



Final Report

Mortgage default in Australia: nature, causes and social and economic Impacts

authored by

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ACRONYMS

ABS	Australian Bureau of Statistics
ADI	Authorised Deposit-taking Institution
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investment Commission
CALC	Consumer Action Law Centre
CCLC	Consumer Credit Legal Centre
CEO	Chief Executive Officer
EDR	External dispute resolution
GFC	Global financial crisis
HIA	Housing Industry Association of Australia
IMF	International Monetary Fund
LVR	Loan-to-value ratio
OFT	Office of Fair Trading
RBA	Reserve Bank of Australia
TARP	Troubled Assets Relief Program
<i>UCCC</i>	Uniform Consumer Credit Code

EXECUTIVE SUMMARY

This is the second and final report on the problem of mortgage default in Australia. An earlier positioning paper (Berry et al., 2009) presented, in detail, a range of issues, views, evidence and potential policy directions concerning this subject. Both reports are to be read as one.

The project has focused on the incidence, causes and impacts of the rising trend in mortgage arrears and defaults, apparent in Australia over the past few years. The outbreak of the 'global financial crisis' in the second half of 2008 (but the genesis of which was clearly present 18 months earlier) has given the project added currency and urgency. Governments at federal and state levels in Australia have and are addressing many of the issues raised by this study.

This report aims to do two things. *First*, we selectively bring up-to-date the accounts of trends and analysis presented in the earlier report. *Second*, providing the main focus of this report, we will present and analyse primary data gathered from a survey of defaulting mortgagors and a number of follow-up interviews, in order to better understand the factors mainly responsible for borrowers falling into mortgage repayment difficulties, the range of impacts on their lives and the clues all this might give for sensible policy development.

Research questions

The project set out to answer the following four key questions:

1. What were the key triggers and causes of mortgage default in Australia in 2008?
2. What are the consequences of default for affected households — in terms of financial impacts, future borrowing capacity, physical and psychological health, intra-household relations, and the impacts of mobility?
3. What policy interventions – financial, educational, counselling, reporting, regulation – could reduce the incidence and negative impacts of mortgage defaults?
4. What are the broader risks to the Australian housing system and economy posed by the current global mortgage default climate?

Methods

The following methods were used to inform the earlier positioning paper:

1. A literature review of relevant studies and reports since the Berry et al. (1999) study, which identified trends in mortgage defaults in Australia and other advanced economies and summarised findings of the factors behind the trends.
2. An analysis of the macro-economic context and impacts of rising defaults which focused on the liquidity constraints in financial markets and the broader risks of economic recession. This analysis drew on and extended earlier research by Berry (2006), current research by Berry (2009; forthcoming), extensive research by the Reserve Bank of Australia (RBA), and recent and continuing debate in the financial media in the context of current developments in US and global financial markets.
3. A desktop analysis of recent Supreme Court records of mortgagor repossessions in NSW and Victoria.

4. Interviews with key actors in the legal and community sectors, including the Consumer Credit Legal Centre (CCLC) in NSW, the Consumer Action Law Centre (CALC) in Victoria, and financial counsellors at Broadmeadows UnitingCare.
5. An analysis of The 2007 House of Representatives Inquiry into Home Lending Practices and the Processes Used to Deal with People in Financial Difficulty; the 2008 House of Representatives Standing Committee on Economics Inquiry into Competition in the Banking and Non-banking Sectors; and the 2008 Senate Select Committee on Housing Affordability in Australia.
6. Analysis of the primary research data into the incidence and impacts of mortgage stress in Australia, carried out by Fujitsu Consulting.

The approach informing this final report draws on the following:

1. A mail survey of mortgagors who have been subject to state Supreme Court claims of possession on their property during 2008 in NSW and Victoria. We aimed to generate a sample of approximately 300 survey respondents. However, in spite of mailing out questionnaires to 3642 delinquent mortgagors (half in each state), based on Supreme Court information, only eighty-seven completed questionnaires were returned. This is a low response rate but one that is understandable in view of the inherent difficulties in tracking households who have involuntarily moved dwellings, many of whom are likely to be suffering severe disruption to, and distress in, their lives. The results of these responses are discussed in chapters 2 and 3.
2. During the research, twenty-seven in-depth face-to-face interviews were undertaken in order to: (i) better understand the real factors pushing mortgagors into arrears and default, and the impacts on real lives; (ii) document key case studies in depth; and (iii) probe for insights into effective policy interventions to reduce the risk and negative impacts of mortgage default. Thus, the intensive interviews were used to clarify and detail trends apparent in an analysis of the completed questionnaires and were used in triangulating with data collected by government agencies and industry bodies such as APRA, ABS, ASIC, Fujitsu Consulting & JP Morgan, and the RBA. Of the twenty-seven interviews, nineteen were drawn from survey respondents who agreed to be interviewed by phone; the interviews lasted from 30 to 60 minutes. The remaining nine interviewees were recruited through a network of financial counsellors in suburban Melbourne and were interviewed prior to the survey.

By agreement with Martin North, CEO of Fujitsu Consulting, the researchers were given access to the results of Fujitsu's regular survey of mortgagors, which involves a rolling sample of 26 000 respondents, with a panel of 2000 followed over a 3-year period. It provides unique access to data on home sales instigated by mortgage stress and the threat of repossession, and problems associated with 'predation'.

Martin North also provided several detailed scenarios of the development and sources as well as impacts of financial stress in different kinds of households for real (but anonymous) households as well as postcodes for data on mortgage stress during October 2008 in Melbourne; the latter has been presented spatially in this final report.

KEY FINDINGS

a) Who defaults?

The survey cohort of households receiving claims of possession from mortgage lenders was characterised by:

- A fairly even age spread between 35 and 54 years, with relatively small numbers of younger and older defaulters.
- Low-to-moderate incomes.
- Conventional motivations for home ownership – e.g. security, pride, investment value.

In summary, it is clear that defaulter households are similar to most Australian households: home purchase and eventual ownership is an ideal based on their lived housing market and cultural experiences.

b) Circumstances of defaulting households

The survey cohort generally:

- Had high initial loan-to-value ratios (LVRs), varying positively with income.
- Paid relatively high mortgage interest rates.
- Began experiencing difficulties more than 1 year after taking on their mortgages – although more than a third of respondents fell into arrears less than a year into their loans.
- Are more likely than all Australian purchasing home owners to borrow from sources other than the banks – more than a third of the sample had done so. By 2003, with respect to all claims of possession in the Supreme Court of Victoria, 80 per cent of defaulters had borrowed from non-bank institutions.

c) Triggers

With respect to the survey respondents:

- Among the 'initial causes' of experiencing repayment difficulties, the 'loss of work and income', closely followed by 'too much debt' and 'interest rates too high' stand out. However, 'illness or accident in the household', 'relationship breakdown' and 'underestimated costs of repayments and other housing costs' are also significant.
- The relative importance of key triggers stayed relatively constant over time. Thus the factors initially driving households into difficulties persisted through the often lengthy claims of possession process.
- In many of the cases, particularly those interviewed, the descent into mortgage default was triggered by a mutually reinforcing combination of factors. Although the research attempted to identify the primary cause, in most cases it was associated with reinforcing secondary factors.

d) Impacts

We sought to identify the initial responses and consequences of failing to meet mortgage repayments, moving on to a consideration of the longer-term impacts on defaulting households.

With respect to the survey respondents, the main initial actions and impacts were:

- Households took on more, and more expensive, debt by using their credit cards more (40 per cent).
- Households took on more debt by borrowing from family and/or friends (38 per cent).
- Household members increased their level of labour market participation, thereby earning more income (14 per cent).

- Households refinanced their dwellings with new loans as they sought to strike a new affordable balance between income and repayments (21 per cent).
- Households took a number of 'other' actions (30 per cent), including significant use of superannuation hardship provisions (allowing the use of superannuation savings to prevent the contributor's home from being sold by the lender who holds the mortgage).

Significantly, only 24 per cent of households 'sought financial advice on budgeting and other ways to address the problem'. Analysis of the interviews suggests that where advice was sought it was often too late to be of use.

Longer-term responses included rearranging the mortgage by:

- *Varying the term of the mortgage.* Less than 20 per cent of survey respondents were approached by their lender to re-schedule mortgage repayments in order to deal with mounting arrears and forestall possession or forced sale. Nearly half the respondents initiated attempts with their lenders to do so but only 4 per cent were successful.
- *Using hardship provisions under the Uniform Consumer Credit Code (UCCC).* At the time of the study there were only grounds for hardship when the size of the loan fell under a threshold and a consumer could not make loan repayments due to 'hardship', such as illness, unemployment or other reasonable cause, but could pay the debt if the terms of the contract were changed. This provision was only available to borrowers once their lender has refused the borrower's request to vary the current loan. With recent Commonwealth intervention aimed at strengthening and harmonising policy in this area, new arrangements are being put in place. Thirteen per cent of survey respondents sought relief under this scheme. Among interviewees, one received hardship relief but was refused a second application when they again fell into arrears. Another interviewee was awaiting a decision on her application for relief at the time of interview.
- *Refinancing existing loans in default.* By refinancing, households seek to overcome their repayment problems through: extending the life of the loan and reducing the size of regular repayments; increasing the mortgage by incorporating other high interest rate debt, such as credit card debt, into a lower interest rate housing loan; and drawing down equity in the house and using this to pay off other debts, or meeting significant other commitments. Almost two-thirds of survey respondents refinanced their loans at least once after taking out their initial mortgages. Over 40 per cent refinanced more than once and 12 per cent more than three times. For those who had refinanced, 89 per cent increased the size of their mortgage loan. More than 60 per cent of respondents refinanced in order to consolidate their personal debt.
- *Drawing down their superannuation savings.* Under the *Superannuation Industry (Supervision) Regulations 1994* the Australian Prudential Regulation Authority (APRA) can approve the early release of superannuation benefits on specified compassionate grounds. One of these grounds is where a person with superannuation savings is faced with 'a forced sale of an applicant's principal place of residence by their mortgagor' (APRA, 2008: p. 20). APRA data shows that, in 2007–08, just under 15 000 applications for early release were approved (on all eligible grounds), up from about 8000 in 2003–04. Several interviewees accessed their superannuation savings in this manner in order to delay possession or forced dwelling sale.
- *Bankruptcy.* Bankruptcy can be a consequence of mortgage default and can also be a way of avoiding having to access superannuation savings. However, only 16

per cent of respondents were declared or chose bankruptcy. The stigma and future constraints on borrowing capacity seemed to dissuade people from taking this route.

Respondents sought to stay in their homes as long as possible, although most expected to eventually have to move into rental accommodation. Interviewees expressed grief at losing their homes and considerable anxiety about how and where they would be able to access appropriate rental housing.

e) The broader picture

Drawing on the industry survey data of Fujitsu Consulting it was found that:

- Total estimated mortgage stress peaked in August 2008 at over 800 000 households. Thereafter, due in large part to falling mortgage interest rates, total and especially severe stress fell.
- The trend turned back up in the second quarter of 2009 as unemployment crept up toward 6 per cent (from 4.4 per cent).
- Looking ahead, Fujitsu forecasts a significant rise in both mild and severe stress by the middle of 2010.

This last point is important. Although official unemployment is expected to peak at below 7 per cent (instead of the 8.5 per cent estimate in the 2009–10 Federal Budget), *underemployment* is expected to continue rising. Full-time jobs are being replaced by part-time jobs and average hours worked are falling (ABS, 2009). If this trend continues, more households will suffer income losses that will impact negatively on mortgage repayment capacity. Fujitsu (2009: p. 1) concludes:

The outlook remains uncertain for homeowners, but it all hinges on unemployment levels through the next few months and expected rises in interest rates later in the year. We now estimate stress by June 2010 will be just over 1 million households, and those in severe stress perhaps as high as 294,000. There are a number of risk factors linked to higher interest rates and falling net incomes which explain this.

In the year to August 2009, the main perceived causes of mortgage stress were fear of unemployment, drop in income and poor investment returns. However, looking ahead, one-quarter of households surveyed expressed concern about future interest rate rises reducing their ability to meet repayments. This proportion rose to half for recent first-time buyers. In October 2009, the RBA raised official interest rates by 25 basis points, the first country to begin to tighten monetary policy; a further 25 basis points rise followed in November.

The impacts of changing mortgage stress fall unequally across different social groups and over space.

Focusing on households in **severe** mortgage stress, the largest numbers are concentrated in three categories:

- *Suburban mainstream*: these 'mid-life course' households tend to have a member or members employed in lower-to-middle income, routine white collar or blue collar jobs, living within the major metropolitan regions.
- *Disadvantaged fringe*: households with low-paid blue collar or service sector jobs, living in peripheral metropolitan or country regions, with relatively low educational levels, a high proportion of whom are of non-Anglo ethnic background.

- *Battling urban*: these younger households are concentrated in lower socio-economic, higher than average density suburbs, employed in casual jobs, vulnerable to recurrent unemployment or reduced hours employment.

Together, these three categories account for more than 60 per cent of households estimated to be in mortgage stress. Although less numerous, it is still worth noting that a number of other household types are experiencing stress. This includes small numbers of older, higher-income mortgagors, facing repayment difficulties in the wake of the global economic downturn.

Mapping households in mortgage stress across Melbourne sees the highest incidence in lower socio-economic areas to the outer north-west and outer south-east. Conversely, mortgage stress is least evident in more affluent inner city, bayside and middle-distance eastern suburbs. This pattern closely resembles the map of employment vulnerability for Melbourne produced by the University of Newcastle's Centre of Full Employment and Equity.

The global context

The genesis and impacts of the 'Global Financial Crisis' (GFC) were discussed in the positioning paper. The central triggering role of US mortgage markets – and particularly the actions of large financial institutions trading complex derivatives based on sub-prime residential mortgages – was stressed. The current year has witnessed a further unwinding of the crisis with negative spillover effects on the economies of the major Western nations. Governments and central banks in the advanced economies have instituted unprecedented fiscal and monetary stimulatory measures in attempts to stabilize their economies. Only Australia among this group of countries escaped a serious recession and writing in late 2009 it is still uncertain as to how quickly other economies will follow Australia into recovery and how robust those recoveries – including Australia's – will be. Employment generally lags recovery and unemployment rates are expected to rise, here and elsewhere, through 2010. The large debt-overhang caused by mortgage-fuelled housing booms may keep consumption growth low by comparison to recovery periods from earlier recessions. As the Australian Prime Minister and Treasurer have repeatedly said: "we're not out of the woods yet".

Policy implications

The House of Representatives 2007 Inquiry into Home Loan Lending Practices and Processes resulted in three main recommendations aimed at reducing mortgage defaults, namely that:

- The ABS expand data collection on repossessions of homes, requiring more detailed information from lenders and the courts.
- The federal government take over responsibility and expand the regulation of credit to all lenders and mortgage brokers in order to simplify and unify legislation and supervision.
- Mortgagors be given comprehensive access to external dispute resolution (EDR) to address complaints, easing current eligibility limits and specifying the lifting of the Banking and Financial Services Ombudsman's limit of \$280 000 to \$500 000.

The Rudd Federal Government has subsequently implemented or substantially advanced these and related policies. The following table summarises the range of possible interventions, distinguishing between preventative and restorative measures aimed at dealing with the problems of mortgage default. Based on our research

findings we have italicised those measures we believe deserve further consideration by policy makers.

Table 1: Proposals to minimise and ameliorate mortgage default

<i>Structural actors/processes —topics to address</i>	<i>Preventative measures</i>	<i>Relief measures (restorative)</i>
<p><i>Lenders' practices</i></p> <p>Establishing a balance between conservative and irresponsible lending.</p> <p><i>Models, indicators and/or formulae for defining and assessing hardship and debt-servicing capacity of mortgagors that are commonly accepted by the financial industry, government regulating agencies, in legal forums and by financial advisers.</i></p> <p>Embedding clear and widely accepted practices of response to hardship (variations) due to both individual circumstance and wider economic impacts.</p> <p><i>Planned response by government to economic downturn, diminishing credit and increasing vulnerability of specific households to falling house prices, reduced income or higher interest rates.</i></p> <p><i>Borrowers' behaviour</i></p> <p>Better inform borrowers about responsible borrowing and options to minimise the risk of default, repossession of a home and high financial losses due to problems with repayments.</p> <p>Improving borrowers' skills and knowledge about the dangers of certain lending practices and products.</p> <p>Improving borrowers' knowledge of and enhancing the support and relief systems available to those in financial distress.</p>	<p>Regulate mortgage brokers.</p> <p><i>Stricter criteria for lending based on debt-servicing capacity, not asset value, restricting the size of loans (LVR), and aspects of eligibility relating to income.</i></p> <p>Make lenders, and their agents/brokers, more responsible for confirming debt-servicing capacity of borrowers — eradicating no-doc and minimising or redefining low-doc loans.</p> <p><i>Require open, plain English, and detailed information on all loan products and services — perhaps through ASIC and the Understanding Money website.</i></p> <p>Improve reporting as well as regulation of non-ADIs and provide borrowers with lists of regulated borrowers, all demanded to be members of APRA-approved external dispute resolution organisations.</p> <p>Improve secondary and tertiary education on financial management of home mortgages.</p> <p><i>Free, easily accessible and independent financial advice when a home loan is applied for.</i></p> <p><i>Redefine hardship to take more account of how severe and longstanding illness in households constrains income generation and saving and requires variations to loans.</i></p> <p>Publicise responsibilities of a mortgage and default — e.g. build a narrative around a great Australian nightmare.</p>	<p>Expand and enhance APRA-approved external dispute resolution (EDR) services as well as their powers to discipline lenders.</p> <p><i>Ensure repossession cannot occur while independent appeals — EDR — over rejected hardship claims or other serious and legitimate disputes are in process.</i></p> <p><i>Establish a specific home mortgage ombudsman with special powers.</i></p> <p>Regulatory agencies, such as OFT and APRA, continue reviewing products and services as well as market demand and awareness.</p> <p>Monitor national, state-by-state and regional developments in terms of default and house prices for timely introduction of government relief to householders.</p> <p><i>Free, easily accessible, and independent financial advice if in arrears.</i></p> <p><i>Revise and expand eligibility for mortgage relief assistance to provide uniform national coverage, redefining hardship to take into account temporary emergency measures during downturns.</i></p> <p>Identify and publicise through the popular media those lenders taking most court actions, borrower types, and loan kinds most prone to default.</p> <p>Improve public credit reporting.</p>

<p>Housing context</p> <p>Improving collection and up-to-date analysis of data on mortgage arrears, defaults, and claims of possession (lodged and successful) as well as monitoring levels of mortgagors' financial stress and forced sales.</p> <p>Ensuring households have a range of options for accommodation that are affordable and accessible where they need to work.</p> <p>Private and public tenants' rights to secure long-term housing at a manageable cost.</p> <p>Access to temporary housing for evicted households and tenants of leased properties where the mortgagee is threatening to take, or has taken, possession.</p>	<p><i>Improve terms, conditions and supply of housing accommodation options that compete with owner-occupation, e.g. enhance public and private tenants' rights, expand social housing, etc.</i></p> <p><i>Implement guidelines and rights to temporary housing assistance for defaulters.</i></p> <p>Enhance tenants' rights when the house they are leasing is subject to a claim of possession and later when it is repossessed. Appropriate reforms include sufficient notice to vacate, the claim of possession providing sufficient reason to break a lease, and compensation for costs associated with moving.</p>
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Note: already implemented or planned proposals have been shaded; proposals that require addressing are italicised

Of particular urgency are the following:

- One-on-one independent expert financial counselling at crucial times in the mortgage borrowing cycle – namely, while seeking the loan, before committing to the loan and immediately when difficulties in servicing the loan arise – would reduce the incidence of defaults. This is particularly important for first-home buyers.
- Strengthening the consumer rights framework in relation to mortgage borrowing.
- Standardising language and making lenders responsible for providing such information is more easily achievable through the new federal powers in the area of credit. ASIC has expanded its research and consumer information for household credit and mortgagors, as well as taking responsibility for the Understanding Money website.
- Developing effective new protocols for accessing the debt-payment capacity of borrowers, effectively reviving a more sophisticated and graduated version of the old '30 per cent rule' (i.e. repayments limited to no more than 30 per cent of eligible income).
- Requiring and monitoring 'responsible lending' by banks and other mortgage providers.
- More appropriate and better-targeted mortgage assistance schemes.
- Adequately funded and regulated external dispute resolution processes.

1 INTRODUCTION

1.1 Context of Final Report

This is the second and final report on the problem of mortgage default in Australia. An earlier positioning paper (Berry et al., 2009) presented, in detail, a range of issues, views, evidence and potential policy directions concerning this subject. Both reports are to be read as one.

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1.2 Research questions

The project set out to answer the following four key questions:

1. What are the key triggers and causes of mortgage default in Australia in 2008?
2. What are the consequences of default for affected households — in terms of financial impacts, future borrowing capacity, physical and psychological health, intra-household relations, and the impacts of mobility?
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1.3 Methods

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1. A literature review of relevant studies and reports since the Berry et al. (1999) study, which identified trends in mortgage defaults in Australia and other advanced economies and summarised findings of the factors behind the trends.
2. An analysis of the macro-economic context and impacts of rising defaults which focused on the liquidity constraints in financial markets and the broader risks of economic recession. This analysis drew on and extended earlier research by Berry (2006), current research by Berry (2009; forthcoming), extensive research by the Reserve Bank of Australia (RBA), and recent and continuing debate in the financial media in the context of current developments in US and global financial markets.

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6. Analysis of the primary research data into the incidence and impacts of mortgage stress in Australia, carried out by Fujitsu Consulting.

Further detail on the methods used in the project can be found in the first report (Berry et al., 2009).

The approach informing this final report draws on the following:

1. A mail survey of mortgagors who have been subject to state Supreme Court claims of possession on their property during 2008 in NSW and Victoria. We aimed to generate a sample of approximately 300 survey respondents. However, in spite of mailing out questionnaires to 3642 delinquent mortgagors (half in each state), based on Supreme Court information, only eighty-seven completed questionnaires were returned. This is a low response rate but one that is understandable in view of the inherent difficulties in tracking households who have involuntarily moved dwellings, many of whom are likely to be suffering severe disruption to and distress in their lives. The results of these responses are discussed in chapters 2 and 3. Nevertheless, the particular nature of the sample, added to the low response rate, means that the results must be treated with caution. The difficulty in reaching people who are suffering mortgage distress and the dearth of reliable data in this area (one of the main conclusions of the Parliamentary inquiries discussed in the positioning paper) reinforce the need to improve data reporting to inform policy in this area.

The questionnaire instrument was developed and trialled prior to its dissemination late in 2008; it is included as Appendix 1. Reply-paid envelopes were included with the invitation letter to participate. The survey sought to identify key factors leading to or triggering default and focused on the post-default financial, familial, social, health and housing accommodation impacts.

2. During the research, twenty-seven in-depth face-to-face interviews were undertaken in order to: (i) better understand the real factors pushing mortgagors into arrears and default, and the impacts on real lives; (ii) document key case studies in depth; and (iii) probe for insights into effective policy interventions to reduce the risk and negative impacts of mortgage default. Thus, the intensive interviews were used to clarify and detail trends apparent in an analysis of the completed questionnaires and were used in triangulating with data collected by government agencies and industry bodies such as APRA, ABS, ASIC, Fujitsu Consulting & JP Morgan, and the RBA. The interview schedule is included in Appendix 2.

Of the twenty-seven interviews, nineteen were drawn from survey respondents who agreed to be interviewed by phone; the interviews lasted from 30 to 60 minutes. Interviewees were offered a \$75 supermarket voucher to participate. The remaining nine interviewees were recruited through a network of financial counsellors in suburban Melbourne and were interviewed prior to the survey.

3. By agreement with Martin North, CEO of Fujitsu Consulting, the researchers were given access to the results of Fujitsu's regular survey of mortgagors, which involves a rolling sample of 26 000 respondents, with a panel of 2000 followed over a 3-year period. It provides unique access to data on home sales instigated by mortgage stress and the threat of repossession, and problems associated with 'predation'.

Martin North also provided several detailed scenarios of the development and sources as well as impacts of financial stress in different kinds of households for real (but anonymous) households as well as postcodes for data on mortgage stress during October 2008 in Melbourne; the latter has been presented spatially in this final report.¹

1.4 Structure of Final Report

This report is structured in a similar way to the positioning paper. Each of the remaining chapters is organised around one of the research questions. Chapter 2 focuses on the triggers and causes of mortgage delinquency in Australia (research question 1). Chapter 3 concentrates on the impacts on the lives of mortgagors in distress (research question 2). Section 4 looks again at the macro-economic and broader financial sector context (research question 4). Section 5 focuses on the policy implications of the research findings (research question 3).

In each section, the analysis in the positioning paper will be updated, where possible and relevant. However, as noted above, especially in sections 2 and 3, this report will concentrate on analysing the results of the surveys (our own and Fujitsu's) and interviews.

¹ The researchers wish to thank Martin North, CEO of Fujitsu Consulting, for providing us with access to this data and his personal insights into industry conditions and developments. He and his organisation bear no responsibility for any of the views or findings presented in this report.

2 TRIGGERS AND CAUSES OF MORTGAGE DELINQUENCIES

This chapter investigates why households default on their mortgage repayments by reporting on four components of field research:

- Semi-structured interviews were conducted with nine people who were members of households who had experienced difficulties in repaying their mortgages. They were recruited through financial counselling services and the interviews were either undertaken face-to-face or by telephone. The interviews were recorded and transcribed.
- A survey instrument was sent to 3642 households drawn from the records of the Victorian and New South Wales Supreme Courts (half from each jurisdiction). These were households named as defendants by mortgagees seeking possession of a residential property. These defendant households returned a total of eighty-seven completed surveys. Ninety per cent of respondents were home purchasers, 5 per cent were landlords and another 5 per cent were investors using a mortgage for business purposes.
- The surveyed defendant households were invited to be interviewed and, if they were willing, to include contact details on the survey. This enabled a further eighteen interviews to be conducted by telephone, recorded and transcribed.
- An analysis of Supreme Court of Victoria claims to possession files, mainly in 2008.

This field research made available two types of data for analysis. The survey data provided the basis for a statistical description of the respondents and factors associated with their inability to meet their mortgage repayments. Interviewee narratives describing the events and circumstances leading to their inability to make timely repayments enabled an extended analysis of triggers and causes. The analysis below focuses on the following questions:

- Who defaults?
- What are the housing histories of defaulter households?
- What sets off mortgage delinquency?

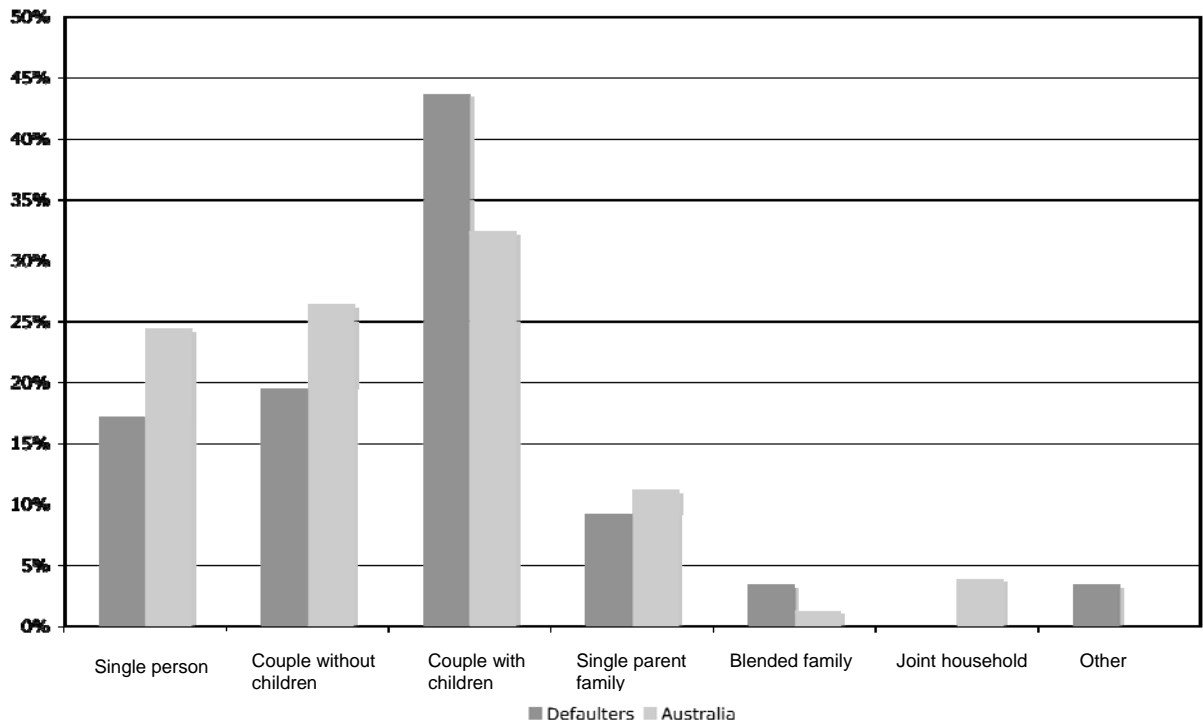
As noted in chapter 1, it was not possible, given resources and legal limitations, to draw a large unbiased sample of people in mortgage distress. The results and analysis in this and the next chapter must therefore be seen in this context.

