death of low-docs?

Are lenders burying low-doc lending in the wake of the credit crisis? *MPA* investigates what brokers can do to help their self-employed customers

Five months ago, industry heavyweight John Symond declared the death of low-doc loans.

His announcement made headlines and was heralded by consumer groups. Newspapers referred to low-doc loans as "controversial" and one commentator from the real estate sector went so far as to say that low-doc loans were "built on deception and false hope".

Judging by the enthusiasm with which the news was received, it was as if Symond announced the destruction of a particularly insidious disease. Finally the evil 'liar loans' (as they are called in the US), were being wiped from the face of Australia's lending landscape.

While far from 'dead', recent statistics do suggest that the low-doc loan market has suffered a rapid decline since the credit crunch hit Australia.

In the last 12 months, the choice of low-doc home loans has shrunk from 180 loans across 46 providers down to 153 products across 38 providers. Big names in low-doc lending such as Bluestone, Virgin Money, Macquarie Group and HSBC have all dropped out of the low-doc market – a significant statement in itself.

The proportion of low-doc loans written by Aussie had dropped from 15% to below 2%.

"Our people won't even go there because it's a waste of time. This is the death of the low-doc loan," he told media.

In October, when *MPA* contacted Symond about this feature, we were informed that "Aussie has never sold low-doc loans, however it believes that the products will continue to service a small niche in the market."

While this suggests Aussie is back-pedalling from Symond's earlier proclamation, it does imply low-doc loans will play an increasingly smaller part in mortgage lending than they have in the past.

History

Low-doc loans were first introduced in Australia in 1990. By 2003, low-doc loans made up 3% of all loans written, and by 2005 newspapers were reporting a "low-doc loan boom".

Datamonitor predicted the growth rate of low-doc loans would outstrip mainstream products by a multiple of four. The independent market analyst predicted the sector would almost double to $20.2bn by 2009 as a result of rising interest rates and a tightening of lending criteria as more households defaulted on their mortgages.

"A slow-down in the mainstream mortgage market may actually drive business to non-conforming lenders, particularly as mainstream lenders tighten their lending criteria," said the Datamonitor report.

But at the time, Liberty Financial's Sherman Ma, among other low-doc specialists, doubted the predictions, stating that they were based on a whole bunch of assumptions.

Most notably of course, while lending criteria have indeed tightened, interest rates have fallen steeply, not risen.

In addition, what the report failed to predict was the stupefying decline of the securitisation market and its hibernating effect on many non-banks and low-doc lenders.

Need

The credit crunch has caused many lenders to leave the market, while remaining players have tightened or changed their low-doc lending policies in the wake of this economic crisis.

Today, more than 10% of Australia's loans are high-risk, low-documentation loans. And almost 7.5% of all loans considered to be high risk are in arrears, or 90 days overdue.

But where does this leave brokers and their clients who may have a genuine need for these products and a legitimate ability to repay the loans? It is not as if the segment of population that these products were designed to service has suddenly disappeared.

The ABS estimated that in June 2006 there were 1,646,344 small business operators. It also found that self-employed business operators generate about 30% of Australia's economic activity and the small business sector is responsible for generating 3.6 million jobs.

Some 60% of small business owners say they get more financial reward from running their own business, rather than being an employee, and 29% say they can generate "significantly more" financial reward. These facts suggest that this segment of the population is a significant target market for mortgage brokers. But how can brokers service it?

Brokers' viewpoint

Otto Dargan, director of Dargan Financial, says the demand for these products is still very much alive. "We've experienced increased low-doc enquiries through our website, possibly because some lenders have reduced their low-doc discounts," he says.

About 20% of Dargan's clients use low-doc loans. Dargan says he carefully questions clients about their situation and their intentions with the loan to ensure responsible lending practices are maintained. "As a result, we haven't as yet had any significant problems with our low-doc customers," he says.

Recent changes in the credit market have made it more difficult for Dargan to get these types of loans across the line.

"Banks are looking very closely at their low-doc applications. We've had a few loans at 80% LVR that the banks have asked for additional information even though the loan was 100% within policy. There also appears to be fewer exceptions to policy that were common in the past, ie, bad credit history or unsatisfactory security are less accepted."

