

A New Mortgage Market

From my perspective, we have seen more changes over the past 12 months in the mortgage market than we have over the previous 15 to 20 years. It has been a very tumultuous time for all mortgage brokers and many lenders. If we survive this, we'll survive anything. We have seen lenders close their doors, merge or get eaten up by bigger players, many interest rate changes, fixed rates are changing nearly daily, major credit policy changes, mortgage broker commission cuts – it's been a huge year and it's made life difficult for us and our clients.

As Gordon Gekko from the movie Wall Street said, "the most valuable commodity around is information". Therefore, my aim with this article is give you a crash course on the changes in the lending game to bring you up to speed. More now than ever borrowers need professional help and guidance as today's lending market is very different to what we are all used to. Let's get into it.

Summary of credit policy changes

I provide below a summary of the key credit changes that have occurred over the past 12 to 18 months. They are generic and don't really relate to any specific lenders.

- **Loan to value ratios** – this is probably the biggest change in the lending market and is likely to affect most people. Most lenders will now only lend up to 90% of a property's value (down from 100%). In some situations (normally where you have existing loan with a lender), lenders may lend up to 95% to existing customers. However, 'new to bank' customers are generally limited to 90%. This lending change could have a negative effect on house prices should loan to value ratios (LVR) contract further. In the UK we have seen LVR's contract to 70% to 80% and this has been devastating for housing prices (although many negative factors have also affected housing prices in the UK). On balance, I don't think it's likely we'll see more changes below 90%. If we do, I will be concerned about the effect on property prices. I think the likely reason for these changes is a form of credit rationing rather than out of concern for a property price crash. The banks have been snowed under by increased volume – more loan applications than they can process. Therefore, one way of managing this is to make credit policies tighter so they end up with the better quality loans.
- **Employment stability** – lenders are focusing more on employment stability particularly now in an environment where redundancies and wholesale

staff cuts are being made. Many large companies tend to use the 'last in, first out' principal when implementing redundancies. Therefore, if you have only been in your job a short time (or you're looking at changing), be careful as this will not be viewed favorably by lenders in this environment.

- **Genuine savings** – in my opinion, this change makes good sense. This change means most lenders will want to see home buyers hold a cash deposit amounting to 3% to 5% of the property's value in the form of genuine savings. Genuine savings is defined as money held or accumulated in a bank account over a period of 6 months. This demonstrates to the lender that you have surplus income each month and that you don't spend every cent you earn. This is a good policy in my opinion as you shouldn't be buying a home if you can't save a small deposit. Common sense.
- **Low Docs & No Docs** – Low doc and no doc products are mainly used by self-employed people and do not require the normal level of documents like tax returns, etc. Instead, borrowers declare their income figure and the lender relies on this. My feeling is that these products have been abused by many people in the past. No docs didn't require the borrower to disclose any income and these have all but now disappeared. Low docs are harder to get, are more expensive and come at reduced LVR's. This is quite a tight market with far fewer lenders to choose from. These products have been impacted the most by the credit crisis so they might take many years to return to normal.
- **Cash out** – this relates to increasing an existing loan or applying for a new one without disclosing a specific purpose for the loan funds (i.e. once you have the loan you have the ability to take the cash out). For example, in the past you could go to a bank and ask for a \$200,000 line of credit for investment purposes and no more questions would be asked. In today's environment, the bank will ask a lot more questions and often ask for proof. For example, they might ask for a financial plan which will address how you will invest your \$200,000. We often recommend people build in buffers into their loan for safety sake (to covers unforeseen expenses or vacancy) but this is becoming a bit harder to do. Lenders are scared about giving borrowers an open cheque book in this environment.
- **Lenders mortgage insurance waivers** – Lenders Mortgage Insurance (LMI) is normally payable if you borrow more than 80% of a property's value. Over the past number of years, in some circumstances, we have been able to get LMI waived which has saved borrowers thousands of dollars. However, in today's

market, the Melbourne Football Club has a greater chance of winning this year's AFL premiership than we do with getting an LMI waiver approved. For those of you poor souls that don't follow AFL, I am suggesting that we have close to zero chance of approval. There are still certain policy exceptions for medical practitioners when it comes to LMI waivers.

- **Fine tooth comb** – credit officers are looking at applications in closer detail. We are getting asked to supply a lot more supporting documents and getting asked a lot more questions – many not very logical questions. It's like some lenders are trying to find a reason why not to approve a loan as opposed to a reason why they should approve it.
- **Interest rate discounts** – a side-effect of lower competition is that special interest rate discounts are harder to get these days. Some lenders have pulled back completely. Others have just tightened up. On the whole, it is a lot more difficult to achieve the same discounts we were getting approved 18 months ago.
- **Valuations** – bank valuations tend to be more conservative in today's environment. This is particularly an issue with properties worth more than \$1 million to \$1.5 million. At the higher end, it's not unlikely for a valuation to come in 20% to 25% lower than valuation results 12 months ago. This top-end market has been hit quite hard in some areas.

Warning: Lower competition = become a shareholder

We have seen many mergers and acquisitions in the banking sector with smaller lenders such as BankWest, St George, RAMS, Aussie Home Loans and Wizard all now owned by the Big 4 lenders. Recently, there have been rumours that ING Bank (in Australia) will be up for sale soon. Other smaller lenders are really struggling to compete with the Big 4. This is absolutely devastating for competition (it's nearly non-existent) and I don't think we've seen the full effects yet. I think we'll see more bad news resulting from lower competition. The fact of the matter is the global financial crisis has been the best thing that has happened to the Big 4 banks in Australian banking history. They will come out of this bigger, stronger and more profitable. Sadly, consumers will pay a price for this.

Borrow when you don't need to

So what do all these credit policy charges mean? Firstly, it means we are working a lot harder these days for less money (due to commission cuts – another side-effect of lower competition). It's taking us at least 50% more man hours to settle an average loan compared to 18 months ago. The frustration factor is high in our office.

The difficult thing to know is how far will this credit policy tightening go? Will we see more? No one really knows so I think it's prudent for people to apply for lending when they don't really need it. Often, this is when borrowers are in the strongest position. Just ensure you have access to additional funds in case of emergencies or opportunities.

You need help!

The fact of the matter is, I strongly believe that most borrowers will need to seek the council of an experienced mortgage broker. In the past, anyone could visit a bank branch and take money out in wheelbarrows. However, this has changed a bit. I am not saying you'll have to beg for it but you will have to ask nicely. Moreover, it's important to know which lender to ask first. Which lender is going to like your circumstances? A professional mortgage broker should have all the answers and can be invaluable in this fast changing environment.

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