2.1 Who defaults?

This section seeks to answer the question 'Who are the defaulters?' by presenting evidence on household composition, age and income and housing aspirations.

The household composition of surveyed defaulting households compared to household composition for Australia for the 2006 census (ABS, 2007) is presented in Figure 1. These data indicate that single-person and couple-without-children households are under-represented among defaulters compared to the population as a whole, whereas couple-with-children households are an over-represented group compared to the population as a whole.

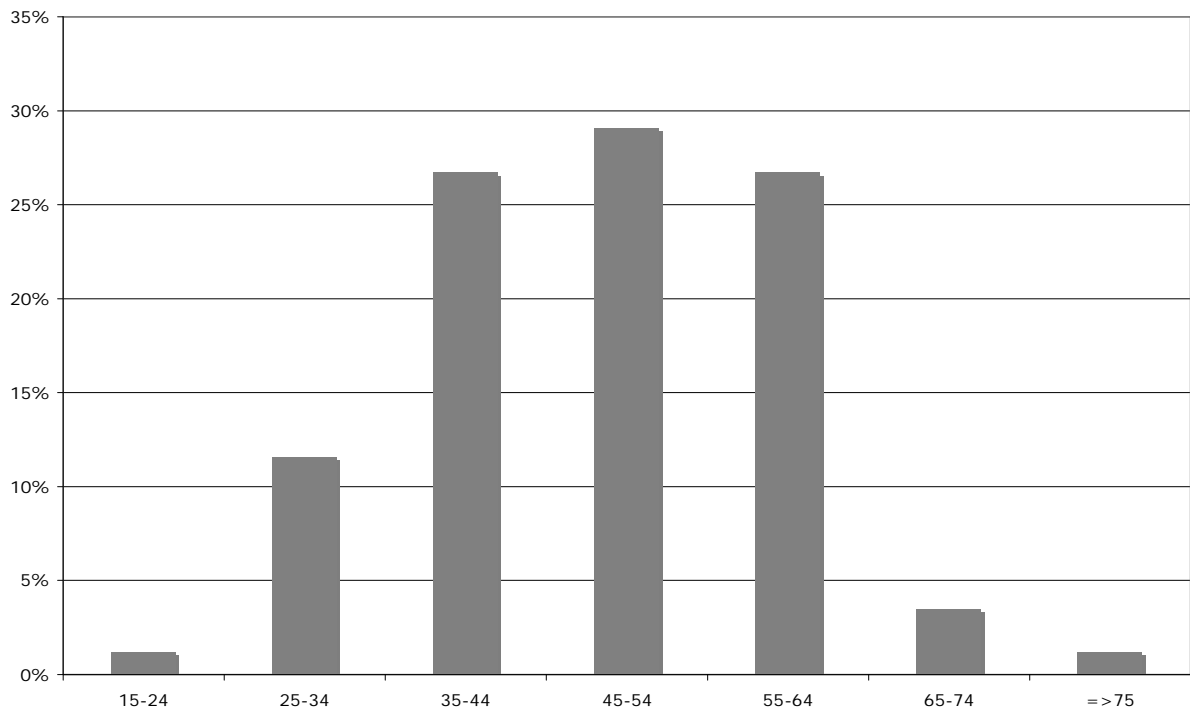
Figure 1: Defaulter households compared to all households



Source: household survey and ABS (2007)

The age profile of survey reference persons is presented in Figure 2. Of particular interest is the similarity of the profile for three age brackets: 35–44, 45–54 and 55–64 years. In the broader population home-purchaser households in the 45–64 age range are typically beginning to experience a decline in the proportion of household income used to meet mortgage payments and are moving into outright home ownership (Badcock and Beer, 2000). The factors that lay behind the mortgage difficulties of these older-person households are explored further below.

Figure 2: Age of reference person



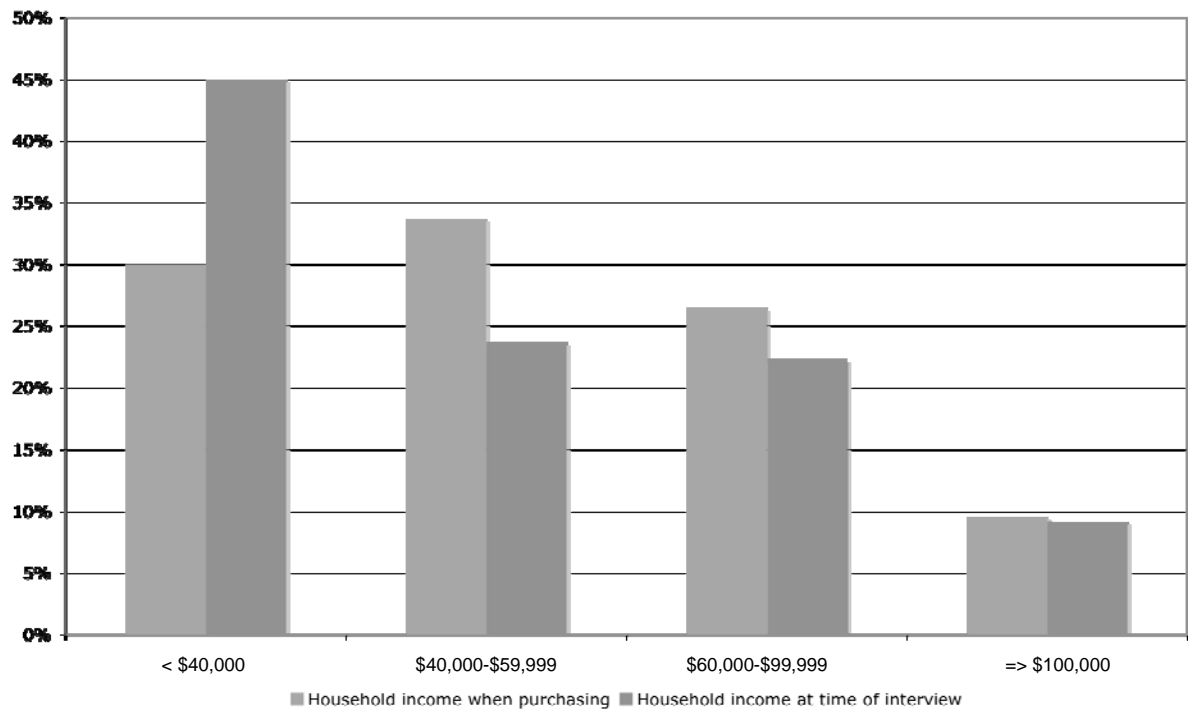
Source: household survey

The income profile of mortgage defaulters is presented in Figure 3 for two points in time. The first is household income at the time of purchase and the second at the time of interview (i.e. once the household has encountered severe problems in repaying its home loan). Two observations can be made.

First, the profile at the time of purchase shows that most defaulter households had low-to-moderate incomes. However, it is important to note that the 'time of purchase' income profile is not a single year, because it records the time of home purchase spread from before 2003 to 2008, the year of the survey.

Second, Figure 3 shows that, notwithstanding the distortion resulting from measuring income across a time period of more than 5 years, a significant minority of mortgage defaulters with initial incomes over \$40 000 p.a. had suffered a loss in income. Those households with less than \$40 000 income swelled from 30 per cent of those surveyed to 45 per cent of those surveyed. Concomitantly, the size of the \$40 000–\$59 999 group has declined from 34 per cent to 24 per cent and the \$60 000–\$99 999 group has declined from 27 per cent to 22 per cent. Therefore, not surprisingly, loss of income is closely associated with mortgage default.

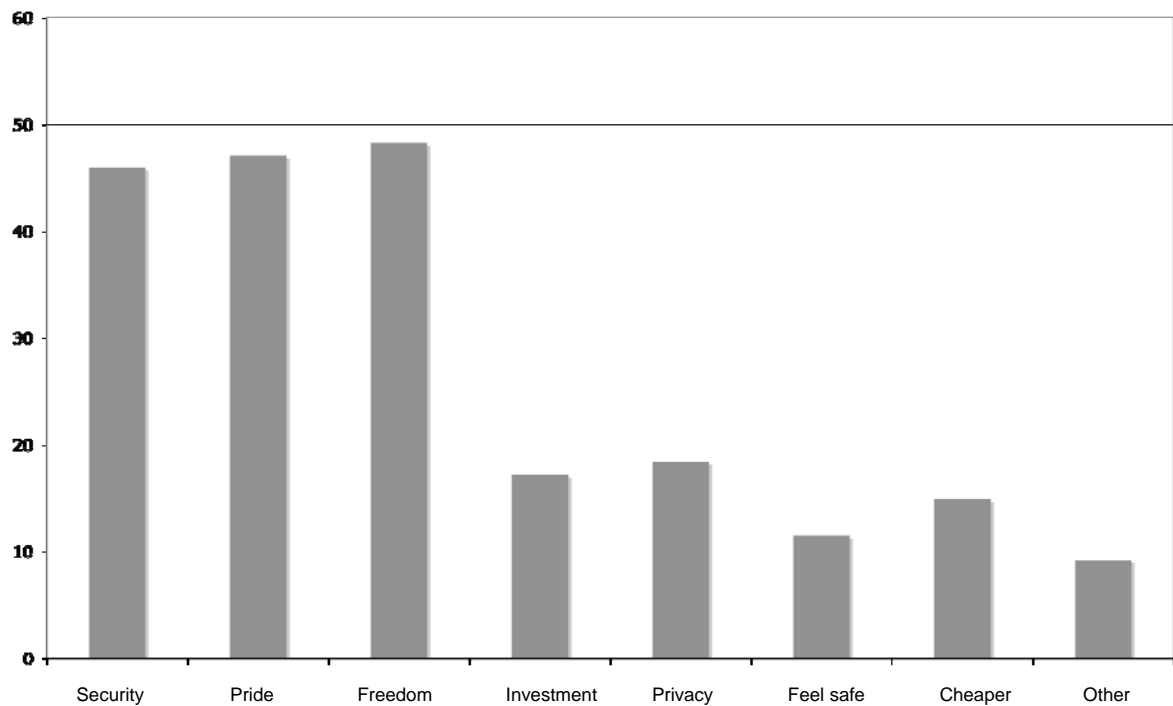
Figure 3: Household income at time of purchase and interview



Source: household survey

Survey respondents overwhelmingly expressed a familiar set of motivations for purchasing a dwelling and becoming a homeowner, as presented in Figure 4. Defaulters emphasise the usual motivations of security, pride and freedom, similar to those reported in earlier household preference studies (e.g. Baum and Wulff, 2003).

Figure 4: Reasons for purchase (per cent)



Source: household survey

These sentiments were also evident in the nine initial interviews with defaulters recruited through financial counselling services. They put into words what the survey data presented in Figure 4, and that shown in the more extensive survey data (Baum and Wulff, 2003). Australian households view permanent home ownership as the most 'secure' and 'cheapest' form of housing. These defaulters' views were formed against the background of experiencing shortages of private rental housing supply, insecurity of renters' tenure and unaffordable rents.

We couldn't get extensions on the rental we were in, we still had no where to go... there was just nothing available and it was looking like we were going to have to go to the Housing Commission.

It was ten houses in ten years. It was a lot. Like they were always sold ... we always had really bad luck.

...because of rent[al] problem[s] we had to come to this area because this is a cheaper area.

Participants also expressed their attachment to the culturally embedded value of home ownership as they spoke about attachments they formed, what was normal and how others viewed them:

... it was just a normal average home, but it was a lovely home... gorgeous ... peaceful. I love my home.

I mean part of settlement process [for migrants] is for you to own your own place, you know ... it is just a dream that everyone is entitled to have.

the house is ... brick, double brick, two bedroom, massive, massive backyard, it's got a little garage. It's just perfectly located, the end of the street, drive straight into my driveway...it's a beautiful house ... both of my neighbours I'm on first name basis with... it was ideal.

Also, as the participants faced the possibility of relinquishing their house and returning to the private rental market they expressed the same fears about uncertainty and costs in the private rental market:

if the home does go, where do we go? I mean the market at the moment... I have heard these nasty rumours that people that are bankrupt can't get rental properties because they have got a black name or something ... it is like, where do we go, where do we go?

I know too many people suffering to find a rental house because there is not many around ... The rent goes up? more than repayments now, nearly, and the repayments are too much as well.

In summary, it is clear that defaulter households are similar to most Australian households: home purchase and eventual ownership is an ideal based on their lived housing market and cultural experiences.

2.2 What are the housing histories of defaulter households?

This section presents summary data on the housing histories of defaulter households by examining:

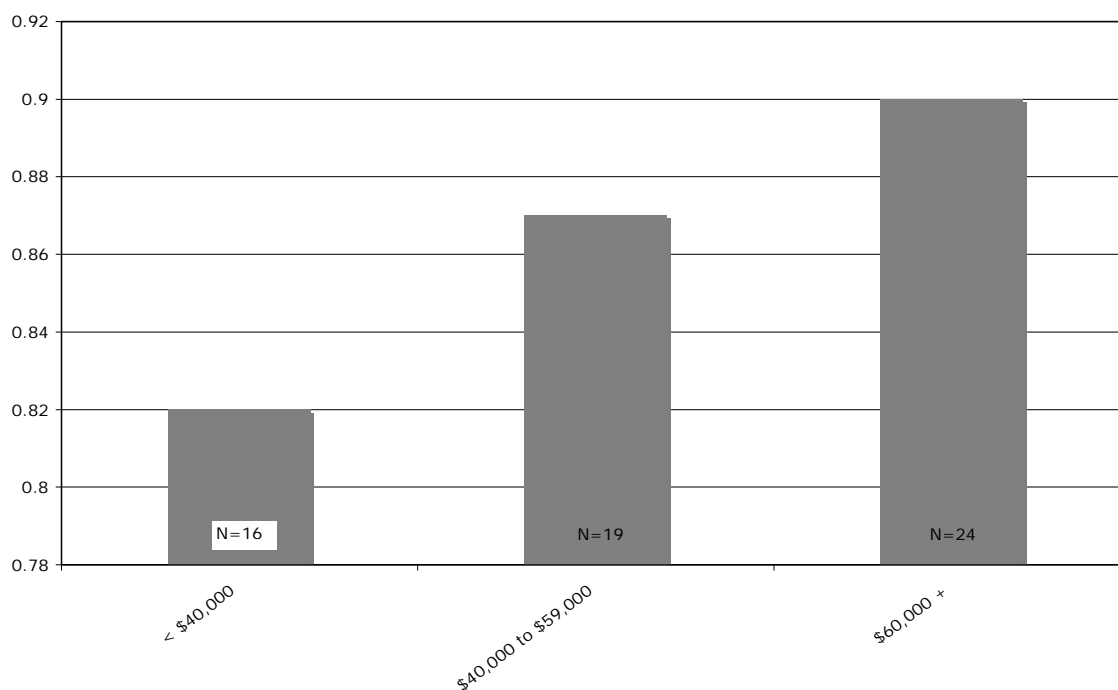
- Purchase price, mortgage size, mortgage-to-price ratios and interest rates.
- Timing of purchase.
- Timing of first difficulties in meeting payments.
- Profile of intermediaries lending to defaulters.

- Involvement of brokers in the lending process.
- Kinds of mortgages taken out by defaulters.

In a very general sense, the survey data accords with calculations of the average purchase price, average mortgage amount and the average deposit of Australian home buyers. Of course, the dwelling prices reported referred to different periods, so 'averages' cannot readily be compared to annual national price, mortgage and deposit data. However, with this limitation in mind, the 'average' dwelling purchase price was \$244 000, 'average' mortgage was \$203 000 and the 'average' deposit was \$50 000.

The mortgage-to-house price (loan-to-value) ratio (LVR) is a particularly important indicator for an analysis of housing affordability and assessment of household default risk. These data support the presentation of mortgage-to-price ratios in a number of ways. First, the data suggest that the average LVR remained consistent. The median was 0.90 for both those who took out a mortgage before 2003 and the post-2003 group, suggesting some consistency in the aggregate LVR for defaulters across time. The data also reveals that defaulter households, by and large, start with some equity in their dwelling and hence did not take out 100 per cent loans. Figure 5 shows that the lower the household income, the greater is the starting equity as a proportion of price. Presumably this reflects the normal risk assessment of lending institutions.

Figure 5: House price and mortgage ratio (median)

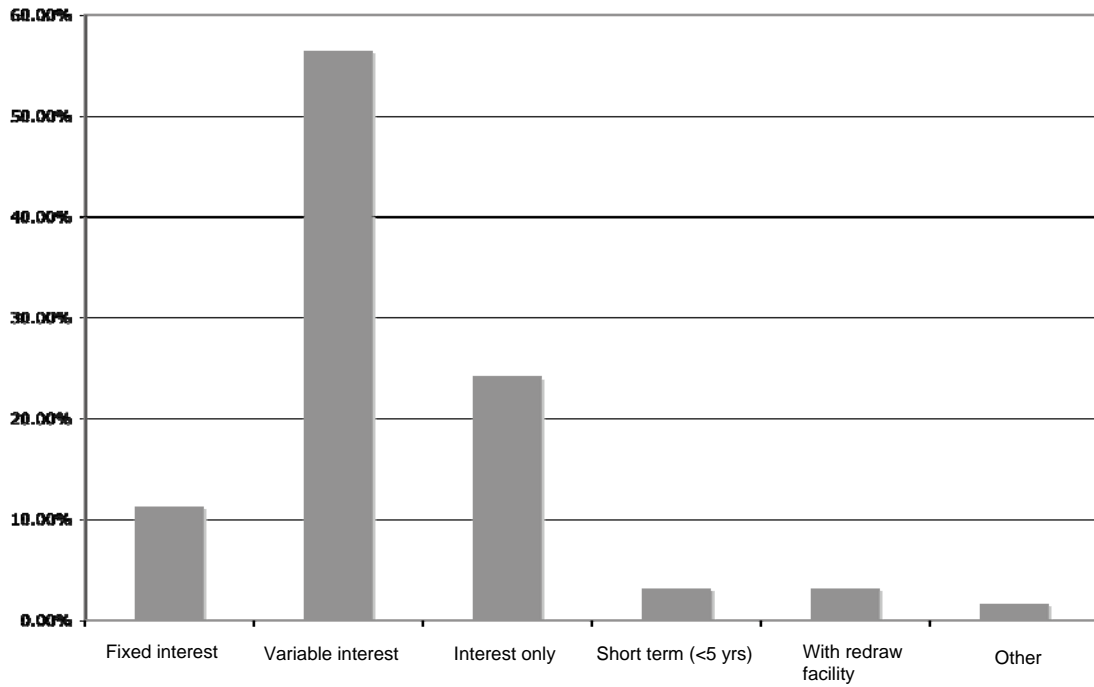


Source: household survey

Exposure to increasing interest rates is another particularly important factor for an analysis of affordability and assessment of household default risk. Figure 6 indicates that approximately 60 per cent of households had obtained variable interest rate loans. Further, as Figure 7 indicates, they were exposed to increases in interest rates. The variable bank rate rose from 6.55 per cent in 2003 and peaked at 9.60 per cent by mid-2008. However, even more significantly, it appears that defaulter households are, on average, paying well above the prevailing interest rate. Figure 7 also presents available interest rate data (mean interest rate) for defaulter households in the Victorian Supreme Court claims for possession records. This data indicates that the

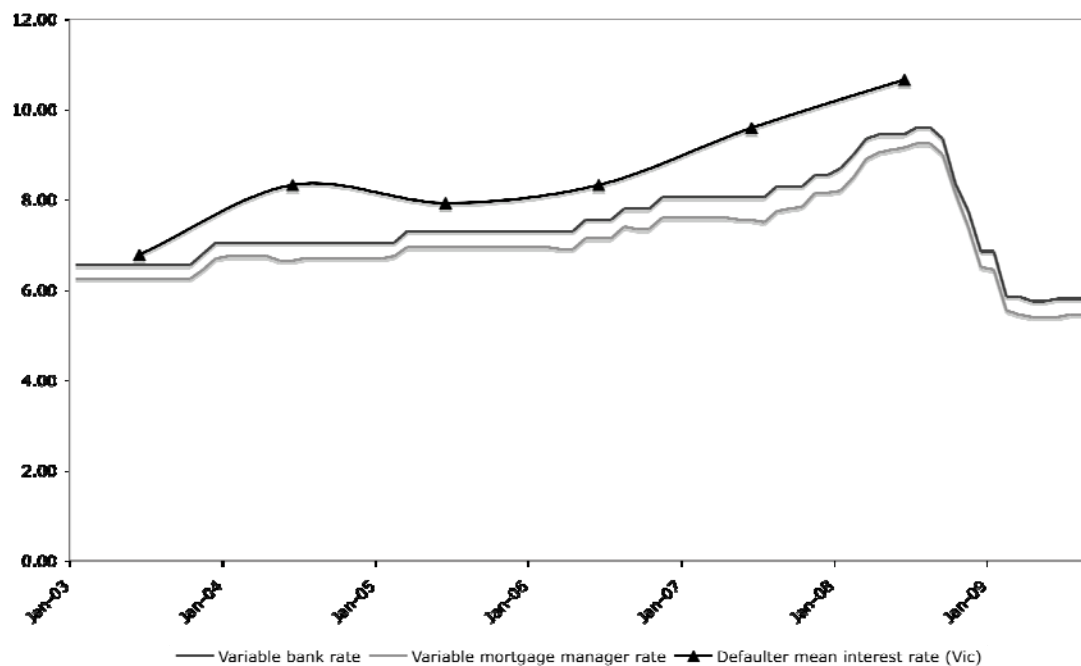
interest rate paid by defaulter households had been consistently significantly above the non-bank and bank variable home loan rates. Presumably these households were judged at the time of the original loan, or at some other point in the life of the loan, perhaps at the time loans have been refinanced, to have a risk profile requiring an increase in the interest rate. These higher rates may have then contributed to decreasing affordability and eventual delinquency and default.

Figure 6: Type of home loan



Source: household survey

Figure 7: Home loan interest rates 2003–08



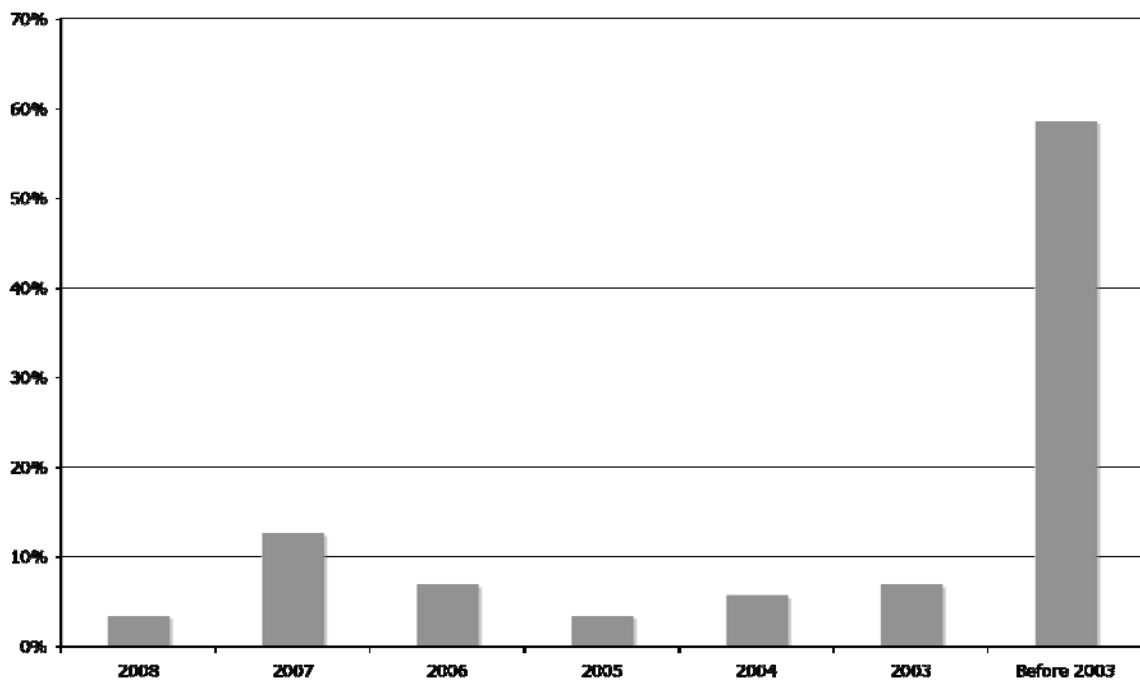
Source: Reserve Bank of Australia (2009c) and Victorian Supreme Court claims for possession records

The temporal dimension of mortgage default among the survey respondents, shown in Figure 8, indicates that nearly 60 per cent of the household survey group had purchased over 5 years before receiving a claim to possession on their homes. In other words they appear overwhelmingly to be ‘well-established’ purchasers.

However, Figure 9 indicates that they may also have been experiencing difficulty in meeting repayments for some time. This figure indicates a steady movement into the ‘difficulties with repayments’ category: 15 per cent within 6 months, 17 per cent between 6 months and 1 year, 17 per cent between 1 and 2 years and 13 per cent between 3 or more years. Another group, 32 per cent of households, only experienced difficulties in making repayments after 3 or more years. These data suggest that defaulter households can experience initial difficulties in making payments a considerable time after purchase. For Australia overall, RBA (2009a: p. 55) data suggests that recent borrowers have fallen into mortgage arrears more quickly than earlier borrower cohorts.

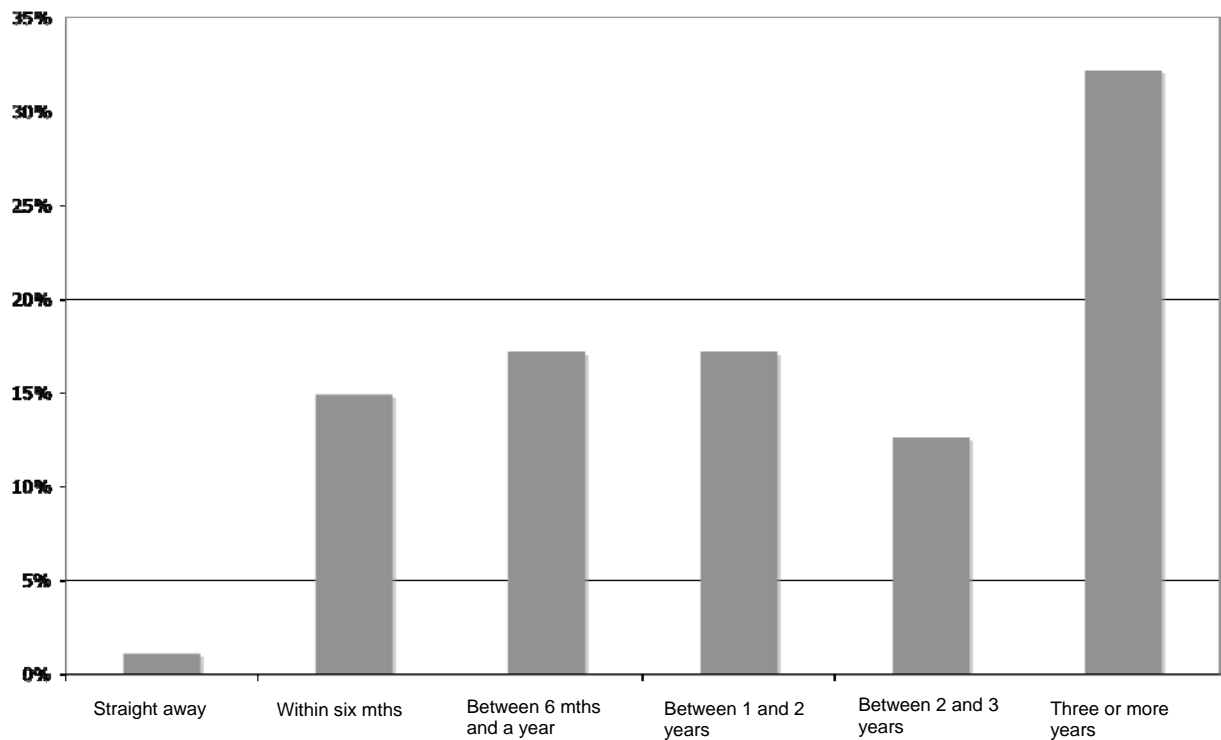
However, another clue as to what may be happening can be detected by examining the median LVR for each of the cohorts shown in Figure 9. In the case of the ‘within 6 months’ cohort the LVR was 0.97 and decreased, with the exception of the ‘between a year and 2 years’ (LVR=0.98) cohort, to 0.82 for the ‘3 or more years’ cohort. Households with the shortest time before experiencing difficulty in making payments were the most extended (had the highest LVRs). Concomitantly the cohort that had the longest time before experiencing repayment difficulties, more than 3 years, were the least extended, having the greatest equity and lowest LVRs. This latter trend may also have reflected rising dwelling prices during period of ownership.

