Housing Finance

Banks should determine the risk of lending money, not regulators

By Tim Reardon

The winding back of consumer credit reforms is a very small piece of the regulatory reform needed to ease household's access to finance. Not only was easing of access to finance central to Australia's recovery from the 1990's recession, it is also essential to sustaining the dream of home ownership.

Since the GFC, despite evidence of a problem, the government and regulators have adopted a 'belt and braces' approach to regulation. In the process they are taking away the dream of home ownership for many Australians.

Australia's financial market and banking regulators have spent the decade since the Global Financial Crisis attempting to create an 'unquestionably strong' financial system. This decade of red tape has reduced risk but it has come at a cost. This cost is borne by first time home buyers who are being forced out of the market, which is contributing to the decline in home ownership.

Lower interest rates have made repaying a mortgage easier now than at any time since the 1990's, but the banks deposit requirements have become increasingly onerous.

Residential mortgages are deemed to be significantly more risky today than prior to the GFC. Since 2008, ADIs have increased their capital as a share of total risk–weighted assets from around 10.5 per cent to 15 per cent. This means that it is simply more expensive for banks to lend to first home buyers now than it was prior to the GFC. This risk-weighting was more significant for loans such as interest only loans, loans to investors, loans with high loan to value ratios and loans in riskier geographic areas.

Just in case this wasn't enough, APRA reviewed its Prudential Practice Guide for Residential Mortgage Lending in 2014, 2016 and 2019. At each step making it harder to lend for the purchase of a new home. Compared with the pre-2014 guide, the guidelines in the 2019 edition are considerably more stringent. ASIC added further to the regulatory burden.

From the start of 2018, a credit crunch commenced. The time taken to assess a home loan went from two weeks to two months and the number of clients rejected for finance doubled. All this risk aversion, despite evidence of the risk.

Banks must now apply much greater scrutiny on the income and living expenses of applicants; there are tighter criteria for assessing loan serviceability buffers; lenders are required to discount non-salary income (such as rental income, bonuses, overtime etc.) when establishing an applicant's income; there are more restrictive criteria for assessing applications for interest-only loans; and guidelines were added for mortgage lending to self-managed super funds.

This credit crunch was the primary cause of a 20 per cent decline in the number of homes under construction between the end of 2017 and 2019. It also lead to a decline in home ownership rates as banks increasingly lent to households that already owned a home.

Since 2009, the share of loans issued to customers with a 10 per cent deposit or less has fallen from 21 per cent to less than 7 per cent.

The problem is that in the pursuit of this 'unquestionably strong' financial system, the regulatory squeeze has forced the banking sector to eliminate much of the flexibility in the mortgage market that made home ownership achievable. It should be banks that determine the risk of lending money, not regulators.

Ensuring that home ownership remains an attainable aspiration for Australian households should be an equally important objective.

The regulatory system is in place to ensure that the financial system serves the needs of the Australian people. Australians expect the financial system to facilitate home ownership for all, not just those who regulators consider 'worthy'.