers.

"The traditional arrangement saw banks undertaking not to offer cheaper loans through their own channels than those offered through the broker channel," the report noted. "However these arrangements are breaking down with a number of banks offering exclusive low rate offers through their proprietary branch and direct channels."

Automated valuations

The report also predicted that lenders would increasingly turn to computer modelling for valuation purposes in a bid to save costs, even as accurate valuation becomes more critical.

"In a cycle of ever rising house prices, low unemployment and falling interest rates, erroneous valuation practices have

little practical consequence," the report said. "Conversely with the housing price outlook less certain, interest rates rising and the risk profile of new home loan products drifting upwards, property valuations are becoming a more essential part of the loan origination process."

The interplay between that environment and pressure to improve mortgage processing cost efficiency would prove a "major management challenge", it said.

In an analysis of current valuation practices, the report said some lenders relied on staff and former staff to conduct a 'drive-by' to check on a property's existence in as many as 5 per cent of cases. Less than 15 per cent of loans relied on real estate statistical data and no site visit.

The report tipped that Australia would follow in the footsteps of the United States and United Kingdom, where sophisticated automated valuation models (AVMs) are used for 30 per cent and more than 45 per cent of loans respectively. These computer programs use information such as demographics, property characteristics, sales prices and price trends to calculate a value for a specific property.

"The need to improve mortgage processing cost efficiency while becoming increasingly vulnerable to any slippage in valuation disciplines will likely see the industry adopt AVMs to manage the mortgage valuation process," North said.

AVMs could be linked with credit-scoring techniques to allow virtually instant approval of loans at the point of application, or could be used more conservatively to decide what type of property inspection was required, it added.

The report said the quality of the underlying data in Australia was yet to be assessed. ■