Figure 8: Year of purchase of dwelling



Source: household survey

Figure 9: Time since purchase to difficulty in meeting repayments



Source: household survey

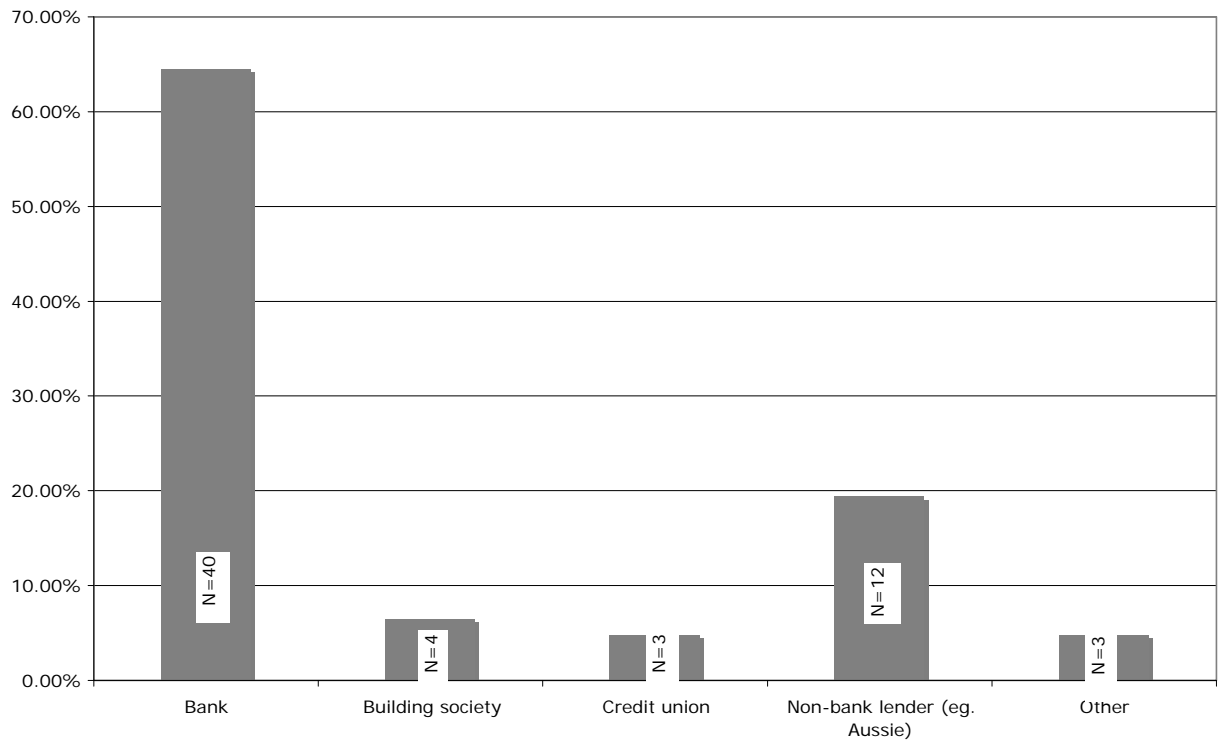
Is there any particular association between defaulters and different types of mortgages? The short answer is that there is a definite association. Further, it is apparent in data from two different sources: the survey and an analysis of the Victorian Supreme Court claims of possession files.

The survey data on the share of loans provided to mortgage defaulters by different types of mortgagees is presented in Figure 10. These percentages are then compared to the broader pattern of lending for all owner-occupier purchasers available from RBA data for 2007 (Lowe, 2008: p. 86)². The comparisons are presented in Table 2.

For defaulters, only 66 per cent borrowed from banks, whereas 80 per cent of all owner-occupier purchasers borrowed from banks. For defaulters, 21 per cent borrowed from mortgage originators compared with only 12 per cent of owner-occupier purchasers. For defaulters 13 per cent borrowed from building societies and credit unions whereas only 8 per cent of owner-occupier purchasers did so. In short, there is a significant difference between the profile of intermediaries lending to mortgage defaulters and the broader population of owner purchasers. For the broader population, banks are most important and mortgage originators have a lesser role, whereas for mortgage defaulters mortgage originators play a more important (though still minority) role.

² Mid-2007 was chosen as a point of comparison as this was the period before the effect of the GAFF resulted in a dramatic shift between categories of mortgagees in the share of owner-occupier loan approvals.

Figure 10: Type of lender



Source: household survey

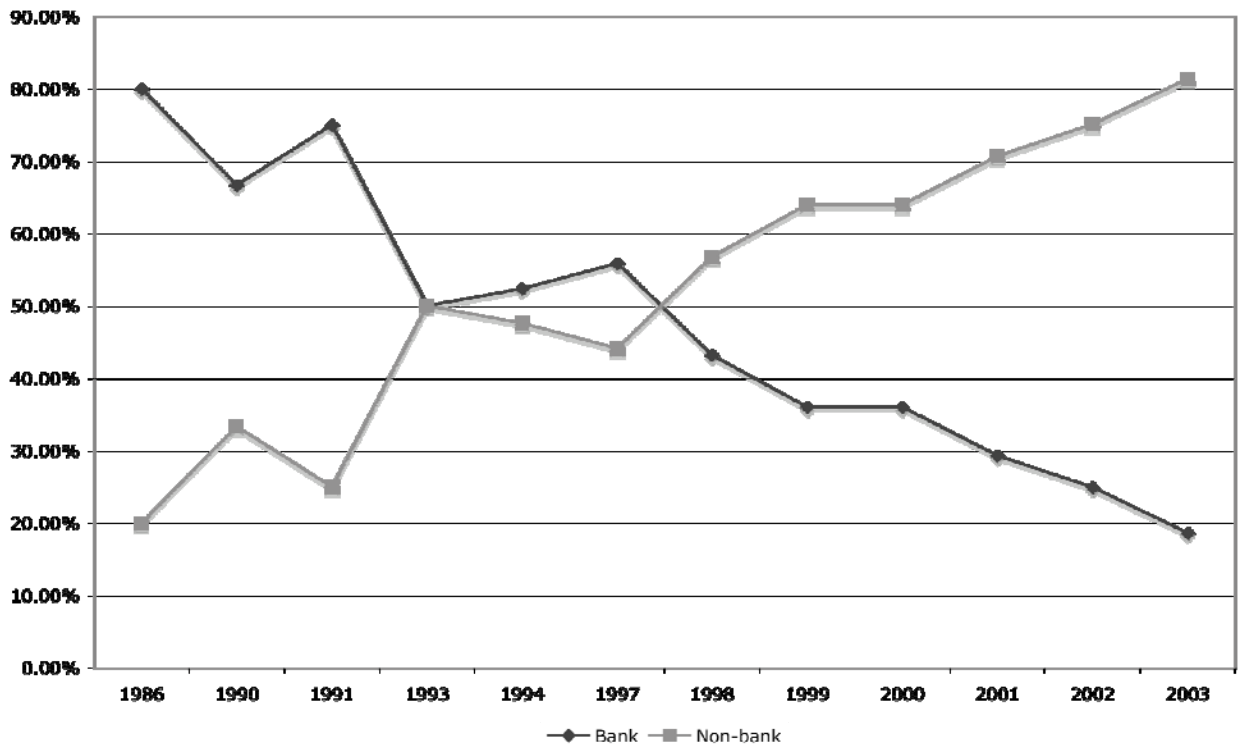
Table 2: Provision of loans to defaulter and owner-occupier households

<i>Lender</i>	<i>Mortgage defaulters</i>	<i>All owner-occupier purchasers</i>
Banks	66	80
Building societies and credit unions	13	8
Non-bank lender	21	12

Source: household survey and Lowe (2008)

Supreme Court of Victoria claims of possession files extracted in December 2008 provided the basis for a time-series trend analysis of mortgagee categories who had taken defaulting borrowers to court. Figure 11 presents this data in just two categories, bank and non-bank lenders. Mortgage originators, building societies and credit unions have all been categorised as ‘non-bank lenders’. The trend between 1986 and 2003 of an increasing association of non-bank lending with court action taken against mortgage defaulters and a corresponding declining association with bank lending is demonstrable.

Figure 11: Bank and non-bank lending to borrowers in receipt of claims of possession (Victoria)³



Source: Supreme Court of Victoria data

RBA data also point to the significantly higher rate of mortgage arrears on loans made by non-bank, as opposed to bank, lenders (see RBA 2009b: p. 53).

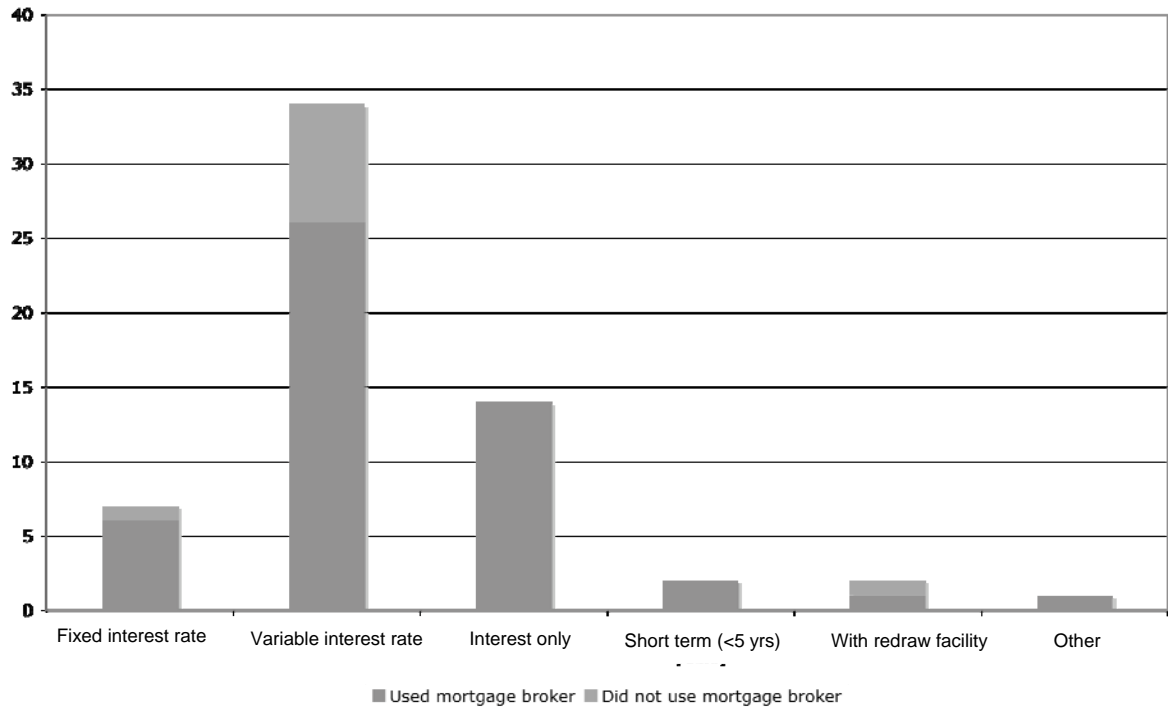
Mortgage brokers are a relatively new type of financial intermediary in the Australian housing finance market. They are engaged by borrowers to advise them on comparing the costs and features of different loans and lenders. During 2003–06 they increased to account for around 45 per cent of lending by early 2007, but subsequently declined to around 36 per cent in the first quarter of 2008 (Australian Mortgage Industry 7 (2008: p. 4). Brokers have generally been paid by lenders rather than directly by the borrowers to whom they provide a service. Information on the presence of such brokers was sought in this survey because the Australian Prudential Regulation Authority (APRA), financial counsellors and others have drawn so much attention to brokers that the federal government is now legislating to license them and regulate their activities. Among other criticisms, APRA found that ‘some lenders were less diligent in verifying borrower information on broker-originated loans than they were on branch-originated loans’ (RBA and APRA, 2007: p. 6).

The survey results indicate that mortgage brokers had a significant presence in establishing loans for householders who subsequently defaulted. We found that 78 per cent of respondents said that they had used a mortgage broker, and only 22 per cent had not. Figure 12 presents data on the types of loans of defaulters who used mortgage broker services and those who did not. While mortgage brokers have definitely been more involved with arranging loans to borrowers who subsequently

³ The total number of cases represented in Figure 11 is 1487. For banks the number is 463 and for non-banks 1024.

defaulted, the association might be mainly circumstantial rather than simply causal. We know that mortgage brokers have fomented ‘industry churn’, i.e. refinancing, which most defaulters pursued in an effort to manage or ease their difficulties (Australian Mortgage Industry 7, 2008: p. 4). At the same time concerns with brokers encouraging borrowers who were not in a strong position to take on the loans that borrowers arranged for them is indicated in our data.

Figure 12: Use of mortgage brokers by loan type



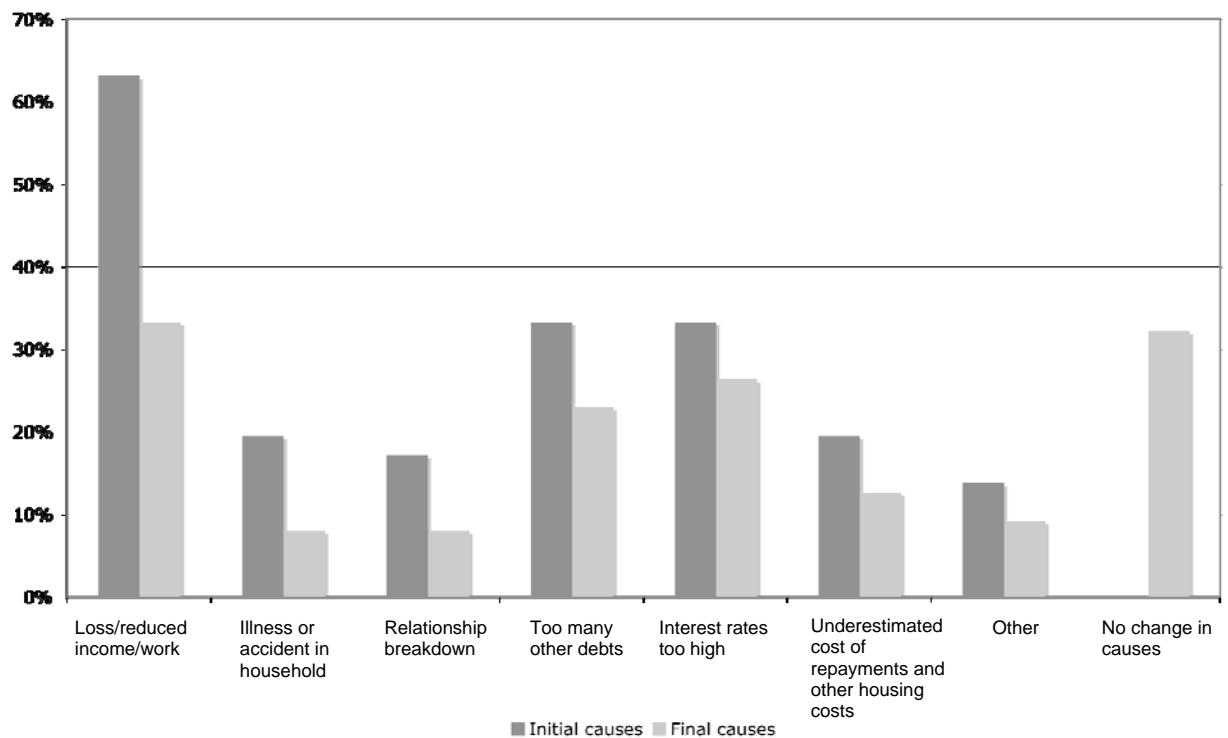
Source: household survey

2.3 What sets off mortgage delinquency?

In this section the focus is on the specific triggers, or causes, that result in households being unable to meet their mortgage repayments. In the survey, respondents were asked: ‘What were the initial causes of missing mortgage repayments?’ Because we were aware that household circumstances could change, and therefore, the causes might change over time, respondents were also asked: ‘If the causes changed over time, what were the final causes of missing mortgage repayments?’ Respondents were able to identify more than one cause in a range of possible causes. We also sought to find out about triggers of mortgage default through interviews.

Figure 13 presents data on the answers to the two survey questions. Among the ‘initial causes’, the ‘loss of work and income’, closely followed by ‘too much debt’ and ‘interest rates too high’ stand out. However, ‘illness or accident in the household’, ‘relationship breakdown’ and ‘underestimated costs of repayments and other housing costs’ are also significant. The data presented for ‘final causes’ compared to ‘initial causes’ suggests that causes did not change a great deal in relative terms over time. Further, 32 per cent of respondents stated that there was ‘no change in causes’.

Figure 13: Initial and final 'causes' for missing mortgage repayments



Source: household survey

Interviewees also referred to the same causes and summaries are presented in the following tables based on a review of the transcripts of interview. These interviews were conducted with the initial group of defaulters recruited through financial counselling services and the follow-up interviews with survey respondents. In each interview all contributing causes were identified and a judgment made as to which was the principal cause that led the household into mortgage delinquency. The titles for Tables 3 to 7 indicate the main causes and a summary of the way this cause played out for these households (shaded). Other contributing causes are also indicated. *It must be stressed that the names listed in the tables and text are fictitious and are not the real names of the interviewees; the names have been changed to preserve interviewee confidentiality.*

As can be observed in these tables, typically more than one thing went wrong in the lives of households who fell into mortgage arrears. These different events and processes became connected and intertwined, 'shocking' the finely balanced financial and relational household arrangements. For a few interviewees there was just one cause but for most the causes were multiple and the stories were more complicated.

Immediately following each table is one case presented in detail using verbatim comments drawn from the transcripts. These accounts demonstrate the complex ways in which payments are missed and households move toward default and legal (re)possession.

Among the causes, 'interest rates too high' was the only one that was not identified in the interview transcripts as a principal cause and therefore does not feature in a separate table. Among interviewees recruited through financial counselling services and the follow-up interviews with survey respondents, 'interest rates too high' was sometimes an issue and is shown in the tables, but in no case was 'interest rates too high' given as the principal cause of default. Other issues were always more

important. However, as variable mortgage interest rates are set to rise through late 2009 and 2010, this situation may change.

Table 3: Loss of, or reduced, employment income as the principal cause of mortgage delinquency

<i>Defaulter</i>	<i>Loss of, or reduced employment income</i>	<i>Illness, accident or disability in the household</i>	<i>Relationship breakdown</i>	<i>Too many other debts</i>	<i>Interest rates too high</i>	<i>Underestimated cost of monthly repayments and other housing costs</i>
Anita, husband and child — couple purchaser	Anita loses job when she discloses that she is pregnant and husband's income fluctuates seasonally			Debt after sale of first house met by Anita's parents		
Brian — single owner (inherited??) with new mortgage debt	Transport industry worker who experiences periods of unemployment	Diagnosed with chronic heart disease	Difficult relationship with brother who seeks share of inheritance	Debt increases during periods of unemployment	Interest rate on RAMS loan is high compared to average rate	
Greg, wife and new child — couple purchaser	Greg moves involuntarily from secure wage work to irregularly paid sub-contract work	Wife loses Disability Support Pension because she recovers from depression after birth of child			Interest rate and repayments went up after 'honeymoon' period	Did not anticipate the increase in repayments
Valerie and husband — new purchasers	Husband's hours of work are reduced, but Valerie is developing a home-based business which is helping			Remaining debt from house purchased on vendor terms (now vacated and house returned to vendor)		
Andrew — single purchaser (once separated)	Unemployed for 12 months and then re-employed on a lower salary		Marriage broke down a few years ago — Andrew bought out his wife's share of	Andrew bought an investment property after receiving a small inheritance and used his equity		

		house and also provides child support	in his house as security and could not meet repayments once unemployed
Michael, wife and children — purchasers	Slump in apartment construction leads to loss in income for plastering business		Debts increased for extension of house and purchase of vehicles

Greg and his wife purchased their new house in the outer suburbs of Melbourne in 2005 and by November 2008 they had moved out and the bank had repossessed it. A mortgagee auction was held in April 2009. Greg's wife described the process:

we'd been in negotiations with them on and off and we'd made arrangements to pay it back, but we just couldn't keep up with them ... And then, when we really fell behind, it was like the eviction notice came and it was sort of three or four weeks before we had to move out.

The principal reason for their difficulty in meeting mortgage payments was Greg's labour market experience. His problems started 12 months before foreclosure when the company he was working for was restructured:

he was working for one guy and then he went out with another one, who split the company, split [it] in two and he had to make a choice ... he made the wrong one of who to go with.

Greg was then paid irregularly for his work. His wife explained:

Yeah, he was having trouble getting paid money ... cos he was a sub-contractor, and they were expecting him to work but only paying him in dribs and drabs so we sort of fell behind ... it was just like this vicious circle, like if you didn't get paid, you didn't make payments

This drop in income was exacerbated by a loss in government benefits. Greg's wife had been severely depressed and was receiving a Disability Support Payment (DSP), which was included as family income at the time the mortgage was established.

they had his payslips and ... I was on disability, so at that stage we could ... I don't think there was any discussion about what happens if I was taken off it.

However, she overcame her depression following the birth of their child. As she said: 'The best thing I did was have Alan, the little one. That cured the depression, because the focus [was] off me'. However, her DSP payments were stopped: 'suddenly everything just dipped, it just went...out the window'. She considered going back to work. However: 'we've looked at that and by the time you pay for childcare and me working, it wouldn't be a viable option'.

In addition to this decline in income, the interest rate and repayments increased:

it was fixed for a while. And then as soon as it came off the fixed it went up, I think that was a bit of a problem.

In sum, Greg and his wife's mortgage default was principally due to Greg's loss of employment income, coupled with his wife's loss of benefit and an interest rate increase.

Table 4: Illness, accident or disability in the household as the principal cause of mortgage delinquency

<i>Defaulter</i>	<i>Loss of, or reduced employment income</i>	<i>Illness, accident or disability in the household</i>	<i>Relationship breakdown</i>	<i>Too many other debts</i>	<i>Interest rates too high</i>	<i>Underestimated cost of monthly repayments and other housing costs</i>
Judy – young single purchaser	Leaves job as a warehouse labourer then gets new lower-paid delivery job	Diagnosed with chronic depression		Began using credit cards and lost control	Increase in repayments due to interest rate increases	
Naomi, husband with dependant child – couple purchasers	Low-paid job as a teacher's aid	Husband was a drug dealer who died from an overdose	Naomi thought that homeownership would help make her husband more responsible	Husband ran up large credit card debt		
John – young single purchaser	Suspended from job as a factory process worker and then loses job	Industrial accident results in John being disabled that makes it difficult for him to find new job		Increased personal debt before accident and increased credit card debt after unemployment		
Emma, husband and child – couple purchasers	Husband unemployed previously resulting in first refinancing	Emma's cancer leads to job loss then part-time work and husband loses work to care for Emma.	Earlier relationships – Emma not receiving child support for child, husband pays child support for another child	Increased credit card debt during period of Emma's illness		
Emily and partner – couple purchasers	Emily, who was in well-paid job, cannot return to work and partner is	Child has disability and care responsibilities prevent Emily from	Relationship between Emily and partner break down following birth of	Increased use of credit cards following loss of employment		

	in low-paid insecure work	working	disabled child
Lucy and child – purchaser	Was in well-paid professional work, now re-establishing in self-employed part-time work	Diagnosed with chronic depression and employment terminated	
Anna and two children – purchaser	Lost part-time work which supplements pension	Disability from car accident limits labour market participation	Single mother caring for two children without child support from father

Judy was a single person in her 30s who was earning 'good money' from a warehouse job who decided to buy a house:

I thought like, people would be proud of me and 'oh you've got a house and good on you'. And the perception is like, it's easy after a couple of years, three or four years. Payments get easier.

Judy had found the house and was offered a 100 per cent loan:

They [mortgage lender] say, you can get \$250,000 because you've got a good job, you're earning – like I was taking home like nearly \$60,000 a year. So, he said, 'Don't worry about your deposit', and whatever.

Her transaction costs were covered by a 'first home owners scheme' grant and a loan from relatives. The fortnightly payments were a manageable \$550 per fortnight. However, following a number of interest rate increases, the repayments were approximately \$800 per fortnight. Further, Judy had a long history of regularly assisting members of her family meet their commitments.

Judy's problems stemmed from pressure that she experienced after she had purchased the house:

I just worked in a warehouse. Normal, mundane, six days a week. I had a lot of overtime. All I did was go to work and go home and go to sleep. I had no social life, hardly any friends. It was just work, work, work and I just grew tired of it.

Judy left her job working in a warehouse 'voluntarily', 6 months after she had purchased her house. This decision was closely associated with depression:

I suffer depression. And once I make my mind up that is it. I walked into work one day and I said, 'I've finished' and walked out and I never returned. ... Well it runs through my family.

Judy left work with a payout of about \$8000 and subsequently drew down some of her superannuation that she used to meet debts. However, she lost control:

I was so depressed after I left that I just had six months off and I didn't work. I just, hide my problems, go to sleep. I mean I don't drink, I don't do drugs ... after I left my job my credit cards went [phew] way out control. I'm so much in debt.

In sum, Judy became a home owner, experienced the pressure of increasing interest rates and was shortly after disabled by depression. At the time of the interview, mid-2008, the house was to be auctioned the following week.

Table 5: Relationship breakdown as the principal cause of mortgage delinquency

<i>Defaulter</i>	<i>Loss of, or reduced employment income</i>	<i>Illness, accident or disability in the household</i>	<i>Relationship breakdown</i>	<i>Too many other debts</i>	<i>Interest rates too high</i>	<i>Underestimated cost of monthly repayments and other housing costs</i>
Trevor, wife and children – purchaser			Relationship breaks down. Trevor leaves and mortgage repayments stop. Court-ordered sale clears all debts.			
Ginny, husband and children – purchaser			Domestic violence leads to Ginny and children moving out to rental house, imprisonment of husband and repayments stopping.			
James, wife and infant twins – purchaser	Cannot work because of injury but hoping to re-enter workforce	Ill health and surgery after a work-related injury results in inability to work	Relationship breaks down. Wife and children leave. James pays mortgage and child support.	Credit cards used to meet on-going commitments and debt accumulates		
Margaret – purchaser			Refinanced in order to support a daughter (living independently) and children who were getting out of an abusive relationship			Margaret did not recognise that payments on the new loan did not leave enough for her to live.

Trevor and his wife bought a small existing suburban house in 2000 for \$100 000 and later borrowed another \$60 000, which they used to enlarge the house. Trevor was, and continues to be, securely employed with a public sector authority on a wage of about \$45 000. His wife left the workforce and stayed at home to look after their two children.

The relationship then broke down. Trevor says: 'I moved out of the house and I was basically forced to [by] the ex-wife'. The relationship deteriorated even further:

It got really ugly and I just could not even speak to her in the end. So it was – yeah, it was hard. There was no communication at all. If there was, it was just abuse. Well, so much so, that I had to get an intervention order against her.

Initially Trevor kept up all the payments. In the early stages this was possible because he was living rent-free. However, as time went on, he found that he could not keep up the mortgage payments and other outgoings, such as rates. A significant factor in his inability to meet the costs associated with maintaining the family home was the requirement that he pay 27 per cent of his gross income as child support.

Trevor's first attempt to resolve the situation was to try to transfer all responsibility for the house to his wife:

See, I wasn't living in the house for quite some time. And I just kept telling the bank that look, I know it's half in my name, but I don't live there anymore. And they were basically saying to me well that's bad luck, you're still on the title. I said I want to get off the title and they said you can't unless you sell it.

In the context of the complete breakdown in communication between Trevor and his wife, Family Court intervention was the only way the situation could be resolved. The court ordered that:

the real estate agent was to sell the house, was to take the first offer. And then there was, you know, like 20 other clauses in the court orders pay – to pay out all the joint debts. But the number one thing was sell the house.

Ultimately the house was sold and the mortgage repaid to the bank and there was sufficient left to meet the other costs associated with the divorce and sale of the house.

In sum, the failure of Trevor and his wife to maintain mortgage payments was due to the single cause of complete relationship breakdown.

Table 6: Too many debts as the principal cause of mortgage delinquency

<i>Defaulter</i>	<i>Loss of, or reduced employment income</i>	<i>Illness, accident or disability in the household</i>	<i>Relationship breakdown</i>	<i>Too many other debts</i>	<i>Interest rates too high</i>	<i>Underestimated cost of monthly repayments and other housing costs</i>
Raman, wife and family – purchasers	Retail business failed and Raman went back to driving taxis			Business loan was secured against the house at a high interest rate		
Colin, wife and children – purchasers	Strain of work associated with servicing the debt leads Colin to close business down and return to normal professional work		Marriage breakdown and Colin leaves the family home	Business loan secured against the house plus other debt, all in the wife's name		
Wendy – almost outright owner				Wendy refinances house, lends money to son for business, which fails. Wendy's pension insufficient to cover repayments	Bank refuses loan on Wendy's pension income so refinancing done at higher rate from mortgage lender	
Phillip – purchaser	Business fails due to poor location and poor support from the franchisor		Marriage breakdown results in Phillip buying out his wife's share in the family home	Phillip purchases a retail business through a franchise using his equity in the house as surety. The business fails.	The finance for the business was organised through a finance company at high interest rate.	
Kerry and husband – purchasers	Economic downturn results in loss of	Husband diagnosed with long-term		Husband borrows against the house		

income for main business	degenerative illness	to establish another business which fails	
Jenny and husband – owner		New mortgage on home to invest in rental property – fraud results in no property and extensive debt	

Wendy was a recent widow on an aged pension who had a remaining mortgage of about \$50 000. Her husband had died shortly after they had increased the mortgage by about \$20 000 up to \$50 000 and used the money to support a daughter through a training program, repair the house and purchase a car. Wendy had four children and one 22-year-old daughter still living at home. The repayments on the loan were manageable. As Wendy stated:

I was paying \$250 a month then, so that was okay, actually I think it might have been a little bit more than that, it was \$200 a fortnight so I was paying \$400 a month, roughly that anyway.