He says the lenders he has spoken to have confirmed that their arrears with low-doc loans have been higher and many appear to be considering policy or pricing changes.

Policy changes

Low-doc loans make up a small percentage of the overall lending for the major banks. Westpac has the greatest exposure to this sector, with an estimated 5.5% of its loan book comprised of low-docs. CBA sits slightly under that, with low-doc loans making up about 4% of its book.

In the wake of the sub-prime crisis, major banks have been tweaking their own policies regarding these loans.

Changes to CBA's low-doc loans came into effect on 20 October. Under the changes, borrowers qualifying for low-doc loans, where the LVR is more than 60%, are not eligible for Mortgage Advantage – a program that benefits borrowers by giving them interest rate discounts, reductions in mortgage-related fees and deals on other products such as credit cards. In effect, the changes make low-doc loans more costly for borrowers who do not meet


Huw Bough


John Symond

low-doc specialist

RAMS holds a unique spot in the lending spectrum. After being one of the first non-banks to implode in the credit crisis in 2007, it was bought out by Westpac and now continues to operate as a flexible home loan specialist, backed by major bank funding.

The non-bank was one of the first lenders to offer low-doc loans and remains a strong supporter of this sector. *MPA* did a short Q&A with Huw Bough, head (at the time) of broker business:

Is there still a need for low-doc products?
There is a still a demand for low-doc home loans, especially considering there are around two million self-employed workers across Australia who make a significant contribution to our economy.

What is RAMS current offer (as of October 30)?
RAMS offers competitive low-doc loans of up to 80% LVR plus Lenders Mortgage Insurance (LMI) premium. The RAMS Self Employed Pro Pack is a popular choice for the self-employed segment as it caters to their individual needs.

We also have very competitive rates for our Pro Pack Loans at a time when some of the major lenders in the low-doc market are reviewing their lending criteria.

Has RAMS changed or tightened its credit policies?
RAMS has always applied and will maintain strong credit policies and responsible lending practices because this makes good business sense and protects our customers. Therefore, we believe that these prudent credit policies will hold up to the challenges presented by the current market environment.

How has the credit crunch impacted these products?
[As of] the end of October 2008, there continues to be uncertainty in the global financial markets. As a result, we have already seen mortgage insurers tighten their stance on the high end (LVR) low-doc loans. The federal government has recently announced it is looking to tighten consumer credit laws, enact a single standard national regulation and establish a national licensing regime for credit-related broking services. It remains to be seen what impact these developments may have.

Any plans to change low-doc products in future?
At this stage, there are no plans to change the RAMS low-doc offering. However, we are continually reviewing and monitoring the market to develop solutions to balance the needs of individual customer segments whilst maintaining responsible lending practices.

Otto Dargan

John Flavell

the LVR requirements. "That's where the big change in the market is," says John Flavell, head of broker sales at NAB.

"A lot of our competitors have actually changed their interest rates, or changed the discounting and how it applies to their low-doc loans in recent times ... With [NAB] low-docs are part of policy, not a product, so we haven't made any changes in that regard."

Flavell says NAB's low-doc policy has always been prudent and consistent, and it has not cut back low-doc lending since the credit crunch hit.

By way of example, Flavell says if they are doing a refinance, NAB asks for statements for all loans it is refinancing and any additional loans that the individual may have as well, just to see that they are all being serviced adequately.

If it is a purchase, then the bank will ask for proof of the deposit, in the form of a bank account statement. It also may ask for proof to demonstrate that the person has cash flow to service the debt, such as transaction account statements, to see a pattern of money going into the individual's account that will support the loan application.

NAB has recently changed its policy with its mortgage insurer. It no longer has to refer low-doc applications for its mortgage insurer to review – its credit department can now sign off internally.

Pending regulation

Speculation that new regulations to govern the finance broking industry would effectively stamp out low-doc and no-doc loans has been hovering for months. At the time of writing, many were waiting to see how the implementation of such proposals would affect this sector.

Brokers could be exposed to severe penalties and even lose their licences should they not make sufficient enquiries about a borrower's financial position to ensure they can repay the recommended loan. But with the industry petitioning for changes to this part of the legislation, and with the demand still there, brokers may yet keep low-docs as part of their selling arsenal. **MPA**