This was the situation when one of her sons asked her for assistance in financing a business. Wendy agreed to support him through further equity withdrawal and an agreement that he would assist in repaying the loan with business proceeds. The first approach for equity withdrawal was to the existing bank mortgagor. The request for further withdrawal of equity was declined. Wendy, guided by her son, then approached a mortgage lender who agreed to take over the mortgage and provide a further \$80 000 of equity withdrawal through the provision of an interest-only loan. The \$80 000 was passed through to her son's business.

The problem was that the son failed to make regular payments:

my son, although he had the business, he had no income coming in from that business and my only income was a pension which was just on \$1000 a month and the payments were \$970 a month or something similar. He gave me \$1000 and that was all that I got from him towards the payments and I struggled and tried to get it but I just couldn't manage.

In this context Wendy:

kept hoping for a miracle to happen and they just don't happen... I'd gotten behind in everything else in all other payments and everything and I just couldn't catch up with everything.

Then Wendy found out later that the mortgage lender knew more about her son's financial history than she did:

why did they loan me that money knowing that my son had had trouble before financially and had had the problems with them which at the time I was unaware of completely?

The outcome was that Wendy was forced to sell the house and repay the mortgage.

The sale price of \$170 000 enabled Wendy to repay the mortgage, meet costs, repay other small debts and invest a remaining \$10 000.

In sum, Wendy, motivated by family ties and loyalty, agreed to become a guarantor for her son's business debt. The financial intermediary acted dishonestly by not disclosing what they knew about her son and allowing her to guarantee debt with levels of risk that was well beyond her capacity to assess.

Table 7: Underestimated cost of monthly repayments and other housing costs as the principal cause of mortgage delinquency

<i>Defaulter</i>	<i>Loss of, or reduced employment income</i>	<i>Illness, accident or disability in the household</i>	<i>Relationship breakdown</i>	<i>Too many other debts</i>	<i>Interest rates too high</i>	<i>Underestimated cost of monthly repayments and other housing costs</i>
Tony, wife and two teen children – purchasers	Tony and wife in continuing low-income employment in community services					Committed to an over 100% loan, which absorbed most of their income

Tony and his wife were long-term renters earning a low-to-moderate household income from jobs, one part-time, in the community services and health sectors. They were supporting two teenage children at school and were very keen for them to continue through to tertiary education. They were immigrants who thought that home ownership was important. As Tony said:

part of settlement process is for you to own your own place, you know. It is something, it is just a dream that everyone is entitled to have.

This was the background for a chance visit by Tony and his family to an outer suburban display village during a weekend drive to watch a soccer match. The sales people presented 'beautiful arguments in favour and very beautiful pictures' and explained how it was possible for them to become home purchasers and live their dream:

But, look, we got into this negotiating with these guys and they put it in a beautiful way and it appears to be so nice and the loan was not even 100 per cent, it was over that. It was more than 100 per cent loan because we didn't have any savings, we didn't have anything. We just had an income that we had, plus some debt that you accumulate.

These discussions led to Tony and his wife agreeing to purchase a new home. However, Tony looked again at the figures and began to doubt whether they could afford what was being offered:

I woke up and I realised that this cannot be true. I mean, we are not going to be able to pay this. It was, the monthly amount was nearly both wages together and then we started – well hang on, what about food, what about school, what about this, what about that.

The problem was that Tony had signed documents and they were well into the purchase process. Nevertheless, Tony was insistent that they withdraw. The company then pressed for the sale to continue and pursued their legal options to conclude the exchange. Tony sought out financial counsellors whose advice was that they could not obviate the contract but did have the option of declaring themselves bankrupt:

So we discuss in the family and we believe that at that point in time, this needs to stop and we need to get some help to actually see if you can reach that life in this country. So we applied to bankruptcy and we went to bankruptcy.

In sum, Tony and his family underestimated the cost of monthly repayments and other housing costs. They did this against the background of renting, the dream of home ownership and the high-pressure techniques of sales people selling the dream.

2.4 Conclusion

These cases suggest that defaulting on a home loan is generally the result of many factors, not just one, even though we have highlighted key factors. In most cases those interviewed and surveyed had run up many other debts, especially on credit cards, often to 'alleviate' or manage the mortgage debt, a situation that ultimately in these cases often made things worse. Many had refinanced for the same reasons. Thus there was a downward spiral, a sense that their financial situation was completely out of control. Nine of the interviewees were recruited through financial counsellors, but even this cohort illustrated a characteristic tendency to avoid or neglect seeking financial advice early on when there might have been more options available that would lead to more favourable outcomes for the borrowers.

3 CONSEQUENCES OF MORTGAGE DELINQUENCY

In the previous chapter the focus was on the causes leading to households not being able to meet their regular mortgage commitments. The evidence presented showed that sometimes there was an unambiguous cause. However, more often the causes were multiple and connected. This chapter presents evidence on the consequences for households defaulting on mortgage repayments. As in chapter 2, the survey data provide the basis for a statistical description of the consequences and the interviewee narratives describe such consequences.

The analysis is presented below in response to the following questions:

- What were the initial actions and consequences of inability to meet mortgage repayments?
- What were the consequences for dwelling and household finances of mortgage delinquency?
- What are the anticipated longer-term housing implications of mortgage delinquency?

3.1 Initial consequences of inability to meet mortgage repayments

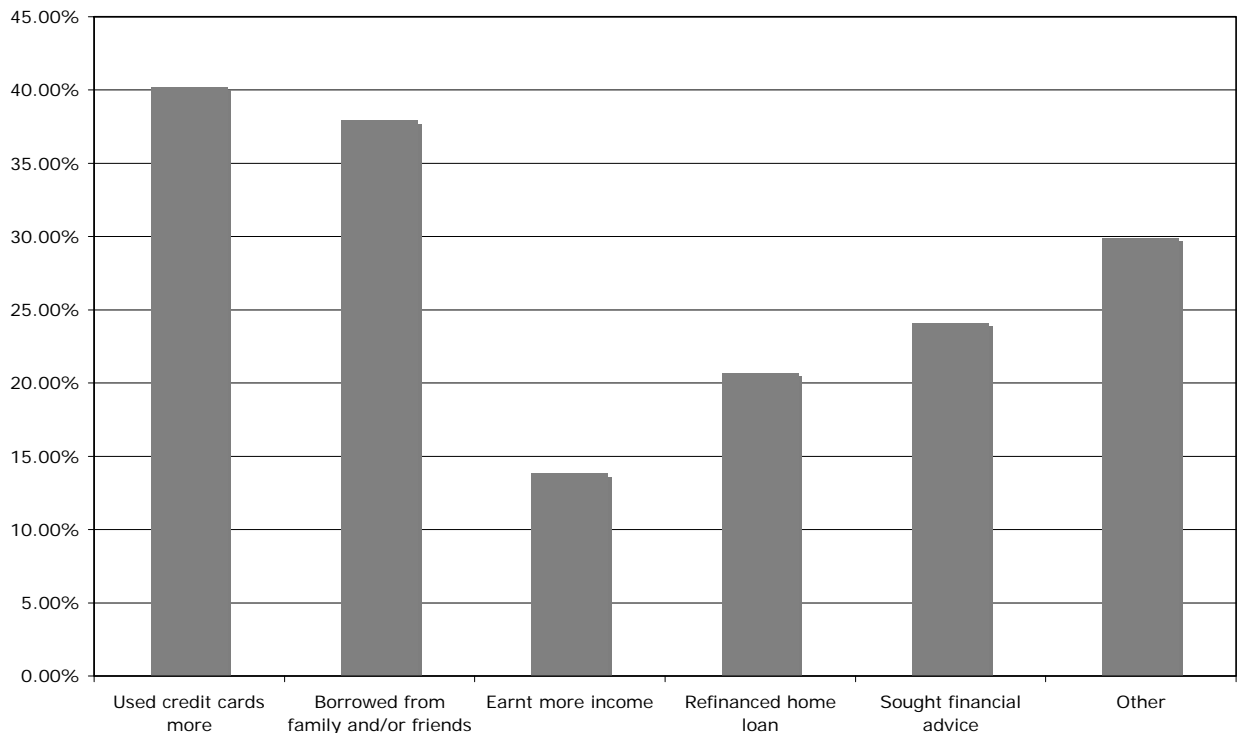
Figure 14 presents data on the initial household responses to being unable to meet their mortgage repayments. The question asked was: 'When you first got behind in repayments what did you do?' Respondents were able to select more than one action. The responses establish a framework for understanding the possible/likely longer-term consequences of default for these households.

A summary of the material consequences for households can be summarised thus:

- Households took on more, and more expensive, debt by using their credit cards more (40 per cent).
- Households took on more debt by borrowing from family and/or friends (38 per cent).
- Household members increased their level of labour market participation thereby earning more income (14 per-cent).
- Households refinanced their dwellings with new loans as they sought to strike a new affordable balance between income and repayments (21 per cent).
- Households took a number of 'other' actions (30 per cent), including significant use of superannuation hardship provisions (allowing the use of superannuation savings to prevent the contributor's home from being sold by the lender who holds the mortgage).

Significantly, only 24 per cent of households 'sought financial advice on budgeting and other ways to address the problem'.

Figure 14: Initial responses to missing mortgage repayments



Source: household survey

3.2 Consequences for dwelling and household finances

This section presents data on the housing and financial consequences of mortgage delinquency. It does this by examining the following strategies and outcomes:

- Rearranging the mortgage.
- Trend in mortgage debt.
- Effect on superannuation/retirement income.
- Bankruptcy.
- Employment – working more, going back to work.

There are three ways in which defaulting households can seek to rearrange the mortgage and try to prevent foreclosure once they fail to make repayments and fall into arrears (in addition to selling the house and paying out the mortgage). They are to: use hardship provisions; vary the terms of the existing mortgage; or refinance the loan.

Varying the terms of the existing mortgage through agreement with the lender is the first option. Either the mortgagee or the mortgagor could seek to initiate change in the terms of the mortgage. The question: ‘Did the lender approach you to vary the terms?’ was answered by fifty-five respondents. Only 18 per cent (N = 10) were approached by the lender while 82 per cent (N = 45) were not. Figure 15 presents data on respondents’ attempts to vary their mortgages in response to the question: ‘Did you attempt to change the terms of any mortgage?’ It shows that nearly 50 per cent of survey respondents tried, but only 4 per cent were successful.

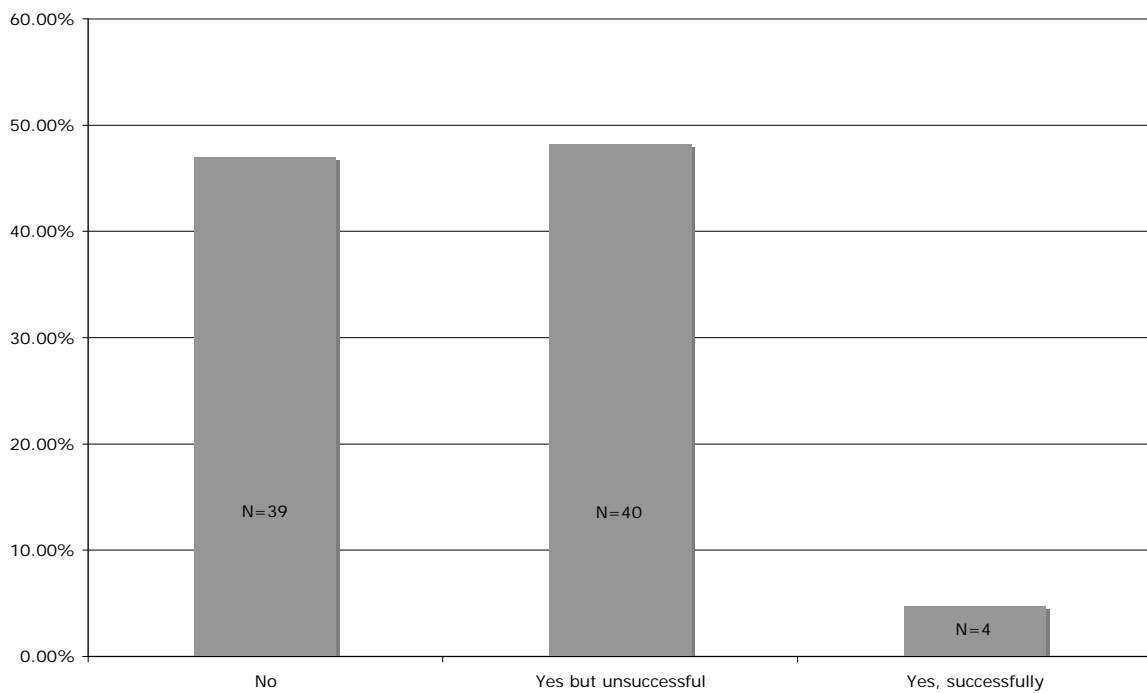
Hardship provisions provided under the Uniform Consumer Credit Code (UCCC) enabled households to seek variation in the terms of their loan with a state or territory

tribunal or court. There were only grounds for hardship when the size of the loan fell under a threshold and a consumer could not make loan repayments due to 'hardship', such as illness, unemployment or other reasonable cause, but could pay the debt if the terms of the contract were changed. This provision was only available to borrowers once their lender has refused the borrower's request to vary the current loan (the first option). With recent Commonwealth intervention aimed at strengthening and harmonising policy in this area, new arrangements are being put in place (see chapter 5 for details).

In the survey we found that the attempted use of this provision (in 2008) was limited. Of the respondents to the question: 'Did you apply for a hardship variation?' 13 per cent (N = 10) answered 'Yes', while 87 per cent of respondents (N = 70) answered 'No' (see Figure 15).

Among the interviewees two sought to use the UCCC hardship provisions. In Greg's case, his wife said: 'We got it once'. However, as noted in chapter 2, the bank foreclosed on Greg and his wife and they were evicted. Before they were evicted they tried again to use the hardship provisions but 'they wouldn't do it again, because we sort of didn't keep up with what was happening'. In Lucy's case, she had applied to the New South Wales Consumer Trader and Tenancy Tribunal to have the terms of her loan varied using the UCCC hardship provisions. The hearing was still pending at the time of interview.

Figure 15: Attempts to change terms of any mortgage



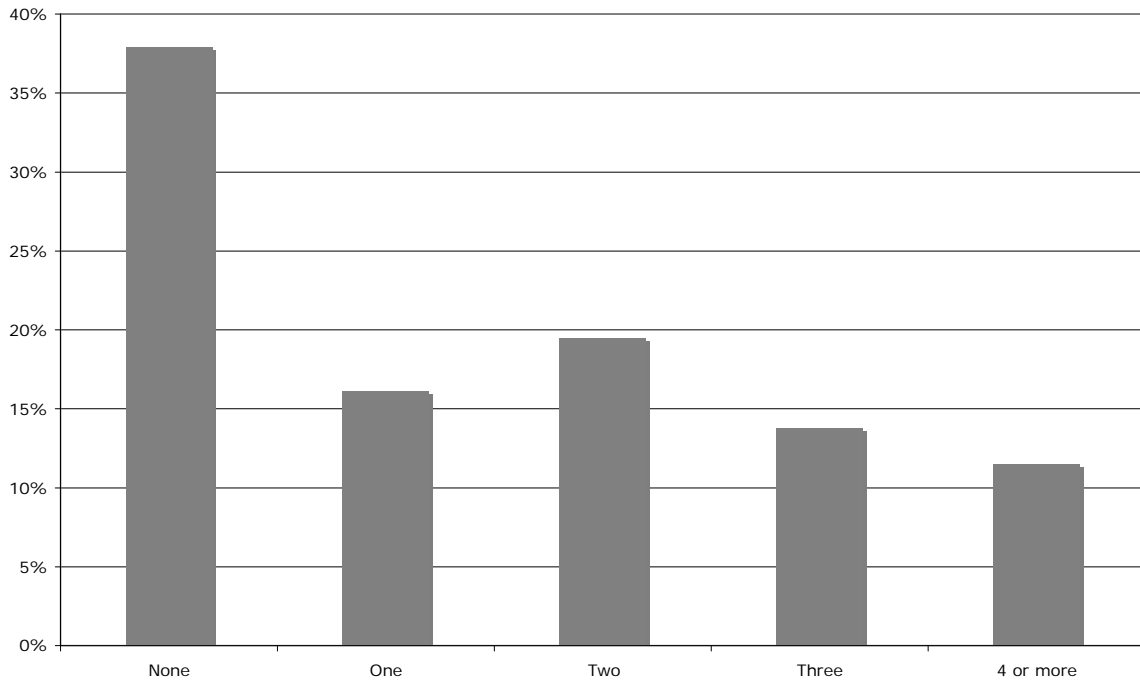
Source: household survey

Refinancing is another alternative. Through refinancing the mortgagor closes down an existing mortgage and establishes a new mortgage. By refinancing, households seek to overcome their repayment problems through: extending the life of the loan and reducing the size of regular repayments; increasing the mortgage by incorporating other high-interest rate debt, such as credit card debt, into a lower interest rate housing loan; and drawing down equity in the house and using this to pay off other debts, or meeting significant other commitments.

Households can refinance their dwellings either with the existing mortgagee or with a new lender. The interest rate for the new loan may be greater or less than the previous loan. The rate for the new loan will depend on various factors, including the prevailing official interest rates, the type of intermediary providing the loan and their position in the mortgage market and the way the intermediary assesses the level of borrower credit risk. It is worth noting, in relation to this last point, the evidence presented in Figure 7: Home loan interest rates 2003–08, which showed that mortgagors subject to claims of possession in Victoria were, on average, paying higher than normal interest rates. The process of mortgage refinancing may contribute to this higher than average interest rate.

Figure 14, above, showed that 21 per cent of survey respondents refinanced their loan when they first got behind in payments. Figure 16 presents additional data on the refinancing profile of survey respondents drawn from another question: ‘How many times did you refinance after taking out the initial loan?’ It revealed that over this extended period, a considerably higher percentage of households had refinanced; almost two-thirds of households refinanced one or more times and just over a third did not refinance.

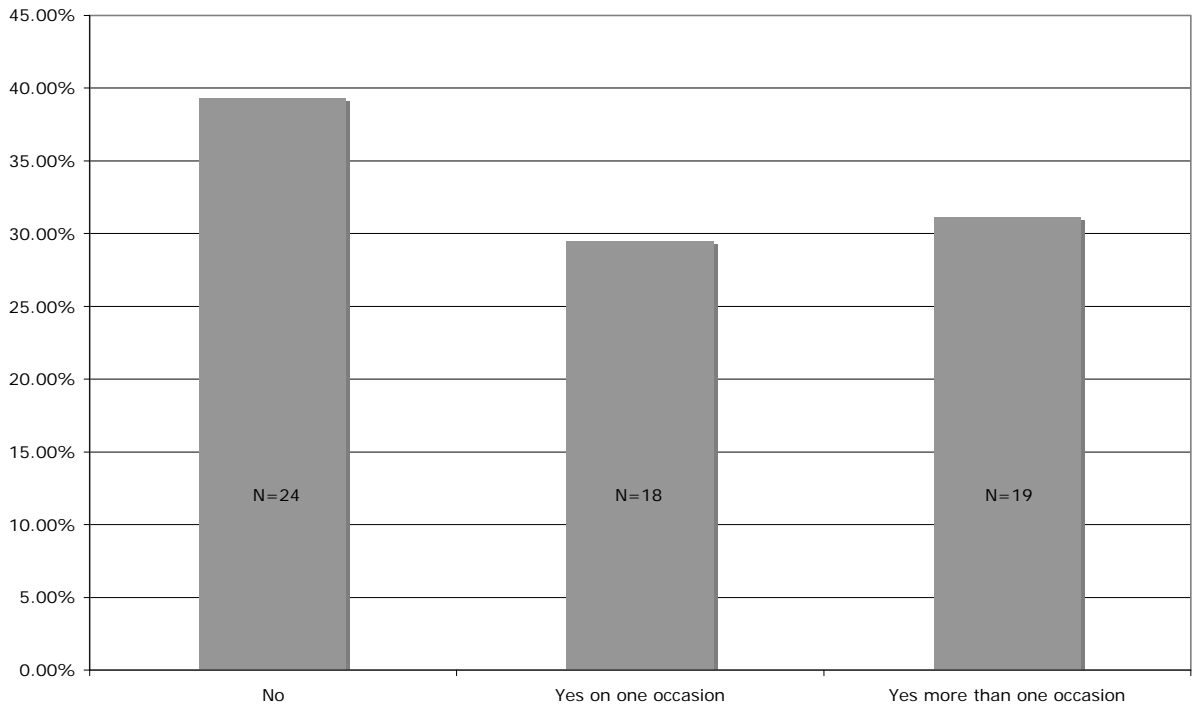
Figure 16: Refinancing by households (number of times)



Source: household survey

It seems that a considerable proportion of mortgage refinancing does involve ‘debt consolidation’. Figure 17 presents data in response to the question: ‘Did any of this refinancing involve debt consolidation?’ It indicates that more than 60 per cent were debt consolidators, with 30 per cent consolidating once, and 31 per cent more than once.

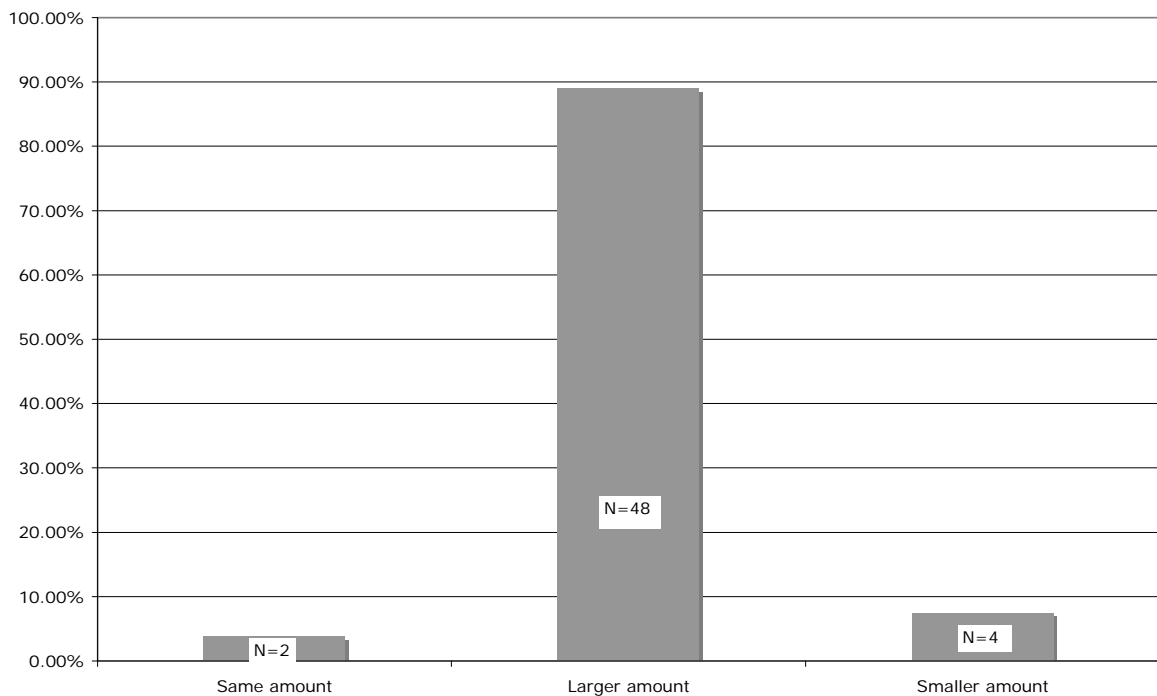
Figure 17: Refinancing by households and debt consolidation



Source: household survey

A consequence of the refinancing process for many households is increased mortgage debt. Figure 18 presents data in response to the question: 'When you refinanced your loan – the first time if you refinanced more than once – was it for the same, or a different, amount of money? Respondents were asked to indicate whether it was for the same, larger or smaller amount of money. For 89 per cent of respondents, they refinanced for a larger amount.

Figure 18: Refinancing by households and size of debt



Source: household survey

Under what circumstance do mortgagees support what appears to be serial refinancing by some households? In general, where there is sufficient remaining householder equity in the dwelling to cover the risk of losses if there is further default. This assumes that, at each point of refinancing, the mortgagee judges whether possible future arrears and associated transaction costs could be recovered through a subsequent foreclosure and asset realisation process.

This was the case with Brian, whose circumstances associated with his difficulty in meeting mortgage repayments were summarised in Table 6. He shared the family home with his mother who died in 2000 and he inherited it debt-free and continued to live in the house. He subsequently established a mortgage as he sought to fund debts associated with periods of unemployment, the cost of his mother's funeral and to provide his brother with a share of the estate. At the time of the interview he had recently refinanced. The new loan was:

a \$12,000 extension so [I could] get rid of all the excess bills that I had and the rest of the money was there for repayments and what money I had I just kept putting into it.

However, it seems that the interest rate Brian was being charged included a risk premium. He stated:

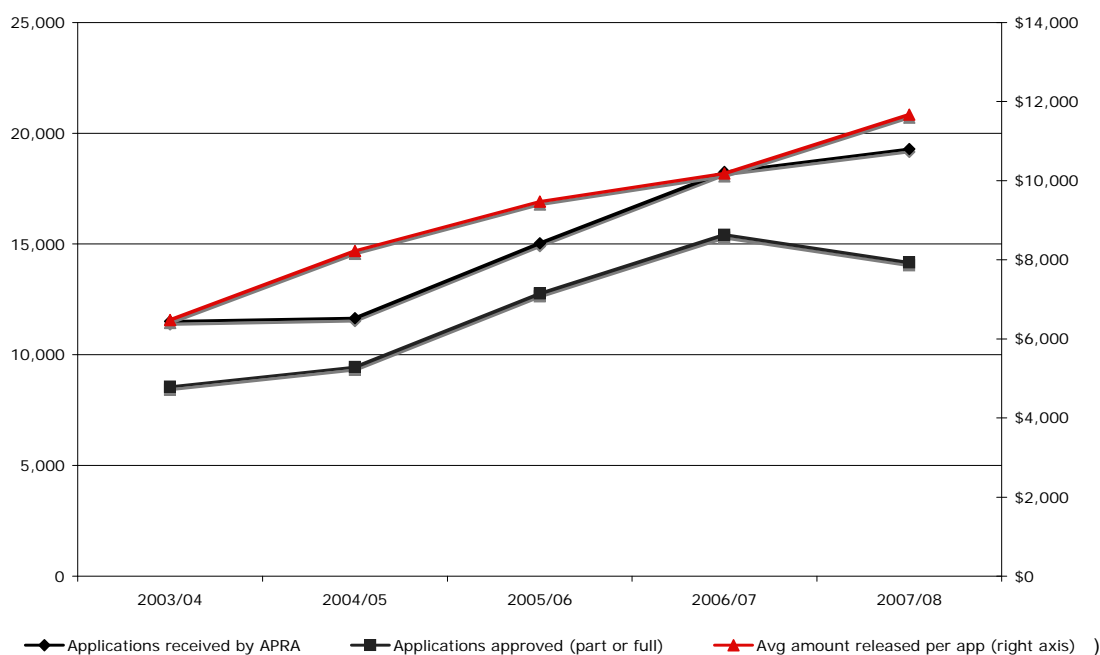
Well I will put it to you like this. It was at 8.25 and they started to get greedy and they went up to 10.79, no 10.95. While the rest of the country was at 5.5 or up to 6.0%.

A final aspect of defaulter debt is the situation at the end of and after foreclosure. However, there is little data available from our field research because most of our interviewees and survey respondents were still involved with the process stemming from claims of possession. However, for some respondents, their house had been sold (N = 33). Of this group 42 per cent were still left with a debt while 58 per cent

were not. Whether the household is left with a debt at the point of sale will have a great deal to do with two factors. First, there is the state of the property market in the area. If property prices are rising the remaining equity may have stayed ahead of debt. Second, it will depend on how quickly the mortgagee acts once the mortgage is in arrears. The sooner they act, the less debt accumulation.

Another source of capital for households who experience mortgage arrears and face foreclosure is the possibility that they may be entitled to access superannuation savings. Under the *Superannuation Industry (Supervision) Regulations 1994* the Australian Prudential Regulation Authority (APRA) can approve the early release of superannuation benefits on specified compassionate grounds. One of these grounds is where a person with superannuation savings is faced with 'a forced sale of an applicant's principal place of residence by their mortgagor' (APRA, 2008: p. 20). Data is not available on the number of applications and approvals made on the grounds of a prospective forced sale of principal places of residence. However, there is aggregate data, presented in Figure 19, on applications and approvals across all compassionate grounds that show sustained growth in applications, approvals and amount granted.

Figure 19: Early release of superannuation benefit trends



Source: APRA (2008)

It is not possible to enumerate the survey respondents who applied for early release of superannuation. However, it is clear from written comments about early responses to mortgage arrears that a number of our respondents had sought to use these provisions. One of those interviewed was Lucy, whose circumstances associated with mortgage repayment difficulties are summarised in Table 4, described how early release made it possible for her to stay in her house:

That kept us for a while, I mean if we hadn't done that we wouldn't have made it through ... I mean at the time while I was trying to deal with this I'm trying to deal with losing my job, looking after my son, stress, anxiety, depression

Similarly Andrew, whose circumstances associated with mortgage repayment difficulties are summarised in Table 3, described how early release enabled him to

stay in his house: 'I was probably only about three, it was four payments behind on the house when I got rescued by my superannuation.' However, superannuation might simply be a band-aid. Financial counsellors (consulted during this study) report concerns that these funds can be misused: some debtors are so far behind that the benefit is only to the lender who ends up with these funds as well as the repossessed home. APRA expresses similar concerns.

Bankruptcy can be a consequence of mortgage default. However, it seems that defaulters overwhelmingly seek to avoid bankruptcy. Survey respondents were asked: 'As a result of the difficulties of repaying a loan on this house, have you been declared or chosen to become bankrupt?' Only 16 per cent (N = 13) of respondents who answered replied 'yes' to this question whereas 84 per cent (N = 66) answered 'no'. Also, among all the interviewees only two were prepared to become bankrupt. One of their stories is told in chapter 2: the family went bankrupt in order to protect themselves from continuing action by the builder and finance company that wanted them to complete purchase of the house.

In the case of Jenny and her husband they chose bankruptcy after finding themselves with a debt on an investment property of more than \$500 000, which, because of fraud, they did not own while remaining liable for the debt. Further, they had withdrawn \$100 000 equity from their own home against which they had little remaining debt. They became enmeshed in this as they were approaching retirement, selling their home to meet the debt on the investment property that they did not own. However, because the amount realised was still insufficient to meet all their liabilities, they chose bankruptcy:

we've been placed in this situation that we can't get out of and the only way to do that is to go through the bankruptcy courts because otherwise we would be liable for \$250,000 which we don't have.

Choosing bankruptcy was also a way of preserving their long-term interest in their superannuation. As Jenny explained:

the solicitor did suggest that Michael use his super to pay off that [the outstanding \$250,000]. I said 'come on, what are we going to live on?' That's all we've got left is Michael's super. That's for the rest of our lives, for the next 20 years or something, if we live that long.

Increasing labour market participation by getting a job or working more hours is another way that households respond to mortgage repayment difficulties. In effect, households try to earn more. As shown above in Figure 14, approximately 14 per-cent of households stated that their initial response to repayment difficulties was to earn more. However, this response can continue beyond earning more income and staving off default and may also assist recovery post-foreclosure.

Andrew, whose circumstances associated with mortgage delinquency are summarised in Table 3, is one of those who continues to stave off default. He has responded by taking on casual weekend work in addition to his regular job:

I do get some weekend part-time work, which sort of bumps me through. Sometimes I will get a job, probably twice a month.

Lucy, similarly, is staving off foreclosure by establishing her own business after losing her job because of depression and nearly losing her house. She holds a professional qualification, set up a business at home and found that there was demand for the service she offers.

I've now set up my own ... firm from home and I practice from home. Part of my illness was trying to find the balance between work and home.

Colin's approach to work at the time of interview was clearly about re-establishing himself. After his business collapsed, the family home and other assets were sold, and he separated from his wife, there were remaining debts. However, instead of being declared bankrupt, he resolved to meet his outstanding debts. He gave up all his credit cards, moved into a cheap apartment and went back to work as a professional, earning between \$2000–3000 a week.

For Wendy and Ginny the process for re-establishing themselves post-foreclosure was taking longer. Both were on low incomes and no longer home purchasers. In Ginny's case losing the house and accruing a debt was associated with separation and becoming a single parent. While the domestic situation was unraveling she returned to study. Debt, study and re-entering the workforce were linked together.

I'm left a debt ... I've still got 18 months of my uni course to go, as I try to better myself ... that's going to hang over my head ... [before getting] paid work.

Similarly Wendy was studying at the time she refinanced and lent the money to her son for his business venture. She had started studying again after her husband's death and finished during the period when the house was being repossessed. For Wendy, study and re-entering the workforce were also linked together:

So I did the ... course which then enabled me to be able to get work but it was too late then, everything was too far behind that I couldn't catch up and I couldn't get refinance from anywhere which was only natural, with the record that I had ... one took into the account the record that I'd had with the bank which was a good one.

3.3 Longer-term housing implications of mortgage delinquency

This section presents data on the current housing arrangements and the expected housing arrangements of survey respondents and interviewees by examining:

- Changes in household composition.
- Solutions such as selling, renting and taking in boarders.

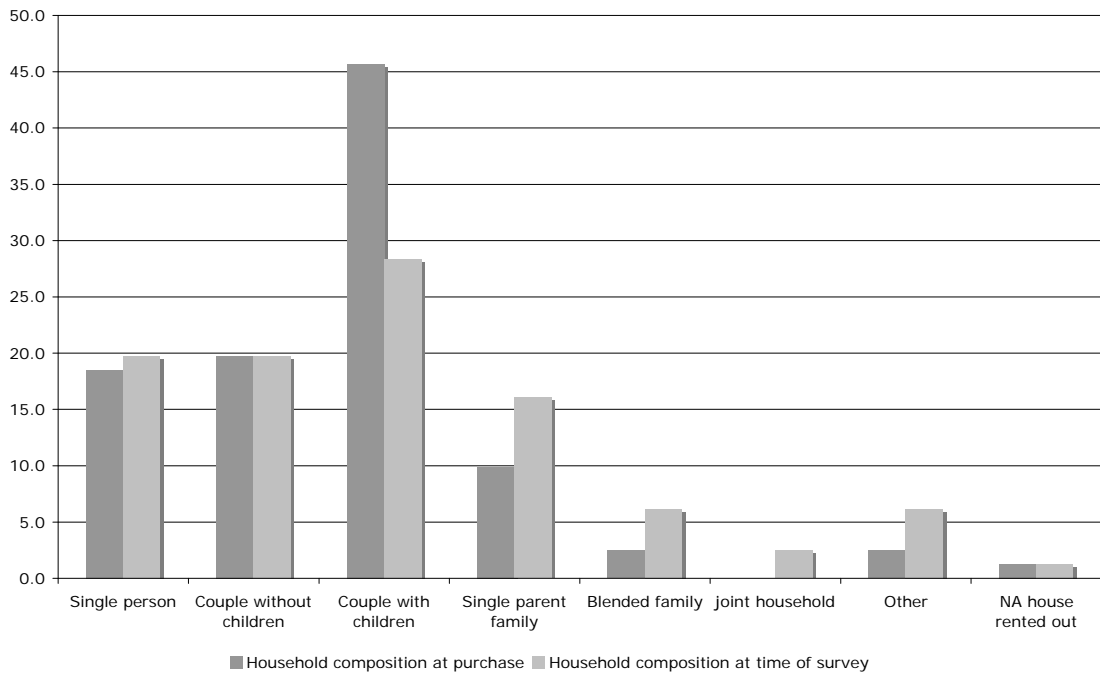
Figure 20 presents survey data on change in household composition between the time of purchase and the time when the household was responding to a claim for possession. The chart indicates the following changes in household composition:

- The proportion of couple with children households declined from 46 per cent to 24 per cent of surveyed households.
- The proportion of single-parent households increased from 10 per cent to 16 per cent of households.
- The proportion of blended families increased from 3 per cent to 6 per cent.
- The proportion of joint households increased from 0 to 3 per cent.
- The proportion of 'other' households increased from 3 per cent to 6 per cent.

Although there has been change in the household composition of households that are in mortgage arrears, it is important to avoid the conclusion that mortgage default causes relationship breakdowns and a shift from couple-with-children households to other household types, especially single-parent households. Indeed the discussion of

survey data and interviews in chapter 2 showed that there were many causes of mortgage arrears. Indeed, causality seems to run the other way so that relationship breakdown is one cause of mortgage default.

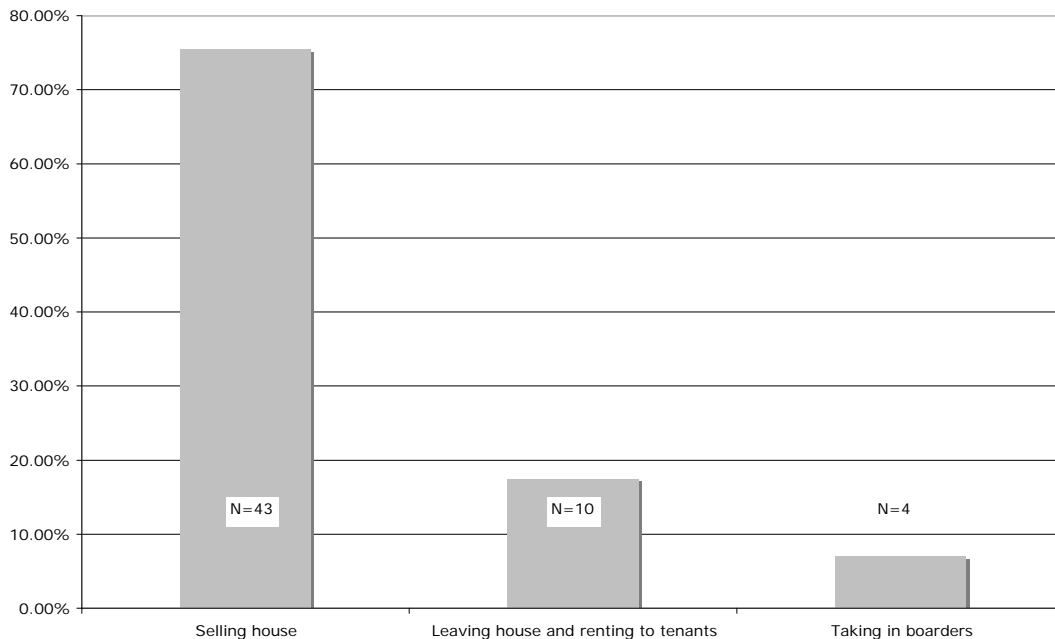
Figure 20: Change in household composition pre- and post-mortgage delinquency



Source: household survey

Overwhelmingly, respondents expected to resolve their difficulties in meeting mortgage payments by leaving the house that was subject to a claim of possession. Survey respondents were asked: 'Did you, or are you trying to resolve your difficulties by (a) selling your house (b) leaving your house and renting it to tenants (c) taking in boarders?' Figure 21 presents data from the responses to this question and shows 75 per cent of respondent expected to sell, 18 per cent to rent the house, and 7 per cent to take in boarders.

Figure 21: Approaches to resolving repayment difficulties



Source: household survey

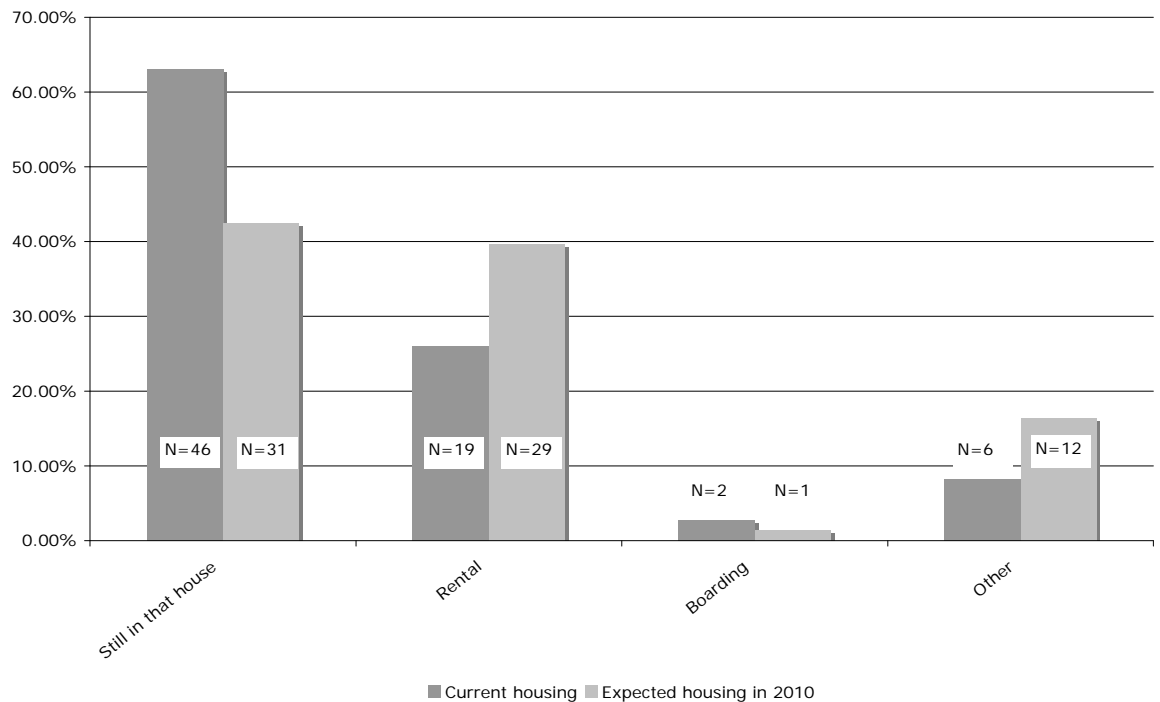
Figure 22 presents data on the expected housing arrangements of defaulters in a different way. It presents data in response to two questions: 'If you ever lived in the house that is/was subject to the claim of possession, what kind of accommodation are you living in now?' and 'If you ever lived in the house that is/was subject to the claim of possession, what kind of accommodation do you expect to be living in next year (2010)?'

Figure 22 indicates the following about current and expected housing circumstances:

- At the time of the survey 63 per cent of respondents were still in the dwelling subject to the claim of possession. However, a year later, only 43 per cent expected to be remaining in that house.
- Overwhelmingly the movement was to rental housing (26 per cent) and the expectations among respondents were that this would increase during the following year (40 per cent).
- Very few defaulters responded to mortgage delinquency by increasing their income by taking in boarders (3 per cent), and even less expect to do so in the future (1 per cent).
- Only a few respondents were forthcoming about what 'other' meant for them. Those who were, identified: parents, children, flat, tent, homeless and overseas.

When the data from Figures 21 and 22 are considered together there is an apparent difference in what respondents think will happen. In Figure 21, 75 per cent think that they will have to sell. However, in Figure 22, 43 per cent of respondents think they will still be in that house a year later. It seems that a significant proportion of respondents thought that they would have more than a year before they moved into rental or some other accommodation. The data suggest household expectations or strategies aimed at hanging on to the house for as long as possible.

Figure 22: Current accommodation and expected accommodation in 2010



Source: household survey

The data presented in Figures 20 and 21 provide some indication of next steps in the housing careers of defaulting households. The interviews provide a more nuanced indication of their experiences. The accounts of moves back into the rental market were typically stories about difficulties in finding accommodation. However, the new rental housing, once it was found and established, was often preferable to the cost and the stress of living in a house where paying the mortgage and overcoming the arrears was a struggle.

In Ginny's case, she was moving out of the family home with her children so as to escape a violent husband. She presents an account of a period of discrimination followed by success:

it was very hard to find somewhere. There was a few houses that I applied for and, you know, they did shove me around a bit because I was a single mum at the time and even though I ... was working on weekends, and stuff, they still were like, "Well you don't have an income" or "You're a single mum" or "You know, the three children."

In the case of Greg and his wife their house was repossessed and they came close to being homeless but were saved by the help their family gave in finding a rental property. However, it was touch and go:

we only had three weeks to move out, it was even more stressful when we couldn't find a house until two days before we had to move out. It was like we were going to be living on the street ... I was actually in the car, ready to go [and]... apply for crisis accommodation.

Wendy similarly reported that it was 'difficult to find rental accommodation and you are paying more or less on rent that you would have on your mortgage repayments.'

However, it was also the case that some of those who moved into rental housing indicated that they did find satisfactory housing outcomes. Ginny, for example,

reported: 'but then I ended up with the perfect home, but it ... took me two months'. Greg's wife also indicated satisfaction and that although 'it's a lot smaller':

we're better off financially now we're renting than what we were, paying the loan. It's halved what we would have been paying.

Likewise Wendy, after she re-entered the workforce, found the costs of her rental property manageable: 'I'm actually probably paying roughly the same as what the mortgage payments would have been maybe \$10, \$20 [more]'. Margaret also expressed satisfaction with renting. She was employed, her housing costs were under control, she had discretionary spending and had re-established a social life: 'I have \$600.00 a fortnight that I can do anything with ... I went out last night ... I couldn't do that before'. In Jenny's case she and her husband did find suitable rental housing but the location was an issue. It was a 'long way away from our network of friends, yeah, because we can't afford to live around here'.

Then, there were those that were finding their way into other new arrangements. In Trevor's case his family helped him, after his separation and the sale of the family home, to put a deposit on a new property that he rented out. At about the same time he helped form a new 'blended family' when he found a new partner and moved in to her house with her and her children. In the case of Michael and his family, his wife's family was providing their housing after repossession. His in-laws had returned to the UK and they were able to rent their house at a reasonable rent.

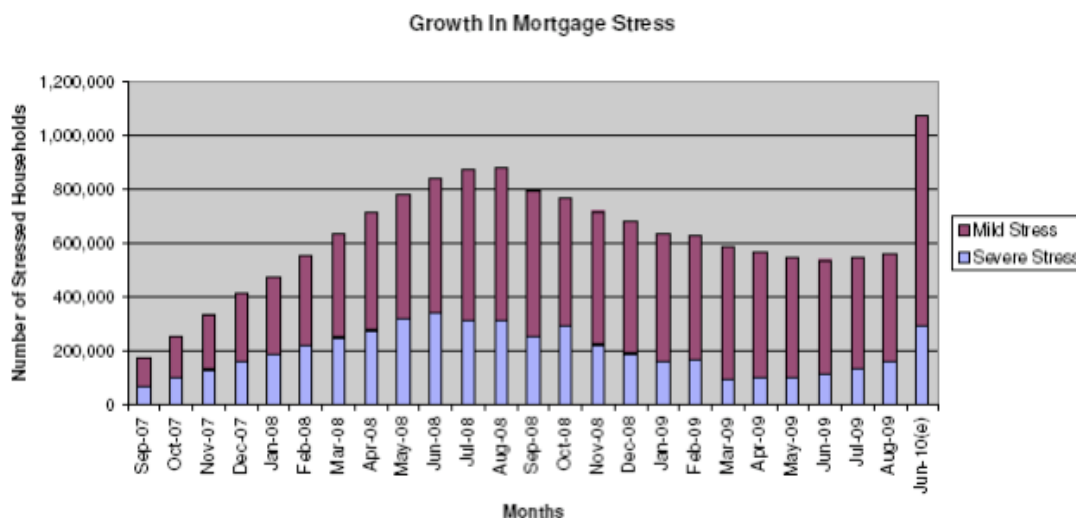
3.4 The broader picture

The consulting firm Fujitsu (2009) tracks mortgagor distress through a rolling Australia-wide sample of 26 000 home buyers. Mortgagors are classified as being in mild or severe stress, as follows:

- *Mild mortgage stress*: households who are maintaining current mortgage repayments but re-prioritising expenditure, borrowing more on credit cards or other loans and/or refinancing existing mortgages, in order to do so.
- *Severe mortgage stress*: households who are in mortgage arrears, are trying to sell their house or refinance, or who are facing foreclosure.

Figure 23 summarises the most recent results of this survey.

Figure 23: Mortgage stress over time, Australia



Source: Fujitsu Consulting (2009: p. 13)

Several key points can be made here:

- Total estimated mortgage stress peaked in August 2008 at over 800 000 households. Thereafter, due in large part to falling mortgage interest rates, total and especially severe stress fell.
- The trend turned back up in the second quarter of 2009 as unemployment crept up toward 6 per cent (from 4.4 per cent).
- Looking ahead, Fujitsu forecasts a significant rise in both mild and severe stress by the middle of 2010.

This last point is important. Although official unemployment is expected to peak at below 7 per cent (instead of the 8.5 per cent estimate in the 2009–10 Federal Budget), *underemployment* is expected to continue rising. Full-time jobs are being replaced by part-time jobs and average hours worked are falling (ABS, 2009). If this trend continues, more households will suffer income losses that will impact negatively on mortgage repayment capacity. Fujitsu (2009: p. 1) concludes:

The outlook remains uncertain for homeowners, but it all hinges on unemployment levels through the next few months and expected rises in interest rates later in the year. We now estimate stress by June 2010 will be just over 1 million households, and those in severe stress perhaps as high as 294,000. There are a number of risk factors linked to higher interest rates and falling net incomes which explain this.

In the year to August 2009, the main perceived causes of mortgage stress were fear of unemployment, drop in income and poor investment returns. However, looking ahead, one-quarter of households surveyed expressed concern about future interest rate rises reducing their ability to meet repayments. This proportion rose to half for recent first-time buyers. In October 2009, the RBA raised official interest rates by 25 basis points, the first country to begin to tighten monetary policy; a further 25 basis points rise followed in November.

The impacts of changing mortgage stress fall unequally across different social groups and over space. Fujitsu has identified and tracked 12 categories of mortgagor households⁴.

Focusing on households in **severe** mortgage stress, the largest numbers are concentrated in three categories:

- *Suburban mainstream*: these 'mid-life course' households tend to have a member or members employed in lower-to-middle income, routine white collar or blue collar jobs, living within the major metropolitan regions.
- *Disadvantaged fringe*: households with low-paid blue collar or service sector jobs, living in peripheral metropolitan or country regions, with relatively low educational levels, a high proportion of whom are of non-Anglo ethnic background.
- *Battling urban*: these younger households are concentrated in lower socio-economic higher-than-average density suburbs, employed in casual jobs, vulnerable to recurrent unemployment or reduced hours employment.

Together, these three categories account for more than 60 per cent of households estimated to be in mortgage stress. Although less numerous, it is still worth noting that a number of other household types are experiencing stress. This includes small

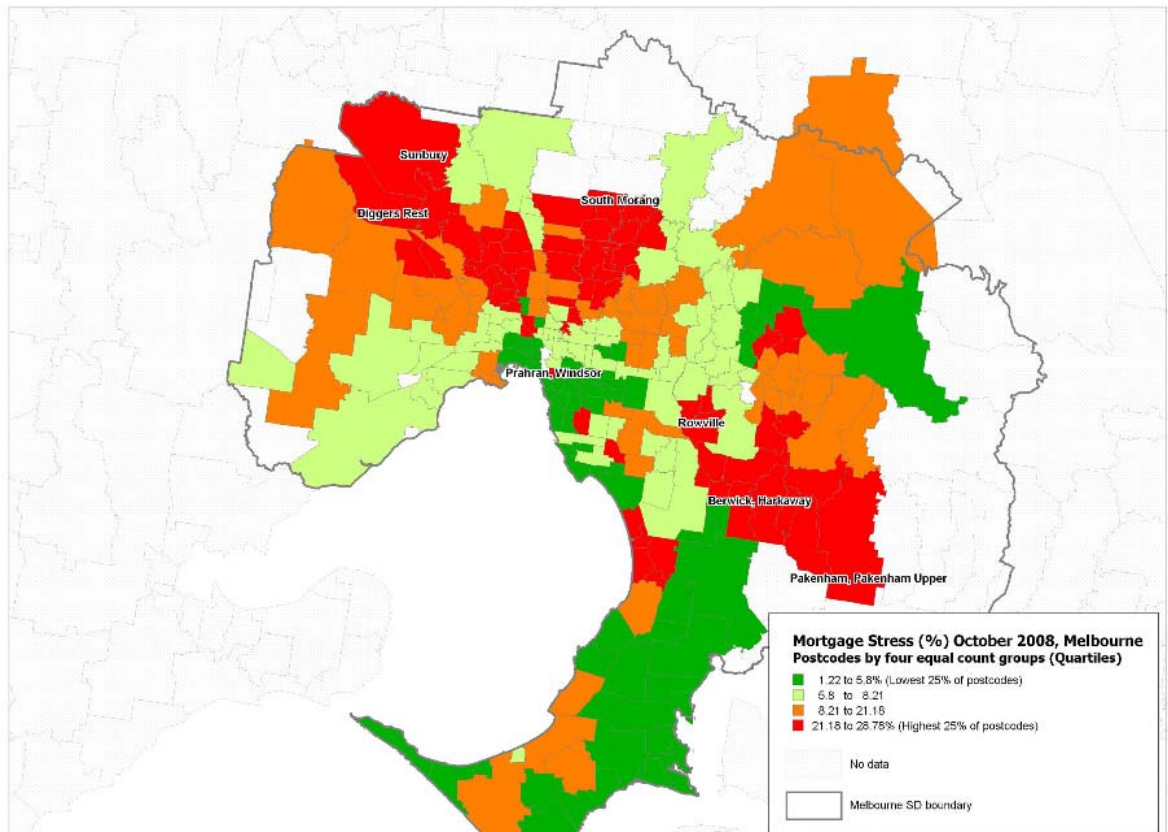
⁴ Further details as to the definition and characteristics of each category can be found in Fujitsu (2009).

numbers of older higher-income mortgagors, facing repayment difficulties in the wake of the global economic downturn.

Figure 24 maps the Fujitsu mortgage stress data across Melbourne. Broadly speaking, stress is concentrated in lower socio-economic suburbs to the outer north-west and outer south-east sub-regions; conversely, low levels of stress are concentrated in the more affluent inner city, bayside suburbs, Mornington Peninsular, outer north-east and middle-eastern suburbs.

This map matches well another representing an 'employment vulnerability index'⁵ (EVI) developed by the Centre of Full Employment and Equity at the University of Newcastle – see Figure 25.

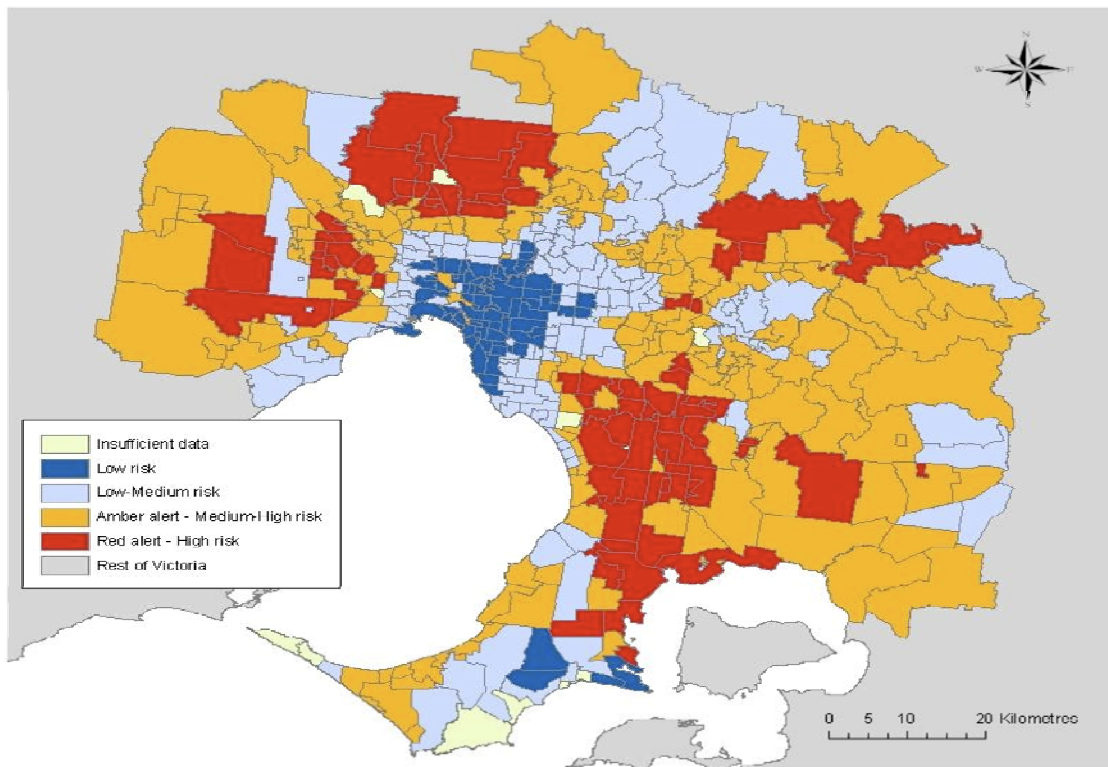
Figure 24: Mortgage stress in Melbourne, 2009



Source: data supplied by Fujitsu Consulting

⁵ This index is a weighted average of three indicators: the proportion of people employed in occupations vulnerable to employment loss; the proportion of people employed who do not have post-secondary educational qualifications; and, the proportion of people working full-time (for details see: Baum and Mitchell 2009: Appendix A).

Figure 25: Employment vulnerability in Greater Melbourne



Source: Baum and Mitchell (2009)

Loss of job and income, as argued in chapter 2, form a powerful trigger of mortgage default. The prospects for experiencing significant mortgage stress would appear to vary widely among different sub-groups and across space in Australia.

3.5 Conclusion

This chapter has focused on the impacts of severe mortgage distress borne by mortgagors whose homes are legally (re)possessed. Although the proportion of households affected in this way is small, especially when compared to the situation in countries like the USA, the impacts can be devastating for those concerned. Our research has found complex patterns of adaptation to mortgage stress across and within households. Among the borrowers facing repossession, household break-up and change figured prominently. Adverse health impacts and anxiety about future housing security were evident, as was a host of problems associated with continuing financial hardship.

Employment vulnerability in a highly uncertain international climate (see chapter 4) raises the real possibility of future problems for an increasing number of mortgagor households in Australia. As interest rates rise back to trend-level in Australia, mortgage stress is likely to impact heavily on vulnerable segments in the housing market and place further demand pressures on already tight rental markets. This raises challenges for policy makers (see Chapter 5).

4 MORTGAGE DEFAULT AND THE MACRO-ECONOMY

Chapter 4 of the positioning paper provided a detailed account of the sharp increase in mortgage defaults in the United States, occasioned by what came to be called 'the sub-prime crisis'. The paper also identified the key developments in the unwinding of this crisis through 2007 and 2008, and the systemic threat posed by the leap in mortgage defaults to global financial markets and through the resulting 'credit crunch' to the national economies of the major developed nations. The point was made that, although mortgage arrears and possessions were also increasing during this period in Australia, they were rising from a very low base. Nevertheless, it was clear that Australia could still be adversely affected by global developments, particularly if our mineral resource exports were impacted by a slowing Chinese economy. Falling exports at a time of declining domestic consumption and investment sparked by falling confidence and reduced bank lending in the wake of the financial crisis, could, it was suggested, lead to rising unemployment in Australia which would place greater pressure on mortgage repayments by heavily indebted home owners and rental investors. This outcome would be more likely to the extent that Reserve Bank monetary interventions and Federal fiscal policies failed to stem the tide of falling confidence and liquidity constraints and/or housing prices falling significantly

This chapter, firstly, summarises the key developments treated at length in the earlier paper (Berry et al. 2009); secondly, it brings the story up to date for the first half of 2009; thirdly, it examines alternative explanations for why these developments occurred, and; finally, it draws some implications for policy.

4.1 Developments up to the end of 2008

With hindsight, it is possible to see the seeds of crisis sown in the early part of this decade as the US Federal Reserve dropped and kept official interest rates low after the collapse of the dot-com boom and the shock of September 11 2001. In an era of easy money, share markets and property markets, especially housing, boomed through the middle years of the decade, reinforced by expanding credit, buoyant domestic consumption and the rapid growth of the emerging economies, especially China and India. Financial innovation, notably the explosion of new mortgage products and derivatives, met demands by the US government to extend home ownership more widely to previously under-serviced groups. Regulatory reforms reduced the previously clear distinction between the primary (commercial) banking system and the 'shadow banking system' (investment banks, hedge funds, money market and mutual funds), and competitive pressures pushed all these financial institutions to aggressively compete for a share of the rapidly growing market of new and complex securities.

Again with hindsight, the housing boom or bubble in the US burst in 2006, ushering in a prolonged series of increasingly serious signs of spreading crisis and eventual recession. These can be briefly stated as follows⁶:

- In mid-2007, two mortgage hedge funds owned by the investment bank Bear Stearns went bankrupt, as did American Home Mortgage Corporation and three investment funds owned by the French bank BNP Paribas.

⁶ For a detailed discussion of these developments, see Berry *et al.* (2009: chi. 4).

- In late 2007 there was a run on the British bank Northern Rock, the first such event there in more than 100 years. Northern Rock was effectively nationalised in February 2008.
- In March 2008, Bear Stearns itself faced bankruptcy and was taken over by J.P. Morgan, with a guarantee provided by the Federal Reserve.
- From mid-2007 to mid-2008, ten US banks declared bankruptcy, including Indymac Bank, at that time the third largest bankruptcy in US history.
- In July 2008, the two largest mortgage lenders – Fannie Mae and Freddie Mac – guaranteeing 40% of residential mortgage-backed securities faced insolvency and were rescued by the US Treasury contributing equity capital in the form of ‘preference shares’; the US Congress authorised US\$300 billion to fund this ‘bailout’ and to assist defaulting home owners to reschedule their debts in order to avoid foreclosure. The Federal Housing Finance Agency replaced the management of Fannie and Freddie.
- In mid-September 2008, investment bank Lehman Brothers went bankrupt, and refused the federal assistance granted earlier to fold Bear Sterns into J.P. Morgan. This marked the true beginning of the credit freeze as confidence in the counterparty compliance of financial institutions collapsed and banks and other financial intermediaries in the US and Europe stopped lending to each other.
- Even more serious was the threat that American International Group (AIG) the world’s largest insurance company and the major trader in credit default swaps, faced insolvency. This time the Federal Reserve provided a US\$40 billion loan to stave off bankruptcy. Subsequently another US\$40 billion of federal assistance was committed to AIG, effectively seeding 80 per cent of AIG ownership to the US government.
- In October 2008, Waucovia, America’s third largest savings and loans institution declared bankruptcy. In Europe, Fortis in Belgium was nationalised to avoid bankruptcy, as were Iceland’s three banks and, in Britain, Bradford and Bingley Bank.
- In the US, the two remaining large investment banks – Goldman Sachs and Morgan Stanley, converted themselves into commercial deposit-taking banks in order to gain US government guarantees and restore confidence in their solvency.
- In the UK, the country’s largest mortgage lender, Halifax Bank of Scotland, was forced to merge with Lloyd TAB to avert bankruptcy and Treasury guarantees provided to Royal Bank of Scotland, the world’s largest company by market valuation, effectively nationalised it.

In the second half of 2008, the central banks of the developed nations, individually and collectively, intervened to attempt to restore confidence to their financial systems and end the credit freeze. They initially sought to do this by aggressively lowering interest rates and providing liquidity through purchasing government securities. However, it eventually became clear that this was not a crisis of liquidity but one of solvency. Over-leveraged banks were in no position to lend more without threatening their existence, regardless of how much liquidity was injected into the system. It was unclear, because of the unknown value of complex securities held and the uncertain credit worthiness of their existing borrowers, just how thick their ‘equity cushion’ was. Further uncertainty about the credit worthiness of other financial institutions and a general decline in the economic prospects of non-financial firms and consumers further mitigated against new lending. The key aim of the banks was to rebuild their balance sheets – i.e. de-leverage – by building up their holdings of cash and other highly liquid assets.

Consequently, national governments were forced to also intervene in other ways, as the full scale of the crisis became evident. An early example at the beginning of 2008 was the move by the Bush administration to cut taxes by US\$168 billion. This move proved unsuccessful as anxious taxpayers saved an estimated 85 per cent of the tax cuts (Posner, 2009: p. 166), dampening any real boost to aggregate demand in the face of the gathering recessionary forces. In addition to the measures listed above, involving government loans, equity injections and guarantees, several other approaches were tried. Blanket guarantees were given by national governments to protect savers' deposits in a range of financial institutions in most European countries, the US, Canada, New Zealand and Australia (with varying reach and conditionality). In Australia, the government also guaranteed the wholesale borrowings of the major banks. Most of the G20 central banks together pledged a US\$600 billion reserve fund to effectively keep the international credit default swap market from failing.

In the US, government rescue attempts went through four stages in 2008, with a fifth stage flagged by the incoming Obama Administration (ibid.: ch. 5). The centre-piece was the enactment of the Troubled Assets Relief Program (TARP), which provided US\$700 billion to unfreeze the lending halt; this amount was in addition to that legislated to rescue Fannie Mae and Freddie Mac. The initial strategy was to selectively buy the 'troubled' or 'toxic' mortgage-backed assets of banks in order to improve their balance sheets by removing these assets for which there was effectively no market. The problem was that without an active market, no one knew how much they were worth and what governments should pay for them. It became obvious that if they were worth very little then taking them off the banks' hands would only underscore their likely insolvency – a case of 'the cure was successful but the patient died'.

Hence, the second stage was to direct government bail out funds into directly recapitalising the largest banks in most distress – e.g. Citigroup – by 'purchasing' preference shares. However, this did not noticeably increase lending since the recipients were more concerned to shore up their solvency by hoarding liquid assets. As this situation became clear the government contemplated setting up a 'bad bank' to acquire all the toxic assets at current marked-down values from all the affected banks – rather than some assets from some banks, as in stage one. Where these assets had not been marked down (because doing so would disclose insolvency), the government would have insured these assets against default; this effectively would have meant relaxing the regulatory requirement for banks to 'mark-to-market'.

The third stage of the bail-out shifted to the US manufacturing sector. As unemployment rose through 2008 and consumption fell, the automobile industry was particularly hard hit. The three large US auto manufacturers – Ford, GM and Chrysler – faced bankruptcy. They sought substantial subsidies from government to facilitate an orderly restructuring. However, Congress refused to pass the necessary legislation and in December 2008 the outgoing Bush Administration provided (by regulation) a bridging loan of US\$17 billion to prevent a disorderly collapse of GM and Chrysler, putting at risk the jobs of up to 3 million workers directly and indirectly dependent on these companies. Further developments on this front awaited the new Administration in 2009 (see below).

The fourth stage of government intervention has been through the Federal Reserve. Traditional central bank intervention had, as noted above, failed. As the banks swapped government securities for more liquidity supplied by the Federal Reserve, they hoarded it or bought further government securities, even as the interest rate on that debt fell toward zero. Cash is king when banks seek to de-leverage. The great danger when lending freezes is that consumption and private investment fall further,

dragging the economy down and threatening a self-reinforcing deflationary spiral, as occurred in Japan through the 1990s. As prices fall the real burden of debt rises and consumers speculate there will be further price falls, further reducing aggregate demand. In response, the Federal Reserve now moved to buy private securities (like promissory notes and other corporate debt, as well as credit card debt) from non-banks by effectively 'printing money'. This 'easy money' policy (officially referred to as 'quantitative easing') was aimed at encouraging these institutions to lend more, thereby sparking demand. In November 2008 the Federal Reserve created a fund of US\$800 billion to pursue this strategy, the first time in history that it had moved beyond the banks to stimulate lending, a clear sign of the perilous state of affairs. The Bank of England later followed this lead in the UK. The range of unconventional measures used by central banks in the advanced economies is canvassed in the July 2009 IMF Global Financial Stability Report (IMF, 2009a: box1.6, pp. 45-47).

Australian authorities have followed some but not all of these policy interventions. From September 2008, the Reserve Bank of Australia (RBA) cut official interest rates by 4 percentage points. The strength of Australia's big four banks did not require direct support beyond the guarantees noted above. The federal government did pledge to underpin the commercial property sector by providing access to loan funds – the so-called 'Rudd Bank'. Some further government support has been selectively provided to car manufacturers but nowhere on the scale mooted for the US car companies. Conversely, Australia led the US in the move to direct fiscal stimulus of the economy. The first fiscal stimulus package entailing cash subsidies to lower income households was introduced late in the year and continued into 2009.

4.2 Developments in 2009

The year to-date has seen economic conditions begin to improve but with most advanced economies still in recession. The latest IMF World Economic Outlook comments: '(t)he world economy is stabilizing, helped by unprecedented macro-economic and financial policy support. However, the recession is not over and recovery is likely to be sluggish' (IMF, 2009b: p. 1). The IMF report goes on to conclude that the advanced economies will, as a group, contract by 3.8 per cent in 2009 and grow sluggishly by 0.6 per cent in 2010. A substantial pick-up in economic activity is not expected before the latter half of 2010. Of this group, only Australia has escaped being in a 'technical recession', and that barely. In August 2009, data showed that both Germany and France had emerged in quarter 2 of the year just in positive growth, joining Australia. The US and UK economies remained in contraction, although the Federal Reserve Governor suggested (in August) that the US economy was 'flattening out'. In Australia RBA Governor Stevens told a Parliamentary committee that Australia may escape with a shallow recession and interest rates would have to rise in the not too distant future as the economy rebounded (Stevens, 2009). Stock markets around the developed world have reacted by rising consistently since mid-year; however, there is widespread speculation that a downward correction is, if not imminent, then very likely in 2010.

Credit for this apparent partial and uneven turnaround is due to the massive economic policy interventions noted above and, in particular, the fifth stage of this intervention: the large fiscal stimulus packages introduced by national governments. The US stimulus package amounted to US\$819 billion; about a third of this total is for further tax cuts and the remainder committed to infrastructure, energy efficiency and social security programs. Australia too has introduced two further fiscal stimulus packages aimed at boosting investment in economic infrastructure, education, health, social housing and energy sectors; the total budgetary commitment is in the order of AU\$43 billion. (Some of this commitment has subsequently been wound back.)

However, of particular concern is the continuing crisis in global financial markets. The IMF forecasts that the total cost of write-downs in financial assets in the US over the 2007 to 2010 period will be US\$2.7 trillion, more than 10 per cent of the total face value of loans outstanding. This is twice the size of the estimate of total US losses proposed by the IMF in October 2008. When loans and securities originated in Europe and Japan are added, the total write-down in asset values is forecast to be US\$4.1 trillion (IMF, 2009a: p35). In the US, banks will bear about 60 per cent of these losses, with the rest spread between insurance companies (9 per cent), the government-sponsored enterprises, Fannie Mae and Freddie Mac (10 per cent), hedge funds and non-financial corporations. Residential mortgages, primary and securitised, account for US\$1.3 trillion or almost half of this prospective loss. In line with this forecast, mortgage delinquencies continued to rise throughout 2008 and into 2009, with 90-day-plus arrears approaching 30 per cent for sub-prime mortgage loans (see Figure 26). Even prime loans are approaching the 10 per cent default rate.

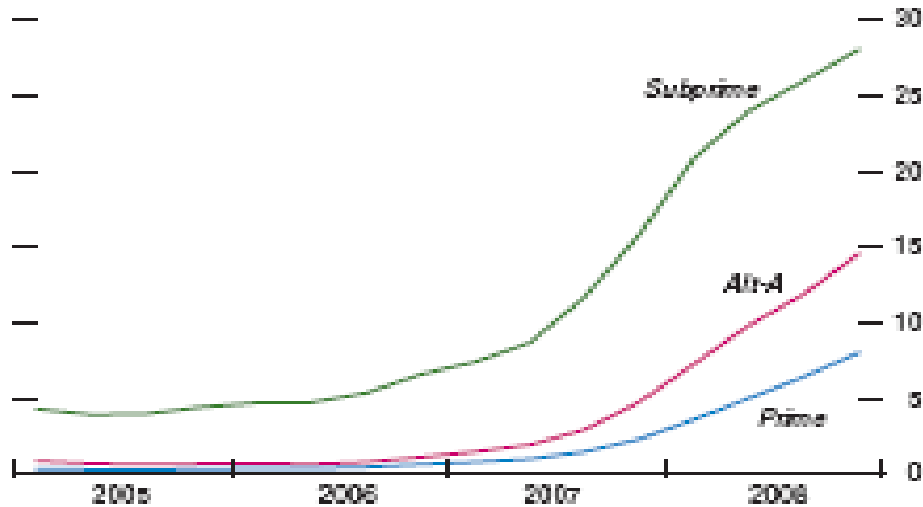
Charge-off rates for real estate and consumer loans have risen sharply since 2007 and are expected to peak in 2010 (see Figure 27). These rates represent the proportion of existing loans written off by lenders. Average house prices have already dropped by 27 per cent from their peak in the US (and 21 per cent in the UK) and are forecast to drop a further 18 per cent by the end of 2010 (IMF, 2009a: p.25). August was the first month that the Case-Shiller index of average house prices in 20 US cities rose slightly (0.5 per cent increase on the month before), since mid-2006 (*The Economist*, 2009). However, repossessed dwellings still account for one in four housing sales; 23 per cent of houses with outstanding mortgages are in negative equity, a proportion forecast to grow to 48 per cent by 2011 (ibid.).

These developments are expected to place continuing stress on the capital adequacy of the major banks in the US, Europe and Japan. Given its baseline estimate the IMF has concluded that if loss provisions for the next 2 years were brought forward (booked) now (ahead of anticipate declining earnings) the aggregate 'total common equity' of the US and European banks would be close to zero (ibid.: p. 36)⁷. This would mean that many banks would have no capacity to absorb further losses and remain solvent. Given that the banks still have an unknown volume of 'toxic' mortgage-backed securities and derivatives on their balance sheets, further losses are a distinct possibility. Crystallising those losses could spark mass bank failures (a systemic crisis) and throw the world's advanced economies back into deepening recession or depression. In such a situation the primary task becomes the need for the banks to further boost their equity base or cushion, delaying an expansion of lending and dampening the prospects for a quick recovery of the major economies. The much-sighted 'green shoots' of recovery may prove to be a mirage, particularly in the US and UK. The prospect of a lengthy W-shaped or L-shaped recovery is still a real possibility.

⁷ Total common equity (TEC) is total equity less preference shares and tangible assets. It is the key measure of the resources available to meet short-term liabilities, including counterparty responsibilities on securities like credit default swaps.

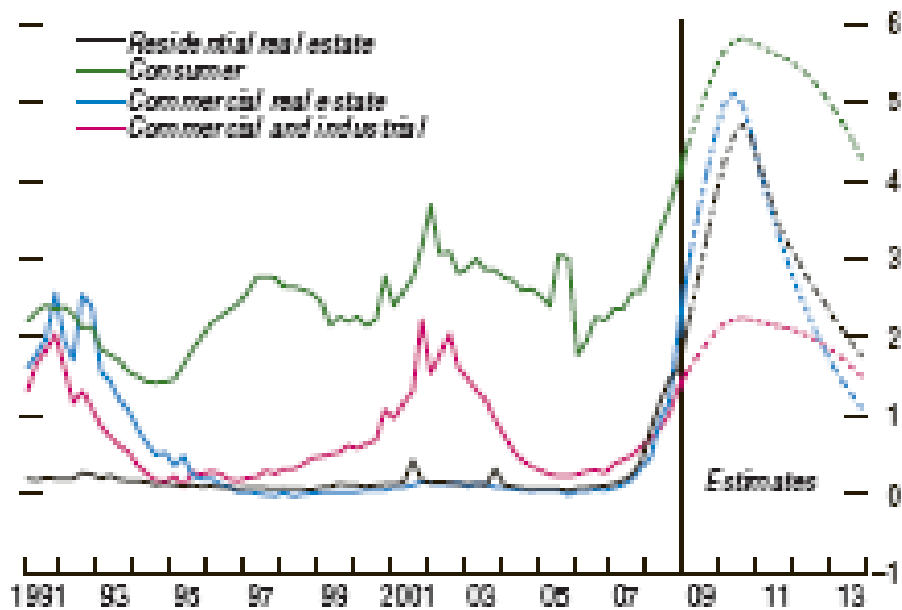
Figure 26: Delinquency rate of US residential mortgage loans

(Per cent of total loans, 90+ days in arrears)



Source: IMF(2009a: p. 26)

Figure 27: US loan charge-off rates, baseline estimate (%)



Source: IMF(2009a: p. 26)

However, it does appear that Australia is best placed to weather all but the biggest financial storm. As long as the Chinese economy keeps growing in line with IMF predictions of 7.5 and 8.5 per cent in 2009 and 2010, respectively (IMF, 2009b: p.2), an early Australian recovery seems likely. Developments in late 2009 make this more likely, as the RBA increased official interest rates in October and November by a total of 50 basis points, quickly passed on in full to mortgagors by the major lenders. The relatively strong position of Australian housing and mortgage markets is reflected in the fact that average housing prices are continuing to rise in the major cities and the 90-day-and-over arrears rate, although rising, is overall, still under 1 per cent

(compare with Figures 26 and 27, above, for the US). Nevertheless, Garnaut (2009) has argued persuasively that the growing trade imbalances between developed Western economies with low savings rates and emerging economies in Asia and the Middle-East with high savings, threaten to increase the future likelihood of serious global recessions. The most critical of these imbalances relates to the growing trade mismatch between China and the US. 'The maintenance of economic stability and growth is among the issues that can no longer be solved without cooperation between China and the United States' (ibid.: p. 194). If the former stops investing its surpluses in the latter, rising US interest rates, inflation and stagnation could well result in a long and painful process of readjustment echoing through the global economy. This is also a possible scenario raised by Ferguson (2008). Australia would be at the forefront of economic casualties in such an eventuality.

This means that the main macro-economic risk to Australia is the possibility that the US, Japanese and European economies may fall into a second and deeper financial sector-sparked recession or full depression. In such an event it is unlikely that even a strong China would keep growth from slowing and unemployment rising in Australia. Only then would mortgage defaults and possessions in Australia be likely to climb significantly beyond the currently relatively low rates. Australia's vulnerability is underscored by its low savings and weak external balance situation, engendered through the first decade of the new century:

Australia has two strikes against it: its huge current account deficit before the crisis, and the deterioration in its terms of trade. This means that Australia will have to reduce average consumption levels more than most countries if it is to restore full employment on a sustainable basis' (Garnaut, op.cit.: p. 185).

4.3 Alternative views on the causes of the crisis

Considerable uncertainty and controversy surrounds current discussions of *why* the events described above occurred. Broadly speaking, analysis and commentary fall into four categories.

1. Greed and malfeasance. In this view, popular in the media, greedy and unscrupulous entrepreneurs misled investors, consumers and governments – sometimes illegally – in order to profit from rising asset values. Financial markets, in other words, did not track basic fundamental values but reflected and rewarded the risk-taking behaviour of financial sector operators. The culture enshrined earlier in the decade by the collapse of Enron, etc. pervaded investment markets and led to a range of business practices that resulted in the breakdown of trust throughout the economy, particularly in the US. These practices ranged from outright illegalities like the Ponzi scheme of Bernard Madoff to the pervasive 'rent-seeking' behaviour of senior finance sector executives in enriching themselves through 'outrageous' bonuses and generous compensation schemes.

Such accounts are natural in an environment that is seeking understanding quickly and searching for parties to blame. However, they tend to be exaggerated and offer, at best, only part of the answer. Fraud, for example, tends to be uncovered after (and because) the economy turns down, and hence cannot be seen as a cause; this was certainly the case in the Madoff scandal and others like it. 'The principal-agent conflict' represented by the evolution of financial executive compensation packages is certainly relevant. These incentives played a material role in stoking aggressive application of the new financial products, but without the plethora of opaque financial innovations in credit derivatives and their non-regulation, the escalating profits would not have arisen to make the huge payouts. Nevertheless, Garnaut (2009: ch. 5) points to 'greed' as one of the key causes of the 'great crash of 2008'.

'Greed', after all, is but another name for 'profit maximisation', and the latter is what drives capitalist development. In that sense, greed is always with us but major economic breakdowns are (fortunately) rare. Other factors must be present for profit-seeking behaviour to lead to economic crisis.

2. Government failure. Explanations based on the failure of government come in two contradictory forms: too much regulation and too little regulation. In the first view, existing government regulation of the financial sector prevented free markets from working efficiently. In the second view, government regulators failed to properly monitor (or even understand) what was occurring until much too late; even then, bureaucratic delays and fragmentation prevented effective and timely action.

What appears to be a more accurate description is not that too much or too little regulation occurred – but that the wrong regulatory structure was in place and the existing regulatory rules and tools were not well-suited to deal with novel challenges posed by the new world of credit derivatives. In a real sense, it was a case of the generals fighting the last war. The proliferating collection of new financial products, most notably credit default swaps (CDS) and collateralised debt obligations (CDOs), was understood by only a very small number of people within the large banks and brokerages, and as it turned out, even these people did not appreciate the real risk being generated throughout the system as a whole by the increasingly tight inter-linkages between the banking and shadow banking systems. Beyond that rarefied minority, financial sector operators, regulators and politicians alike, all accepted the assurances of key spokesmen like Alan Greenspan and Ben Bernanke that risk was being efficiently distributed by these derivatives to those investors best able to manage it. This comfortable position accorded well with the prevailing neo-liberal view that markets left to themselves were well placed to deal smoothly with any external shocks.

With hindsight, it is clear that the government's decision to allow Lehman Brothers to fail, rather than be assisted to merge, was the great blunder in creating panic, barely averted 2 weeks later when a policy about-face resulted in the bailout of AIG. However, this was not a failure of regulation but a near-fatal error of political judgment.

Posner (2009: p. xii), in this respect, comments:

Some conservatives believe that the depression is the result of unwise government policies. I believe it is a market failure. The government's myopia, passivity and blunders played a critical role in allowing a recession to balloon into a depression, and so have several fortuitous factors. But without any government regulation of the financial industry, the economy would still, in all likelihood, be in a depression. We are learning from it that we need a more active and intelligent government to keep the economy from running off the rails. The movement to deregulate the financial industry went too far by exaggerating the self-healing powers – of laissez-faire capitalism.

It is true that the US government, like counterparts in Australia and some other countries, encouraged the extension of mortgage lending to low- and middle-income earners. However, there is no direct evidence that proves that this factor was decisive in causing the current crisis. After all, no one forced the banks to lend (Posner, 2009: p. 242).

However, it might be argued in the Australian case that a relatively complacent attitude of government and regulators to the build-up of very high (by international standards) personal debt levels, coupled with strong government support to extending home ownership by way of 'first home owners' grants, helped to create the climate in

which mortgage defaults would rise if and when external shocks to the domestic economy eventuated. Reinforcing this dynamic, the avowed aim of Australian governments to develop Australia as a financial hub for the Asia-Pacific, may encourage further financial innovation and competition between lenders and even higher household debt levels in future.

3. Investor and borrower 'irrationality'. Behavioural economists argue that the current crisis was essentially driven by a self-reinforcing psychology of over-confidence among both mortgage borrowers and lenders. The major proponent of this view, Robert Shiller (2008: p. 4) stated:

The view that the ultimate cause of the global financial crisis is the psychology of the real estate bubble (with contributions from the stock market bubble before that) has certainly been expressed before. But it would appear that most people have not taken this view to heart, and at least that they do not appreciate all of its ramifications. Accounts of the crisis often seem to place the ultimate blame entirely on such factors as growing dishonesty among mortgage lenders; increasing greed among securitisers, hedge funds, and ratings agencies; or the mistakes of former Federal Reserve Chairman, Alan Greenspan.

Shiller argues (in his book, *The Subprime Solution* and in the second edition of his earlier influential book, *Irrational Exuberance*) that the housing price bubble in major US metropolitan housing markets was caused by a strong positive feedback loop, characterised by increasing confidence in future housing capital gains, plentiful mortgage credit, low interest rates and continuing house price rises. Many of the biases identified by behavioural economists in other areas were present, Shiller argues, in the housing sector; notably, over-confidence, selective information gathering, 'story-telling', ignoring of warning signs, trust in experts, wishful thinking.

Lenders were as subject to these biases as borrowers; so were other institutions like the ratings agencies. Derivatives traders and ratings agencies were used to using standard quantitative tools for assessing the risk and thus price of all manner of debt products. It now appears that they collectively underestimated the real likelihood of sub-prime mortgages defaulting in the real, as opposed to abstract world of the standard models. As Tett (2009) argues, the data simply wasn't there in the case of these loans to accurately assess the correlation of potential defaults. As a result, actual defaults and resulting realisation losses (from the forced sale of repossessed houses) vastly exceeded the assumptions of the models. Common reliance on the available quantitative models lulled most lenders, agencies and mortgage insurers into a false sense of security, the bias of over-confidence or hubris.

Garnaut (2009: p. 23) argues that the increasing interdependence of national economies reinforces the volatility of the global system:

When more and more of the world is linked, the variations across countries develop closer connections and come to reinforce each other. The liberalisation of financial transactions seems to have left more scope for the herd to gain momentum in a boom, as well as in a panic, when the herd changes its course.

4. Systemic market failure. Posner (2009) explicitly rejects the need for explanations that rely on the irrationality of economic actors. He claims, instead, that such factors are likely to have been marginal and that the scale, scope and timing of the crisis can be explained within the standard economic model of rational maximising consumers and producers. In his view, economic actors were responding as would be expected (by economists) to market signals.

As far as one can judge on the basis of what is known today (obviously an important qualification), the depression is the result of normal business activity in a laissez-faire economic regime – more precisely, it is an event consistent with the normal operation of economic markets. Bankers and consumers alike seem to have been acting in conformity with their rational self-interest throughout the period that saw the increase in risky banking practices, the swelling and bursting of the housing bubble, and a reduction in the rate of personal savings combined with an increase in the riskiness of those savings. The market participants made plenty of mistakes, but that is par for the course. Whenever has it been different? Economic life is permeated with uncertainty (Posner, 2009: p. 234).

As credit constraints were relaxed and interest rates fell, households borrowed more to spend on housing. Market-relevant information emanating from the housing industry and government reinforced the message that housing markets were being driven by underlying fundamentals: buoyant economic growth, rising incomes, falling average household size and increasing population. Lenders were able to lend more because the value of their loan books kept rising. A range of new intermediaries placed themselves between mortgage borrowers and investors, all responding to the incentives of competitive markets. Mortgage defaults were low and well within the parameters of the risk assessment models. These factors remained true right to the moment the housing bubble burst in 2006, apart from industry pronouncements that stayed bullish into 2007, for obvious self-interested reasons. Even though some actors came to see the bubble-like nature of housing before then – and acted accordingly, to their good fortune – most continued to act as before, to their cost. But, as Posner argues: ‘that is par for the course’. Some win and some lose in the uncertain economic struggle. No one, he suggests, can know for sure when a rising market turns into an unsustainable bubble — until it bursts. Until then everyone will continue to pursue his or her selfish economic interests. To voluntarily pull out of a rising market means foregoing potential profits (utility) and watching other actors increase theirs. As the then CEO of the then largest bank Citigroup commented, words to the effect that when the music is playing you have to keep dancing, and the music is still playing.

Moreover, the internal organisation of the large lenders and brokers contributed to the expansion of the credit derivatives business. Senior bank executives had little experience or knowledge of what the new credit products were, nor how to ensure that appropriate risk management processes were in place and being complied with. This knowledge was compartmentalised in small specialist teams within the organisation. The external competitive pressures to grow market share and post rising quarterly earnings led many (but not all) US and European banks to encourage the growth of their most profitable products, which in the context of a booming housing market, meant precisely those credit derivatives tied to housing. To some extent, everyone’s overall compensation within the organisation became dependent on the continuing growth of this business.

Potential borrowers, on the other hand, were faced with attractive conditions and inducements to borrow in order to become home owners, even households with few resources and poor credit histories.

What this suggests, and Posner argues, is that micro-efficiency and rationality at the individual actor level can, nevertheless, aggregate to system-wide failure. The metaphor is a fire in a theatre; everyone has a strong individual incentive to flee the

building as soon as smoke is observed, but as all rush for the exits at the same time, no one gets out and all die.

This logic can be applied to the case in point. The dynamic of a booming housing sector in the US led to an insatiable demand for mortgage-backed bonds. Banks could securitise and pass on mortgages, collecting fees for doing so, and remove risk from their balance sheets, freeing up capital to repeat the transactions many times over. This growing demand for mortgages to securitise brought forth a supply response — banks and mortgage brokers offered more and more loans to borrowers who would never before have been considered. This could be done because the new financial engineering turned the sub-prime individual mortgages into higher-rated bonds attractive to a range of investors. Everyone along the line gained, but only as long as housing prices kept rising and sub-prime borrowers kept repaying their loans. When the real risks of default became apparent, all lenders and brokers tried to shore up their solvency at the same time, resulting in the credit crunch and a spiral into recession.

In other words, although individual actors were at all times acting in the rational pursuit of self-interest, macro-efficiency was threatened by the systemic effects. This appears to be partly due to imperfect information and partly to endemic 'moral hazard'. The manner in which risk was transferred through the securitisation process meant that no one had both the incentive and opportunity to properly monitor, assess and control credit risk; hence, no one did so. Banks thought that they had effectively transferred all the risk to someone else — erroneously as it turned out. Eventually, the banks that had most enthusiastically participated in the CDS and CDO trade were left with an unforeseen, unknown but huge liability for defaulting housing loans. Financial stability at both the national and global scales, turns out to be a public good; if left solely to the market it is chronically under-supplied.

When investors cannot appropriately price complex new securities, they cannot properly assess the overall losses faced by financial institutions, and where they cannot know who is holding the risk for so-called toxic waste, this turns into generalized uncertainty. The outcome is an excessive increase in risk aversion, lack of trust and confidence in counterparties, and a massive seizure of liquidity in financial markets. Thus, once lack of financial market transparency and increased opacity of these markets became an issue, the seeds were sown for a full-blown systemic crisis (Acharya et al., 2009: p. 5).

In reality, all the above explanations have some degree of persuasiveness. Even if we agree with Posner that much of what happened can be sheeted home to the pervasive pursuit of narrow individual self-interest, surely 'irrational' behaviours, government failures and fraud had some role. In particular, Posner's claim that agents were acting rationally because one can't know that a bubble is a bubble until it bursts, places a peculiar meaning on individual rationality. Shiller and other behavioural economists have a point when they claim that people decide on the basis of various rules of thumb ('heuristics') based on persistent human biases — to borrow Posner's words, 'that's par for the course'. To wilfully ignore any disconfirming information that a housing (or any other) market is wildly over-valued and act accordingly, hardly qualifies as rational behaviour in any meaningful sense.

4.4 Policy implications

It is beyond the scope of this study to canvas the range of policies that are being suggested to re-regulate the global financial system. Clearly, this poses large challenges for finance ministers in the G20, along with decisions about when and how to scale back current stimulus packages. That some form of major re-regulation is

necessary seems to be generally accepted, or at least regarded as politically inevitable, and various suggestions have been forthcoming (e.g. see contributors to Acharya and Richardson, 2009). Whatever eventuates, a workable balance will need to be struck between leaving too many opportunities for perverse incentives and moral hazard to bring about future systemic crises like the current one, and overly burdensome regulations that discourage continuing positive innovation and development in financial markets. 'We must now face the challenge of redesigning the regulatory overlay of the global financial system in order to make it more robust without crippling its ability to innovate and spur economic growth' (Acharya et al., 2009: p. 1).

What the current crisis has shown beyond doubt is that large financial institutions are now 'too interlinked to be allowed to fail' (as Lehman Brothers was). A second clear lesson is that economic policy makers and regulators need to be aware of the role of housing – the major wealth asset class – in the health of the real economy; instability in housing markets is intimately tied to general instability in the economy, increasingly on a global scale. The 'macro-housing nexus' is an important fact that national economic policy makers need to take seriously (Berry, 2006).

Whereas there are a number of specific policy ideas discussed in the final chapter, particularly with respect to the education and protection of lower-income owner-occupiers, it is worth raising here a larger basic question for future consideration. Is there a limit to extending home ownership? If so, how do we get a more effective multi-tenure housing system that doesn't threaten macro-crisis but does meet the diverse housing needs of households at different stages of the life-course?

AHURI research (Beer and Faulkner, 2009) has chartered the changing nature of housing careers in Australia. There are now more points in the life-course where a household can 'fall out' of home ownership. The research presented in this report suggests that critical episodes like loss of a job or an income in a household and divorce or separation can spark mortgage default. As with the related phenomenon of unemployment, more Australians are going to be affected by involuntary exit from home ownership more often in their lives than in the second half of the twentieth century. The assumption implicit in Australian housing markets and policy since the early 1950s – namely, that virtually everyone would become a home owner at some stage of their lives and the overwhelming majority of retired Australians would be able to enjoy retirement living in their homes that they owned outright – is breaking down. Social policy makers will need to grapple with this reality in the face of an ageing Australian population. Economic policy makers too have been made aware that 'housing matters' by the events in the financial sector and real economy over the past 2 years.

5 POLICIES TO MINIMISE AND MANAGE MORTGAGE DEFAULT

This chapter updates the corresponding chapter of the positioning paper. It concentrates on Australian policy responses to the increasing complexity and more diverse kinds of lending in the twenty-first century. It takes account of the implications and repercussions of the US sub-prime housing lending crisis, including rising interest rates and the greater availability of credit followed by more stringent and reduced access to loans. It also reviews government policies developed during 2008 and 2009 to relieve stress for vulnerable households, to try and keep house prices stable (i.e. from falling) and to reduce the risks of serious failure within financial markets and the real economy.

The most significant development since completing our positioning paper late in 2008 has been the transfer of responsibility for credit institutions and products to the Commonwealth (from the Australian states and territories) and starts made in the implementation of a raft of measures facilitated by these new powers. With new supervisory and regulatory controls to implement reforms nationally, the federal government has sought to improve lenders' practices, initially by expanding control over the entire financial sector involved with mortgage lending. This has enabled, for instance, agreements with lenders to respond to claims of hardship, which had increased with rising levels of unemployment and underemployment in 2008 and 2009, even as interest rates fell. These kinds of activities are discussed in 5.1 below.

Sectors involved with lending, financial counselling, legal aid, charities and consumer advocacy organisations have all made various suggestions for policy interventions to minimise default related to lenders' practices and to borrowers' behaviour. They have highlighted the failings of specific kinds of loans and problems related to financial literacy, especially with the more complex and complicated credit products and services now available. These have been areas of interest to the Australian Securities and Investment Commission (ASIC) too (Fido 2008). Only loosely following the order in our positioning paper, we update discussions on the most significant measures relevant to lenders' practices and borrowers' behaviour that are either in the process of being implemented (5.2) or remain outstanding (5.3).

As outlined in our positioning paper, many commentators (and, subsequently, the householders we interviewed and surveyed) indicated that home ownership promises material, emotional and economic benefits compared with other housing options. The shortage of, and limitations in eligibility for, public housing and high rents, and the limited tenure and associated restrictions to making rented homes more functional and efficient in the private rental market pressure those least able to afford it into home ownership. The federal government has announced an expansion and upgrading of existing social housing and has used First Home Owners grants to stimulate the economy. Though both address deficiencies in the housing system (as detailed in 5.4), both policies have been widely criticised for reasons there outlined.

In short, this chapter outlines further planning towards and implementation of the major measures identified in the positioning paper and the main outstanding areas of concern with respect to preventing and managing the implications of mortgage defaults. It draws heavily on inquiries, research, recommendations and activities of government agencies as well as research and statements by representatives in the financial industry and specialist non-profit organisations involved in financial counselling. The conclusion (5.5) includes a call for more analysis based on improvements in the collection of relevant statistics.

5.1 Platform to launch the reform agenda

As detailed in the positioning paper, the House of Representatives Inquiry into Home Loan Lending Practices and Processes instigated by the Standing Committee on Economics, Finance and Public Administration (House of Representatives 2007b: xv–xvi) resulted in a report with three main recommendations to improve home mortgage lending and ameliorate risks of defaults, i.e. for:

- The ABS to expand data collection on repossessions of homes, requiring more detailed information from lenders and the courts.
- The federal government to take over responsibility and expand the regulation of credit to all lenders and mortgage brokers in order to simplify and unify legislation and supervision.
- Comprehensive access to external dispute resolution (EDR) to address complaints, easing current eligibility limits and specifying the lifting of the Banking and Financial Services Ombudsman's limit of \$280,000 to \$500,000.

With the change of government at the October 2007 federal election, the Treasury (2008) prepared a Green Paper, *Financial Services and Credit Reform*, advocating Commonwealth control of credit, most of all home mortgages. This reform was expected to overcome widely agreed upon deficiencies relating to the complexity, lack of uniformity and duplication of effort under distinct state and territory rules. The Green Paper (Treasury 2008: 9) advanced a national agenda to unify and simplify the sector by dealing with gaps in the regulation of consumer credit and protect all consumers with external debt resolution (EDR), to license providers of credit and require minimum standards of conduct. During 2009 a start was made to implement these measures through the national consumer credit regulation (ASICb).

Plans to bring mortgages under uniform national legislation subjecting mortgage brokers, non-ADI and ADI lenders to consistent licensing requirements, and minimum standards of conduct based on advice provided to borrowers have been implemented relatively quickly. On 27 April 2009 a draft bill was released providing a national licensing system, with minimum standards for education, qualifications and training as well as requirements that lenders only offer loans appropriate to the borrowers' debt-servicing capacity (Woolrich 2009). ASIC has increased its staff by 200 to register the 10,000 suppliers of credit to the 5.7 million Australian households that have debts, including 2.9 million with mortgages. Similarly legislation long in development will take effect late 2009, introducing mandatory licensing throughout the sector of broking activities, attempting to ensure transparency, minimum qualifications, greater responsibility for objectively assessing debt servicing capacities of borrowers (evidence of income etc.) and reasonable fee structures.

In May 2009 the government announced that ASIC would start to regulate margin lending by categorising it as a financial product under the Corporations Act. 'New laws to provide national regulation of the \$21 billion margin loan industry will put curbs on investors from using the family home as security for taking on risky levels of debt to buy shares,' reported the ABC (Ryan 2009). Disclosure of fees, appropriate advice and assessment of debt servicing capacity were now required of lenders as well as improving borrowers access to EDR.

Placing such advances in perspective, Table 8 summarises a range of policy measures considered worthy of serious attention and evaluation by government. All measures in the parallel table in the positioning paper appear here, but others have been added, for instance to address the high incidence of illness in defaulting

household scenarios that our research has revealed. The *ABC Law Report* (Carrick 2009) also identified illness as a cause of mortgage default.

In other words, while most measures evolved from public debates and documents, we have selected those we consider most appropriate and have added some as a result of our primary research. These policy measures are divided into preventative and relief (or restorative) categories. The former seek to reduce the risk of mortgage defaults arising, the latter provide ways to deal with defaults. The measures are listed as possible directions. All those shaded grey have been followed through on to some extent by the government since the positioning paper was written. Additional interventions that we recommend deserve serious attention have been highlighted by use of italics.

As indicated in the positioning paper, wider macro-economic preventative policy measures would focus on actions of governments and financial institutions (such as central banks and key financial regulatory authorities) necessary to ensure stable economic growth and high levels of employment especially since unemployment is one of the major triggers of mortgage default. Clearly, in the current climate of global financial stress, these large policy concerns are uppermost in government priorities for reasons that include but, of course, go well beyond the issue of mortgage defaults. These larger macro-economic policy responses are beyond the scope of this study. However, their salience and urgency at this time provides a strong rationale for effective government intervention to limit the scale and impact of mortgage defaults in countries like Australia, in order to break the cumulative feedback effects of default on consumer confidence, falling aggregate demand, and rising unemployment.

Table 8: Proposals to minimise and ameliorate mortgage default

<i>STRUCTURAL ACTORS/PROCESSES— TOPICS TO ADDRESS</i>	<i>PREVENTATIVE MEASURES</i>	<i>RELIEF MEASURES (RESTORATIVE)</i>
<p><i>Lenders' practices</i></p> <p>Establishing a balance between conservative and irresponsible lending.</p> <p><i>Models, indicators and/or formulae for defining and assessing hardship and debt-servicing capacity of mortgagors that are commonly accepted by the financial industry, government regulating agencies, in legal forums and by financial advisers.</i></p> <p>Embedding clear and widely accepted practices of response to hardship (variations) due to both individual circumstance and wider economic impacts.</p> <p><i>Planned response by government to economic downturn, diminishing credit and increasing vulnerability of specific households to falling</i></p>	<p>Regulate mortgage brokers.</p> <p><i>Stricter criteria for lending based on debt-servicing capacity, not asset value, restricting the size of loans (LVR), and aspects of eligibility relating to income.</i></p> <p>Make lenders, and their agents/brokers, more responsible for confirming debt-servicing capacity of borrowers — eradicating no-doc and minimising or redefining low-doc loans.</p> <p><i>Require open, plain English, and detailed information on all loan products and services — perhaps through ASIC and the Understanding Money website.</i></p> <p>Improve reporting as well as regulation of non-ADIs and provide borrowers with lists of regulated borrowers, all</p>	<p>Expand and enhance APRA-approved external dispute resolution (EDR) services as well as their powers to discipline lenders.</p> <p><i>Ensure repossession cannot occur while independent appeals — EDR — over rejected hardship claims or other serious and legitimate disputes are in process.</i></p> <p><i>Establish a specific home mortgage ombudsman with special powers.</i></p> <p>Regulatory agencies, such as OFT and APRA, continue reviewing products and services as well as market demand and awareness.</p> <p>Monitor national, state-by-state and regional developments in terms of default and house prices for timely introduction of</p>

<p><i>house prices, reduced income or higher interest rates.</i></p>	<p>demand to be members of APRA-approved external dispute resolution organisations.</p>	<p>government relief to householders.</p>
<p>Borrowers' behaviour</p>	<p>Improve secondary and tertiary education on financial management of home mortgages.</p>	<p><i>Free, easily accessible, and independent financial advice if in arrears.</i></p>
<p>Improving borrowers' skills and knowledge about the dangers of certain lending practices and products.</p>	<p><i>Free, easily accessible and independent financial advice when a home loan is applied for.</i></p>	<p><i>Revise and expand eligibility for mortgage relief assistance to provide uniform national coverage, redefining hardship to take into account temporary emergency measures during downturns.</i></p>
<p>Improving borrowers' knowledge of and enhancing the support and relief systems available to those in financial distress.</p>	<p><i>Redefine hardship to take more account of how severe and longstanding illness in households constrains income generation and saving and requires variations to loans.</i></p>	<p>Identify and publicise through the popular media those lenders taking most court actions, borrower types, and loan kinds most prone to default.</p>
<p>Housing context</p>	<p>Publicise responsibilities of a mortgage and default — e.g. build a narrative around a great Australian nightmare.</p>	<p>Improve public credit reporting.</p>
<p>Improving collection and up-to-date analysis of data on mortgage arrears, defaults, and claims of possession (lodged and successful) as well as monitoring levels of mortgagors' financial stress and forced sales.</p>	<p><i>Improve terms, conditions and supply of housing accommodation options that compete with owner-occupation, e.g. enhance public and private tenants' rights, expand social housing, etc.</i></p>	<p><i>Implement guidelines and rights to temporary housing assistance for defaulters.</i></p>
<p>Ensuring households have a range of options for accommodation that are affordable and accessible where they need to work.</p>		<p>Enhance tenants' rights when the house they are leasing is subject to a claim of possession and later when it is repossessed. Appropriate reforms include sufficient notice to vacate, the claim of possession providing sufficient reason to break a lease, and compensation for costs associated with moving.</p>
<p>Private and public tenants' rights to secure long-term housing at a manageable cost.</p>		
<p>Access to temporary housing for evicted households and tenants of leased properties where the mortgagee is threatening to take, or has taken, possession.</p>		

Note: already implemented or planned proposals have been shaded; proposals that require addressing are italicised

5.2 Lenders' practices

All the key issues based on lenders' practices summarised in Table 8 were identified in the positioning paper. Some, such as government guaranteed mortgage-backed securities and mortgage lenders' insurance, require no more explanation. Others, such as certain issues surrounding home valuations, 'business' and other 'special loans', have been sidelined as the government focuses on other priorities. Further issues, such as those relating to bonuses based on lending performance for brokers, are ameliorated to some extent by regulation of brokers. Similarly, needs to tighten regulations on low-doc and no-doc loans have been partly addressed by federal regulation of mortgage lenders, especially demands for them to take more responsibility in assessing borrowers' capacity to pay. Thus, given recent developments, further discussion of such issues seems redundant.

The remaining issues identified in the positioning paper have been acted on either substantially or partially through Commonwealth regulation of credit and the immediate exercise of its powers to direct and enforce better lender conduct. These issues include: debt-servicing capacity and inappropriate lending, access to hardship variations and external debt resolution, and the regulating of non-ADIs and predatory lending. The rest of this section discusses the extent to which the policies introduced address the concerns that our study identified need most serious attention with respect to mortgage default in Australia today.

5.2.1 *Debt servicing capacity*

As outlined in the positioning paper, many concerns have been raised about lenders' assessments of borrowers' debt-servicing capacity. Although there has been much publicity around non-ADIs as the culprits of irresponsible lending, around one in three bank customers report thinking that 'they have been offered too much money by their bank' (Wakeley in House of Representatives 2007a: 55). Citing anecdotal evidence the deputy chair of the 2007 inquiry into home loan lending practices and processes agreed (Ibid: 57). Early in 2009 an advertisement by broker firm Mortgage Choice (2009) showed that a couple earning just \$65,000 per year would be eligible for home loans from \$268,944 from the most cautious of 28 selected lenders through to \$425,246 from the most profligate. With so many lenders with different criteria and limits to their borrowing practices, there have been many questions raised over the reliability and appropriateness of current formulae and models, along with suspicions that evidence of income provided by borrowers was not scrutinised sufficiently by the lenders or the mortgage brokers who facilitated the application process, as well as the dominance of asset-based lending. For all these reasons more responsibility has been placed on lenders to more accurately assess borrowers' capacities to pay.

With Commonwealth control of credit 'responsible lending' regulations are to be formally enacted late in 2009. The new federal regulation drafted includes clauses making it a criminal offence to provide credit 'that cannot be repaid' with punishments of hefty fines and jail (up to five years). However, the wider economic context, especially a more precarious work environment and the generally long term of loans for housing, make estimations of capacity to pay based on evidence of current and immediate past income both less reliable and less relevant. Failings in estimating debt-servicing capacity can be addressed by restricting debt to less than 80 per cent of a home's valuation. Yet, ironically, the federal government's First Home Owners grant has enticed many people who are only capable of purchasing a home by taking out a loan with a higher than 80 per cent LVR into the market. These risks have been accentuated by prevailing low interest rates, the probability that house prices are 'over-valued' (especially in areas with higher levels of demand associated with first

home buying) and the prevalence of desktop house valuations (Martin North cited in McLaren 2009).

Besides improving data fed into home loan applications — by demanding more, and more reliable, evidence of income and house valuations — another way of approaching this problem would be to reintroduce industry-wide protocol for assessing debt-servicing capacity akin to the 30 per cent rule that traditionally applied. This might involve sliding scales of percentages considered safe to lend depending on the level and security of income and/or the kinds of schemes Shiller (2008) has suggested, which have been discussed in more detail in the positioning paper.

While some of the responsibility for capacity to pay has been shifted to lenders, they are exercising their responsibilities in heterogeneous ways, meaning that appeals cannot be judged against a firm uniform standard procedure. There does not seem to be any firm indication that the latter is planned even though ASIC (2009b) will release a 'Regulatory guide on responsible lending' in January 2010. Thus it will not be clear for some years whether the shift of responsibility has led to better lending practices or not. Our research suggests the value of ongoing monitoring and analysis of the effectiveness of policies aiming to make lenders more responsible for assessing borrowers' debt servicing capacity.

5.2.2 Response to borrowers requesting hardship variations

The 2007 inquiry specifically recommended reform to 'provide guidance on lenders' obligations to borrowers who are facing financial hardship' (House of Representatives 2007b: iv). Vagaries in the processes of negotiation between lenders and borrowers as well as outcomes for borrowers who approached lenders to request a hardship variation caused concern (House of Representatives 2008b: 43; Carrick 2009).

On 5 April the federal Treasurer Wayne Swann (2009) announced that an agreement involving 'a common approach' had been made with Australia's four major banks lending around 80–90 per cent of home loans (Bain 2009). The agreement centred on the banks making and publicising arrangements for hardship variations for mortgagors who had lost their jobs 'or are in difficulty more generally', such as interest only 'holidays', reducing repayments temporarily and extending the duration of the loan accordingly, postponing dates at which payments were due and instead capitalising interest that would normally accrue or simply 'offering different banking arrangements that will better suit the customer's needs'.

The agreement required lenders to establish and publicise a toll-free hotline for informing borrowers of their rights, and encouraged them to be pro-active and contact borrowers who seemed financially distressed, and to put on more staff to facilitate such monitoring and negotiations. The banks were required to act in a timely manner, and respond to each borrower in an individual needs-based way while ensuring evidence was provided for eligibility. Borrowers were advised that, if their bank's customer complaint department did not respond to queries over their bank having 'lived up to its obligations', then they should discuss the matter with the Financial Ombudsman Service.

The agreement modelled an approach that the government planned to become universal throughout the sector of home loan lenders. Later in April 2009 the federal government confirmed that 144 financial institutions had already improved access to hardship provisions for struggling households with mortgages up to \$500,000 (i.e. widening eligibility from the pre-existing limit by over 50 per cent) and heralded a universal mortgage hardship relief scheme for implementation by 1 November (Griffiths 2009). Responsible lending is to be assessed in terms of 'suitability' for the borrower in question and their debt-servicing capacity (Commonwealth of Australia

2009: 6). Mandatory membership of an EDR body, which is being required of lenders across the sector now, is expected to be an effective and cost-efficient method of ensuring that lenders respond adequately to reasonable approaches for variations in lending terms and conditions.

However, questions were raised over the extent to which these new regulations really changed opportunities for borrowers (most of whom had access to hardship variations and appeal mechanisms already), and whether the reforms in fact simply buttressed the position of the 'big four' banks and would prejudice custom to other lenders, and even contribute to a property price bubble (Aussie Home Loans Chairman John Symond and Fujitsu Consulting Martin North in Lindell 2009a, 2009b). Indeed, by July, Bain (2009) reported that the Commonwealth Bank was ordering its brokers to improve their individual performance in writing loans or lose their accreditation — apparently expressing and extending the dominance of the big four banks. Given that the government has staked its confidence in the efficiency of the sector on competitiveness of the home lending market, these developments signal further areas of concern, requiring ongoing research and analysis.

The National Consumer Protection Bill was introduced into the Australian Parliament on 25 June 2009, which set off a consultation process organised by the responsible agency, ASIC (2009a), with stakeholders in the home lending sector. Subsequently, on 14 August, the government was moved to announce that it had fast-tracked the most significant 'responsible lending conduct requirements' by one full year, to 1 January 2010, in order both to protect borrowers with enhanced legislation more quickly and to close the gap in consumer protection between the states and territories rescinding control of credit and the Commonwealth taking it over threatened under the original timelines (Bowen 2009). The two phases announced by Treasury and ASIC (2009b) involve, firstly: federal absorption of the supervision of the Uniform Consumer Credit Code (UCCC) enhancing its coverage (including over mortgages on investment properties) to unify its inconsistent application across eight jurisdictions and adding further rules and regulation of credit providers. The second phase includes reforming mandatory comparison rates and default notices as well as more regulation and disclosure requirements associated with reverse mortgages in particular. Box 5.1 summarises the objectives of the bill.

Certainly research will be required (during the next five years especially) to monitor the success of these new regulations over the mortgage lending sector, particularly to assess how responsive the various different lenders have been to borrowers' legitimate needs and how appropriate and successful hardship variations have been in the 'longer term' for borrowers.

The positioning paper referred to two ideas developed by Shiller (2008). First, borrowers could take out a home equity insurance policy against the market value of their dwelling falling with respect to a regional average house price index, protecting them against housing wealth losses and negative equity, which predisposes highly leveraged households to mortgage default. Second, a 'continuous workout mortgage' could automatically (say, every month or quarter) re-adjust repayments to the changing capacity of the borrower and conditions in housing and financial markets. Thus, for example, when the borrower's income fell and/or when variable interest rates rose, the mortgage repayment and loan term would automatically re-set to meet a benchmark repayment to income ratio.

Box 5.1: National consumer credit legislation: objectives

How the proposed consumer credit laws will benefit consumers

- Protect consumers from being offered loans that are clearly unsuitable for them or that they cannot afford to repay.
- Enhance consumers' understanding of credit products by greater disclosure of information, including fees, charges and commissions.
- Increase the maximum threshold for mortgage hardship cases from the current \$312,400 to \$500,000 and puts in place a new, flexible power to raise this further as needed.
- Assist consumers to make informed choices by creating a more level playing field on access to information between the consumer and the lender or broker.
- Ensure consumers receive reliable credit services from suitably qualified and competent persons.
- Protect consumers in borrowing for residential investment property.
- Provide a national regulator, ASIC, with enhanced powers to enforce responsible lending conduct standards.
- Give universal access for consumers to low-cost external dispute resolution schemes.
- Provide the option for the first time of opt-in, tribunal-like access to the Federal Magistrates Court.
- Provide comprehensive regulatory coverage of the credit industry for previously unregulated sectors such as mortgage brokers.
- Broaden criminal and penalty sanctions to safeguard industry standards.
- Enhance consumer protection through improved access to consumer remedies.

How the proposed consumer credit laws will benefit industry

- Reduce duplication, red tape and compliance costs as eight sets of regulation are replaced with one national scheme.
- Cut up to 2,500 pages of inconsistent laws down to one comprehensive national regime.
- Introduce a regulatory regime that allows innovation, and promotes increased consumer and market confidence.
- Create a level playing field across the credit industry by requiring all industry participants to meet required conduct obligations and standards.
- Establish two clear groups of credit participants — credit providers such as banks and credit unions, and credit service providers, such as credit and mortgage brokers.
- Create appropriate sets of obligations on credit providers and credit service providers matched to the current level of regulation of both groups.
- Enhance industry standards through one national market subject to obligations and requirements by one national law enforced by a national regulator — ASIC.

- Raise industry standards by establishing minimum requirements such as responsible lending conduct, and disclosure considerations in providing credit services.
- Reduce costs to business of responding to enforcement action through the use of a broader set of consumer remedies and enhanced ASIC enforcement powers.

Source: Reprint of Commonwealth of Australia 2009: 6.

In the period since the positioning paper was written income security for mortgagors through income insurance has been raised more widely as an antidote to unemployment, which caused mortgagors' levels of financial stress to increase during 2009, but innovations such as Shiller's have not been taken up. The outstanding issue here is commonly acknowledged and accepted criteria, indicators and protocols with respect to debt-servicing capacity and definitions of hardship. As stated in the positioning paper, a formula or model is crucial to fill the void created since the '30 per cent rule' was sidelined to provide common or standard responses to borrowers presenting with difficulties. It is only once debt-servicing capacity and hardship are better defined that the concept of predatory lending is easier to identify and control.

5.2.3 Predatory lending practices

Efforts to make caps on interest rates and other fees uniform across Australia seem to have been sidelined in the Commonwealth's take-over of credit in favour of relying on measures discussed above to address predatory lending (Parker 2009). In May 2008 Queensland moved to protect borrowers with a 48 per cent p.a. limit covering interest and any other fees and charges associated with a loan, as already applied in New South Wales (NSW) and the Australian Capital Territory (ACT). In announcing a connected policy reform (to put \$1.2m into expanding its 'No Interest Loans Scheme') the Minister for Justice Kerry Shine (Brisbane Times 2008) said, 'I've heard stories of people losing their homes and cars and all their possessions because they could not meet the excessive interest charged by pay day lenders who charged up to 1600 per cent on loans.'

In Victoria there was a maximum interest rate of 48 per cent p.a. but, as stressed by CALC Victoria (Bond in House of Representatives 2008d: 20) no cap on other fees and charges. Thus, especially on products sold to non-conforming or financially embarrassed customers or with respect to default terms and conditions, extortionate rates might apply. While Victoria had a 30 per cent p.a. cap on the interest rate on loans secured by a mortgage, if they accumulated too much other household debt at extortionate rates 'it would still bring the edifice down' (Parker 2009).

One predatory lending practice, which is most commonly characteristic of asset-based lending, is selling a repossessed property at an under-value price. In certain areas of NSW defaults have been particularly high in recent years (Fitch Ratings 2008: 7–8). The NSW government recently legislated against mortgagees' accepting low offers when selling repossessed houses. If there is clear evidence that a house has been sold below its market value, the mortgagee might be ordered to pay damages. ABC News (2009) reported Tony Kelly, the Land Minister, saying: 'This legislation will stop banks and other financial institutions from holding fire sales on defaulted mortgages, and this will ensure that there's some equity for the home owner.'

Again NSW here followed the lead of Queensland, where it has been a longstanding policy. However, recently even Queensland needed Fire Sale Amendments to clarify lenders' obligations:

The first is that they've got to adequately advertise the property; the second is that they've got to have reliable evidence of what the value is; the third is that they've got to maintain and repair the property, and then finally they've got to sell by auction unless it's appropriate to sell some other way. So it's really just clarified what reasonable care might be. But one of the new aspects is that there's actually penalties if lenders don't do this, so there's a fine of up to \$20,000 if lenders don't do those things that are set out in the amendment. (Shearer cited in Carrick, 2009)

Predatory lending can be minimised by improving protocol and practices for responsible lending. Ways to address unscrupulous and risky lending practices also include improving borrower awareness and financial skills, and access to timely and independent financial and legal advice, as well as ensuring that people have other housing options rather than simply being pressured into home purchasing because the alternatives are sub-standard, inconvenient, costly and limited. These topics are addressed in the next two sections of this chapter.

5.3 Borrowers' behaviour

As stated in the corresponding section of the position paper, while regulation of lending practices seems to address many problems at source, borrowers' behaviour is a significant aspect of the financial system. However, a consumers' rights framework fails to encompass the peculiar dynamics of lending, which involves a service rather than a once-and-for-all direct exchange and a long-term relationship between borrower and lender, i.e. home loans involve 'debt' though it is sold, and most commonly referred to, as 'credit'. The competitive nature of lending and the readiness, indeed enthusiasm, of lenders has reversed the traditional relationship of going 'cap in hand' to get a home loan. Thus borrowers are more vulnerable. Ways of empowering borrowers include education on financial management and training in skills to apply such knowledge as well as providing free/low-cost access to financial counselling.

This section does not repeat sections in the positioning paper on misuse of superannuation and refinancing to avoid repossession or proposals for a credit register. Rather it discusses whether recent policy reforms address the crucial need for improved financial literacy and reiterates the significant role that independent financial counsellors could play in supporting households to realistically address shortfalls between income and expenditure on credit commitments.

Clearly functional financial literacy involves many challenges: the real difficulty for learners is to apply information related to budgeting, income, spending, debt and saving to everyday life as they develop relationships and responsibilities (dependents), encounter illness, separations, death and unemployment. As financial services and products have become more complex and prolific in their variety, financial literacy is a more time-consuming task. Our interviews with those who developed severe difficulties in servicing their loans confirmed what the literature and many stakeholders told us: that borrowers often fail to present to financial counsellors, especially in time to effectively assist them in ameliorating or avoiding repossession of their homes. In mid-2009 (according to Russell 2009), financial counselors were reporting being more overwhelmed with distressed mortgagors than ever, consistent with the rising level of defaults (RBA 2009b: 48).

As argued in the positioning paper, one-on-one, face-to-face, independent financial counselling at key moments when householders ask for and need guidance has higher success rates in educating and training household borrowers in functional financial literacy than programs that simply distribute informative educational material widely through the print and Internet media. While there has been a concerted effort to

introduce more of the latter kind of material into the school curriculum, it is clear that serious attention needs to be placed on the more numerous adult mortgagors who are experiencing unexpected challenges in addressing financial commitments.

Garner (cited in House of Representatives 2008b: 50) referred to a 2006 Wesley Mission survey, which found that 'the most common response... is to do nothing' when faced with financial difficulties, even crises. In wealthier suburbs even needy people seemed reluctant to attend their financial education course: 'it is not something you really admit that you need to go to' (Ibid: 51). Thus functional financial literacy must include empowering mortgagors with strong psychological approaches to financial crises not simply focus on its arithmetic dimensions. This fact underscores the need to provide easy and free access to financial counsellors, which the Wesley Mission has suggested could be funded by the financial sector. Now that the Commonwealth has taken over and expanded control of this sector these kinds of ideas are more feasible to consider.

Martin North (cited in House of Representatives 2008c: 32) has proposed offering all first homebuyers \$300 to \$400 to pay for a broker or other financial advisor to explain both the terms and conditions of their loan in the context of their existing and future capacity to pay. His research (Ibid: 26) indicates that the vast majority of borrowers actually expect lenders to only 'offer a loan they could afford to repay'. The HIA (2007: 2) has proposed a similar scheme funded by government and industry in partnership, specifically for those taking out loans with a high LVR.

Our research findings would support expanding government assistance for existing and new and improved financial counselling programs and organisations targeting home mortgage holders. Their funding could be tied to their providing real-time data related to their clients to improve the monitoring of stress related to mortgage and other household debt. The government should seriously consider introducing free financial advice for:

- Those accessing first home owners grants.
- Householders facing significant ongoing illness constraining the ability to keep up payments of home loans.
- Mortgagors who have gone into arrears.

The government could develop and deliver special training for financial counsellors who provide such advice and link in re-defining the eligibility criteria and processing of mortgage assistance relief programs.

ASIC works to strengthen consumer sovereignty in a competitive market and, through the Australian Competition and Consumer Commission website (ACCC 2008), has improved provision of simpler and more straightforward explanations of what different loan products and services involve in terms of benefits and disadvantages. Standardising language and making lenders responsible for providing such information is more easily achievable through the new federal powers in the area of credit. ASIC has expanded its research and consumer information for household credit and mortgagors (Fido 2008) as well as taking responsibility for the Understanding Money website (<see <http://www.understandingmoney.gov.au>>).

A well-advertised, easily accessed and well-funded delegated mortgage/loan line and centres providing free independent advice to all home mortgage seekers and applicants, including those refinancing, would assist in helping would-be and new borrowers to plan and better assess the real long-term burdens of their loan. Few borrowers have a sophisticated understanding of the experience of going into arrears especially how easily it might happen and how difficult that situation is to address.

Even EDR bodies have observed the difficulty that borrowers have accessing and using their services effectively (House of Representatives 2008a: 82). Thus the fact that consumers now have legal access to EDR does not necessarily mean they will be used directly by borrowers even if widely promoted. Financial counsellors are best equipped to advise and supervise borrower's access to such mechanism for appeal and compensation.

The introduction of free and easily accessible independent financial advice when borrowers take out a mortgage — and a well-publicised and enforced cooling off period of seven days when such loans have been offered — would be an extremely useful service, and not only for borrowers. Government might initiate such a scheme and require the mortgage-lending sector to assist in funding it. If well-used, and lenders were required to record a minimum amount of data about each case, such information could be collected by the Australian Bureau of Statistics (ABS) to enhance knowledge of the range of factors triggering default, including types of loans offered to borrowers, their size and indications of debt-servicing capacity.

The other point in the borrowing cycle when free and easily accessible independent financial advice would be highly useful is when mortgagors have serious financial difficulties either just before or just as they are unable to make a repayment. This is when they are about to, or already have sought to, refinance through their lender or another one, are seriously considering selling their home and require sound independent advice, even advocacy, to protect their interests. Indeed this kind of locally available support might seem to be more efficient and effective in certain circumstances, and complementary to external dispute resolution.

As pointed out in the positioning paper, the suggestion that emphasis in financial advice and planning shift away from an exclusive restorative (after the event) focus to prevention is in line with the research findings of behavioural economists. Consumers tend to accept standard contracts and lending processes as given – i.e. they act within an established situation that 'frames' their decisions. Shiller (2008) proposes that new 'boiler plate' mortgage contracts be mandated that include clear consumer protection clauses around information disclosure, reasonable dispute resolution processes and reasonable timing. He also proposes a 'default-option' approach to financial planning that would require all borrowers to have access to independent professional advice prior to signing a mortgage contract – the advisor would be akin to a civil law notary who reads aloud to contracting parties and ensures each understands the terms and ramifications of the contract before witnessing its signing.

5.4 Housing policy context

The corresponding section in the positioning paper pointed to the kinds of improvements to housing and housing-related policies and legislation that would reduce risks of mortgage default and alleviate impacts on households when repossession occurs. This section simply updates that one by pointing out reforms to housing policy that work in that direction.

As argued in the positioning paper, potential borrowers are likely to make more thorough and sound decisions about their capacity to service a mortgage if they have viable alternatives to home purchase. Alternatives include secure long-term private and public housing available for rental with payments competitive with 30-year mortgage repayments for similar accommodation (similar standard, size and location). Policy options include improving public housing, community housing, and housing developed through innovative public-private partnership arrangements (e.g. government contracts with investors prepared to limit rent and offer long-term leases), and rental subsidies. Rental shortage and high rents, which characterised markets in

2007–2008, can make risky borrowing appear rational to vulnerable households, especially given that public housing has declined since the late-1990s.

5.4.1 Improving social housing

On 19 March 2009 the Minister for Housing Tania Plibersek (2009) elaborated on significant social housing reforms that promised 70,000 more social housing units supported by \$6.4 billion (subsequently reduced somewhat) as part of a \$20 billion package to enhance Australians' housing options. The minister deplored a situation where the proportion of public housing stock available had deteriorated from 5.8 (when the ALP had been in government previously) to 4 per cent of total housing stock, and pointed to the older age of public housing stock, which meant higher maintenance needs and poorer conditions for tenants. Furthermore, 'we are often not delivering opportunities for public housing tenants; 90% of stock is held by eight government providers; and our system is not transparent or accountable.' Thus the reforms announced involved greater funding to community not-for-profit housing organisations, which proved more flexible and diverse in offering tenants housing options, and more assistance via the National Rental Affordability Scheme. Along with the improvements to social housing, the government provided \$1.5 billion in the form of the First Home Owners 'boost', both as parts of a general stimulus package for the Australian economy, which had deteriorated in line with the international recession.

5.4.2 Defaulting landlords

The positioning paper detailed the vulnerable position of tenants subject to the repercussions of their landlord defaulting, using NSW as a case in point. The City of Sydney (Homeless Persons Information Centre, 2009) reported 18 per cent more calls during 2008 than in 2007, most significantly 20 per cent associated with crisis evictions (up 52 per cent from 2007). This cohort included being in arrears with rent but also those made homeless through their homes being repossessed or whose landlords had defaulted. Glennie (2009) also publicised the case of a family forced out of their accommodation because of a successful claim of possession against their landlord which left them without their personal belongings (which had been locked in the repossessed house) just one day before the mother gave birth to her fifth child. However, NSW has made some progress in addressing this. In June 2009, the NSW amended the Residential Tenancy Act to provide tenants with 30 days rent-free time to find new accommodation once they received notice that a mortgagee required vacant possession of the premises they were renting and allowed them to have access to their security bond more quickly (Bibby 2009).

5.4.3 Mortgage relief assistance

The positioning paper discussed how, for decades, the Commonwealth–State Housing Agreement incorporated schemes that offered a very small number of households mortgage relief. Typically they target mortgagors who have reasonable credit histories, but have suffered temporary illness or unemployment and require some support till their financial position is stable again. Mortgage assistance for home purchasers having trouble repaying their home loans is narrow in terms of eligibility — excluding households simply suffering because of rising interest rates — and has received only low levels of funding and publicity. Yet, redefining and expanding such mortgage relief schemes — in accordance with national and uniform policies and programs that incorporated special response plans for implementation in economic downturns and in specific areas — might prove a very useful way to support households at risk of default mainly because of factors outside their control. Such schemes could work closely with researchers monitoring and evaluating levels and

kinds of default so that they both responded to evidence-based policy indicators and collected and passed on data to researchers, particularly the ABS.

Existing schemes represent a space for providing more robust and comprehensive mortgage relief that takes into account the kinds of profiles identified in chapters 2 and 3 of this report. As an inquiry submission by Wesley Mission (2008) pointed out:

Clients of our financial counselling services primarily get into financial difficulty due to loss of employment, health problems and poor money management skills (including gambling). It is difficult to identify or predict these issues at the time a loan is made.

Many of these borrowers need assistance beyond the strictly temporary relief government systems offer. Current mortgage relief assistance schemes would benefit from uniformity and reforms to better target and address the difficulties of these kinds of borrowers characterised by those we interviewed.

Also, more transparent and consistent ways of monitoring how housing departments in each state and territory deal with those evicted from their homes due to repossession — see positioning paper 5.4.3 — is necessary.

5.4.4 Repossession through bankruptcies

Serious concerns have been expressed that a bankruptcy caused by just a few thousand dollars can lead to home repossession (for example, Mendelson cited in House of Representatives 2007a: 71). Indeed during August–September 2009 the Attorney General’s Department (2009) of NSW was accepting submissions to proposed amendments to the bankruptcy legislation including increasing the minimum debt liable to a lender filing for bankruptcy from \$2000 to \$10,000 and delaying the process from 7 to 28 days for debtors to settle the debt another way. It is clear that the Commonwealth should give serious consideration to isolating home mortgages from general bankruptcy coverage or review the involvement of homes in bankruptcy processes to minimise trivial debts jeopardising the security of the family home.

5.4.5 First home owners’ subsidies

The use of First Home Owners grants to stimulate the economy has been widely criticised for enticing potentially vulnerable householders into home ownership, i.e. young couples with high LVRs with no or few financial buffers against future sharp interest rate rises, unemployment and/or falling house prices. The proportion of first-home buyers among total owner-occupier lending reached over 35 percent early in 2009 compared with less than 20 percent in early 2004 (RBA 2009a: 46). According to the same source, the average value of borrowings by this cohort relative to the remainder reached almost 110 per cent compared with around 85 per cent in the second half of 2000.

One of the biggest areas of concern for the government is its management of first-home buyers’ grants and the extent to which such policies might artificially and temporarily lift prices of Australian houses and then lead to falling house prices, especially in specific areas of first home buyer demand. These fears are allied to Keen’s point that ‘the assets have risen in price because people have borrowed more money to buy them’ (cited in House of Representatives 2007a: 30). To the extent that this occurs, it reinforces concerns with asset-based lending. RBA concerns ‘that we might move towards undesirably strong growth in Australian housing prices’ have been laid out in a talk by their head economic analyst, Tony Richards (2009: 1, 4), who stresses the demand pressures from both natural population growth and immigration.

Thus, Martin North of Fujitsu Consulting (in Lindell 2009a) has warned that government subsidies in the form of First Home Owner's Boost could lead to a longer and worse recession. With rising unemployment, North expects house price falls up to 20 percent in line with IMF forecasts (Fujitsu Consulting 2009: 2). House prices have remained a specific concern as the grants seemed to stimulate and be absorbed in higher prices in the lower end of the market and in certain regions thus dampening the benefit to those who received them. If the conditions for mortgagors deteriorate such homes might well prove impossible to sell at a price that covers repaying the original loan and allowing householders to get out debt free. At the same time the implications of the first homebuyers grants for market values of houses threaten to have broadly felt impacts.

5.5 Improving data, monitoring and analysis

For too long information on mortgage defaults in Australia has been incomplete and lacking in the important detail necessary to formulate clear evidence-based policies. In 2008 the ABS was charged with improving data-gathering. The Commonwealth has, as noted, expanded coverage of lenders it regulates, thereby improving the capacity of government agencies to gather such data through reporting requirements.

The ABS (2008) has identified as areas of special concern for extra data collection: 'default rates on mortgages', 'characteristics of owners with a mortgage who are at risk of defaulting', the 'impact of new financial products on home ownership' (including reverse mortgages and other home equity loans) and the propensity for mortgages 'to fund non-housing consumption and investment'. Just as significantly, the ABS has signalled greater interest in broader aspects of the affordability of home ownership and other forms of accommodation, such as assessing levels of burden that home mortgages entail for people through their housing careers and those who have low incomes.

Thus we expect that more reliable databases and the integration of data-gathering tasks into all activities and institutions developed to advance policy in this area will ensue. Additionally, information on forced sales and mortgagees in possession sales could be recorded through reporting from real estate agents and lenders' mortgage insurers. Assessing the levels and forms of household financial stress – especially causes contributing to default and repossession identified by our and other researchers – throughout economic cycles and the various regions of Australia which experience distinct economic pressures and opportunities needs to be given higher priority. Assisting households before they default or have their homes repossessed has economic as well as social benefits.

Finally, it must be stressed that it is only on the basis of reliable data that strong analysis can be performed and policies evaluated. Analysis will involve identifying or developing appropriate and commonly accepted ('objective') principles for determining debt-servicing capacity at the level of an individual borrower, as well as more comprehensive and broadly acknowledged definitions of 'hardship' that might, for instance, even take into account adverse economic circumstances outside the control of households.

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APPENDIX 1



Mortgage Difficulties Survey



Shade circles like this 
Please DO NOT tick or cross the circles

1. Why did you buy the house?
(Please choose up to three most important factors)
 - Security ownership
 - Pride of ownership
 - Freedom to do own thing in own space
 - Investment
 - Privacy
 - Feeling physically safe
 - Cheaper than rent
 - Other/Comment _____

2. Which description best describes you?
 - Home purchaser
 - Landlord/renting to tenants
 - Investor using mortgage for business purposes

3. How many people lived in the house when you moved in? (Please place a number or a 0 in each box)
 - Female adults (18 years of age or over)
 - Male adults (18 years of age or over)
 - Children/youth (17 years of age or under)

4. What was the composition of your household when you purchased the house? (Please choose one)
 - Single person
 - Couple without children
 - Couple with children
 - Single parent family
 - Blended family
 - Joint household
 - Other, specify _____
 - Not relevant because the house is/was rented out

5. When did you purchase the house?
 - Last year, 2008
 - 2007
 - 2006
 - 2005
 - 2004
 - 2003
 - Before 2003

6. How much did you pay for the house?

Specify \$ _____

About \$ _____ (if you cannot remember exactly)

7. What was the value of your mortgage then?

Specify \$ _____

About \$ _____ (if you cannot remember exactly)

8. What was the deposit on the purchase of the house?

Specify \$ _____

About \$ _____ (if you cannot remember exactly)

9. What other debts did you have when you bought the house?

Credit cards	\$	_____
Car loans	\$	_____
Other mortgages	\$	_____
Personal loans	\$	_____
Education	\$	_____
Business/investment	\$	_____

10. Did you take out the loan for the purchase of the house with any other person? (Please choose one)
 - No
 - Yes, one other
 - Yes, more than one other

11. How many times did you refinance after taking out this initial loan on this house?
 - 0 (if you choose 0, please go straight on to Question 14)
 - 1
 - 2
 - 3
 - 4 or more

12. Did any of this refinancing involve debt consolidation - rolling other household/personal debt into the new mortgage?
 - No (if you choose No, please go straight on to Question 14)
 - Yes, on one occasion
 - Yes, on more than one occasion

13. How much did you owe when you consolidated your debts?

Specify \$ _____

About \$ _____ (if you cannot remember exactly)

14. On which loan/s did you experience your initial difficulties in missing mortgage repayments on this house? (Please choose one)

- The initial and only home loan
- Only the most recent home loan
- Refinancing was prompted by difficulties with repayments on one occasion
- Refinancing was prompted by difficulties with repayments on more than one occasion
- Other, specify

15. How long after taking out the loan to purchase the house did you begin to experience difficulties with repayments? (Please choose one)

- Straight away
- Within six months
- Sometime between six months and a year
- Sometime between a year and two years
- Sometime between two and three years
- Three or more years

16. What were the initial causes of missing mortgage repayments?

- (Please choose up to three most important factors)*
- Loss of, or reduced, employment/income
- Illness or accident to someone in the household
- Relationship breakdown
- Too many other debts
- Interest rates too high
- Underestimated the cost of monthly repayments plus other housing costs (rates, maintenance etc.)
- Other, specify

17. If the causes changed over time, what were the final causes of missing mortgage repayments? (Please choose up to three most important factors)

- No change in causes (causes remained the same as answers to Question 16)
- Loss of, or reduced, employment/income
- Illness or accident to someone in the household
- Relationship breakdown
- Too many other debts
- Interest rates too high
- Underestimated the cost of monthly repayments plus other housing costs (rates, maintenance etc.)
- Other, specify

18. When you first got behind in repayments, what did you do? (You can choose more than one, or none if you did none of these)

- Used credit card/s more
- Borrowed from family and/or friends
- Managed to earn more income
- Refinanced the home loan
- Sought financial advice on budgeting and other ways to address the problem
- Other, specify

If you refinanced, please answer Questions 19-22 with respect to the last loan you have had on the house. Otherwise the questions all relate to the one and only loan you had.

19. What type of home loan did you have? (If you refinanced, answer in relation to your most recent loan)

- Fixed interest rate
- Variable interest rate
- 'Interest-only'
- Short-term, i.e. less than 5 years
- With redraw facilities
- Other, specify

20. Did your lender require you to provide evidence of income, like a payslip or a tax return, so that you could get your loan? (If you refinanced, answer in relation to your most recent loan) Yes No

21. What kind of lender provided the home loan?
(Please choose one, if you refinanced, answer in relation to your most recent loan)

- Bank
 Building Society
 Credit Union
 Non-bank lender, e.g. Aussie
 Other, specify
-

22. Did you use a mortgage broker to get the loan?
(if you refinanced, answer in relation to your most recent loan)

- Yes No

You only need to answer Questions 23-28 if you refinanced your loan. If you have not refinanced on the house jump to Question 29.

23. What kind of lender did you have for your initial loan on the house? (Please choose one)

- Bank
 Building Society
 Credit Union
 Non-bank lender, e.g. Aussie (Home Loans)
 Other, specify
-

24. When you refinanced your loan - the first time, if you refinanced more than once - was it with the same or a different lender (Please choose one)

- Same lender Different lender

25. When you refinanced your loan - the first time, if you refinanced more than once - was it for the same or a different amount of money? (Please choose one)

- Same amount Larger amount Smaller amount

26. When you refinanced your loan - the first time, if you refinanced more than once - did you use a mortgage broker? Yes No

27. Did you approach the lender of your loan - the most recent one if you refinanced - to vary the terms of your repayments? Yes No

28. Did the lender of your loan - the most recent one, if you refinanced - approach you to vary the terms of your repayments? Yes No

29. Did you apply for a hardship variation through a court or tribunal? Yes No

30. Did you attempt to change the terms of any mortgage on your house? (you can choose more than one)

- No
 Yes, but I was unsuccessful
 Yes, successfully - specify number of successes and kinds of changes
-

31. Did you, or are you trying to, resolve your difficulties by

- Selling your house
 Leaving your house and renting it to tenants
 Taking in boarders

32. If you sold the house, were you left with a debt to your lender or legal advisers? Yes No

33. As a result of the difficulties with repaying a loan on this house, have you been declared, or chosen to become, bankrupt? Yes No

34. Did you at any time seek financial and/or legal advice, when you applied for any loan on your house or for the problems related to repaying your mortgage?

- Yes No (if you choose No, please go straight on to question 37)

35. If you did seek financial and/or legal advice, from whom did you seek advice?

(Please choose more than one if applicable)

- A member of the family, or a friend
 The lender
 Another lender
 A broker
 An 'external dispute resolution' or mediation service (such as the Banking and Financial Services Ombudsman)
 Other, specify
-

36. If you did seek financial and/or legal advice, when did you seek that advice? (Please choose more than one if applicable)

- Before finding this house and taking out the loan to purchase
 When repayment difficulties started on the most recent loan
 Once a notice demanding payment from the lender was received
 Once a notice was received about action in the Supreme Court
 Other, specify
-



37. How many people live your house now?
(Please put a number or 0 in each box)
- Female adult/s (18 years of age or over)
- Male adult/s (18 years of age or over)
- Children/youth (17 years of age or under)
38. What is the composition of your household now?
(Please choose one)
- Single person
- Couple without children
- Couple with children
- Single parent family
- Blended family
- Joint household
- Other, specify _____
- Not relevant because the house is/was rented out
39. If you ever lived in the house that is/was subject to the claim of possession, what kind of accommodation are you living in now? (Please choose one)
- Still in that house
- Rental
- Boarding
- Other, specify _____
40. If you ever lived in the house that is/was subject to the claim of possession, what kind of accommodation do you expect to be living in next year (2010)?
(Please choose one)
- Still in that house
- Rental
- Boarding
- Other, specify _____
41. What was the total gross household income when purchasing the house? (Please choose one)
- Unemployment or disability benefit, student allowance, pension etc.
- Under \$40,000
- \$40,000 to \$59,999
- \$60,000 to \$99,999
- \$100,000 and over
42. What is the level of your total gross household income now? (Please choose one)
- Unemployment or disability benefit, student allowance, pension etc.
- Under \$40,000
- \$40,000 to \$59,999
- \$60,000 to \$99,999
- \$100,000 and over

43. What range does your current age fall into?
(Please choose one)
- 15-24 55-64
- 25-34 65-74
- 35-44 75 and over
- 45-54

Also are there comments that you would like to make about your experience in buying a house with a mortgage? Here is some space to include extra comments about your experience in buying a house with mortgage. If you want to write more, either attach a sheet of paper to the survey or email your comments to : mdsurvey@rmit.edu.au

INTERVIEWS

Also, we are interviewing a small number of borrowers about their repayment difficulties. We want to hear their experiences in their own words. Your privacy and confidentiality is guaranteed. Interviewees receive a \$75 supermarket gift voucher in appreciation of their contribution to our research. If you are willing to be interviewed, we need your name and at least one way to contact you.

Name: _____

Address: _____

Phone : _____

Email: _____

Any complaints about your participation in this project may be directed to the Executive Officer, RMIT Human Research Ethics Committee, Research & Innovation, RMIT, GPO Box 2476, Melbourne, 3001. Details of the complaints procedure are available at: http://www.rmit.edu.au/ind/inec_complaints

Thank you for your time.

APPENDIX 2

Interviews with mortgage defaulters (May 2009)

1. Introduce self.
2. Thank you for the earlier return of survey and volunteering for an interview.
3. Quickly say what will happen during the interview:
 - a) Ethics statement and agreement.
 - b) We will summarise what we understand your situation is in your survey response.
 - c) We will ask you questions which will enable you to elaborate on what is in the survey.
 - d) We will ensure we have correct address to send the super market voucher.
 - e) We plan/expect that the interview will take 30 mins.
4. I would now like to read to you several short statements about the ethical arrangements for this interview and ask for your agreement to a number of statements following this statement. I will read and then ask you to answer yes or no. Before I begin reading I would like to turn the tape recorder on so that your understanding and agreement of these arrangements is recorded.
 - a) I have previously read the letter about this research and completed The Mortgage Difficulties Survey. I agreed in that survey to be interviewed and provided my name and contact details. (Yes or No).
 - b) I acknowledge that I have been informed that I am free to withdraw from the project at any time and to withdraw any unprocessed data previously supplied. (Yes or No).
 - c) I acknowledge that the project is for the purpose of research. It may not be of direct benefit to me. The privacy of the information I provide will be safeguarded. The privacy of the personal information I provide will be safeguarded. (Yes or No).
 - d) The security of the research data is assured during and after completion of this study. Data collected during the study may be published. A report of the project outcomes will be provided to AHURI.
 - e) I give my permission to be audio taped. (Yes or No).
5. Your situation summarised from your survey response:
 - a) Couple with three children.
 - b) Paid \$245 000 but does not indicate any deposit.
 - c) \$20 000 of credit card debt and \$10 000 other mortgage.
 - d) Difficulties in paying the mortgage were due to reduced employment income.
 - e) You refinanced twice and this was done through a broker with a bank.
 - f) You sought advice when you received notice of SC action.

6. I would now like to ask you to elaborate on what you told us in the survey.
- a) First, we'd like to hear a bit about how you went about applying for the loan. Thinking back now:
- Why did you choose that particular house? Location, size...?
 - Was it your first home loan? If not, how many home loans have you had?
 - Was it difficult gaining the loan? Tell us a bit about that...
 - Which household members made contributions by way of rent or board?
 - Did you get financial advice from anyone at the time? If so, who (family, friends, professional) and can you remember what advice they gave you?
 - Can you recall other kinds of debts you had at that time (e.g. credit cards)?
 - Did you regularly budget, i.e. work out how much was coming into the household and what you spent money on? Can you recall the big expenses?
 - In a word or two, how would you describe the experience of getting the loan, e.g. 'a relief', 'a struggle', 'a breeze'?
- b) Second, looking at this period between taking out the loan and having trouble with the repayments:
- Was it always a struggle making repayments or was there a major event or development that suddenly made everything harder?
 - Did you refinance the loan, or try to refinance it, or borrow money from friends or family to keep up the repayments?
 - What finally made it impossible to find the money to repay the mortgage?
 - Did you make contact with the lender to see if they could adjust the terms of the repayments?
 - When you first got a notice from the lender saying you were in arrears: How did you feel? What did you do?
 - Did you gain financial and legal advice? From whom? Why them?
 - Were you talking about it with friends or family then?
 - Did you have any other support in facing this challenge — had you sought advice through any credit/debt hotline or other advisory service?
 - Did you get conflicting advice? What options did you have? Or did it seem that everything was just going down one path?
 - Did you get a formal writ and statement of claim from the lender showing that they were taking steps in the Supreme Court? What happened then?
 - So what ended up happening?
 - Is there any other comment that you'd like to make about this process?
- c) Third, what is the situation now?
- Where are you living, and how long do you expect to be living there?
 - How has the experience changed your household — are you still living together? — how would you say that your relationships have changed?

- Looking back over the whole period since you moved into the house and took on the mortgage — have you had to go to a doctor or hospital to be treated for any health issues or had any accidents? Did you decide not to investigate any problems because it might cost too much?
- How has the mortgage trouble impacted on work, and other income?
- In what ways do you think that your finances are better and worse now?
- Can you outline where you think you will be living in 5 years time?

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