Genworth

Home Grown

Mortgage Industry Perspectives | 2013

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Welcome to the fourth edition of Home Grown

Welcome to the 2013 Genworth Home Grown report; an overview of mortgage industry perspectives on trends in credit demand, borrower sentiment, channel distribution and innovation, as well as the outlook for the Australian market.

Home Grown draws upon quantitative surveys, in-depth interviews and workshop discussions held between August and October 2013, and offers insights on the mortgage industry from over 300 brokers, lenders and industry experts (see page 22 for methodology). The study included representative participants from major and non-major banks, non-bank lenders, broker groups, and industry bodies. We refer to this cohort as 'industry' experts throughout the report.

This edition of Home Grown, which is in its fourth year, builds on past Home Grown reports to shed light on challenges and opportunities facing the mortgage industry over the coming years. It also lends fresh perspective to the Genworth Streets Ahead consumer survey and so, provides a 360-degree view of the Australian mortgage market.

I know you will find its insights as valuable as we have.

Key take-outs

- Against a backdrop of weak economic growth, lenders expect that regulatory impacts, slow credit demand and housing affordability issues will challenge the mortgage industry over the next five years. In an increasingly competitive environment, industry experts believe that lenders will need to become more innovative to meet these ongoing challenges.
- It is widely accepted that moderate credit growth is the new normal, with industry experts noting that the days of double-digit growth have now passed. Industry experts also highlight that the low interest rate environment worsens the impact of slow credit demand on growth, as consumers are also more likely to make overpayments on their mortgage.
- Removing or reducing stamp duties is seen as the one government change that would benefit the mortgage market. However, it is also argued that this will only incentivise demand and increase house prices, thereby worsening affordability rather than improving it.
- Most surveyed brokers (45%) believe that helping Australians overcome the lack of access to affordable housing will be the biggest challenge facing the mortgage industry over the next five years. Perhaps reflective of the fact that most brokers have written fewer loans for FHBs in the past 12 months, the expectation is that there will be more innovation in products for self-employed borrowers than for FHBs over the coming years.
- Some industry experts question whether the proportion of FHBs entering the market has been understated. First homebuyers are typically identified as borrowers who have used the first homeowner grant, which has been removed for established dwellings in some states.
- Lenders are more optimistic about the prospects for online banks over the next five years, and nearly nine in 10 of those surveyed believe the volume of home loan sales via the online channel will increase over this period. Sales via the broker channel are also expected to increase, with industry experts believing consumers will continue to value face-to-face contact.
- Technology is also expected to increase competition in the mortgage market. Surveyed industry experts acknowledge that while mortgages are still too complex for digital channels, lenders who can simplify the online application process or enhance the on-boarding experience will have an advantage over their competitors.
- Looking forward, some in the industry expect there will be new entrants in the mortgage market, with online operators, superannuation funds and supermarkets posing the biggest threats.

Note: This report used the latest publically available data from the Australian Bureau of Statistics, Reserve Bank of Australia, RP Data, and the Housing Industry Association at the time of publishing, which may have been revised since that time.

Definitions

- **Banks** means major banks, or 'the big four', regionals and foreign banks. Foreign banks operate in Australia but are headquartered overseas.
- **Mutuals** mean credit unions, building societies and mutual banks.
- **Non-banks** are non-deposit taking financial institutions and include wholesale lenders and originators.
- **Mortgage brokers** means those acting as intermediaries between borrowers and lenders.
- **First homebuyers (FHBs)** means people who bought their first home to live during the past year, while prospective FHBs means those who plan to buy their first home in the next year.

Introduction

The Australian mortgage industry has faced another testing year in 2013, with annual housing credit growth trending below 5%, according to the Reserve Bank of Australia (RBA), and the official cash rate falling to a historical low of 2.50% in August 2013.

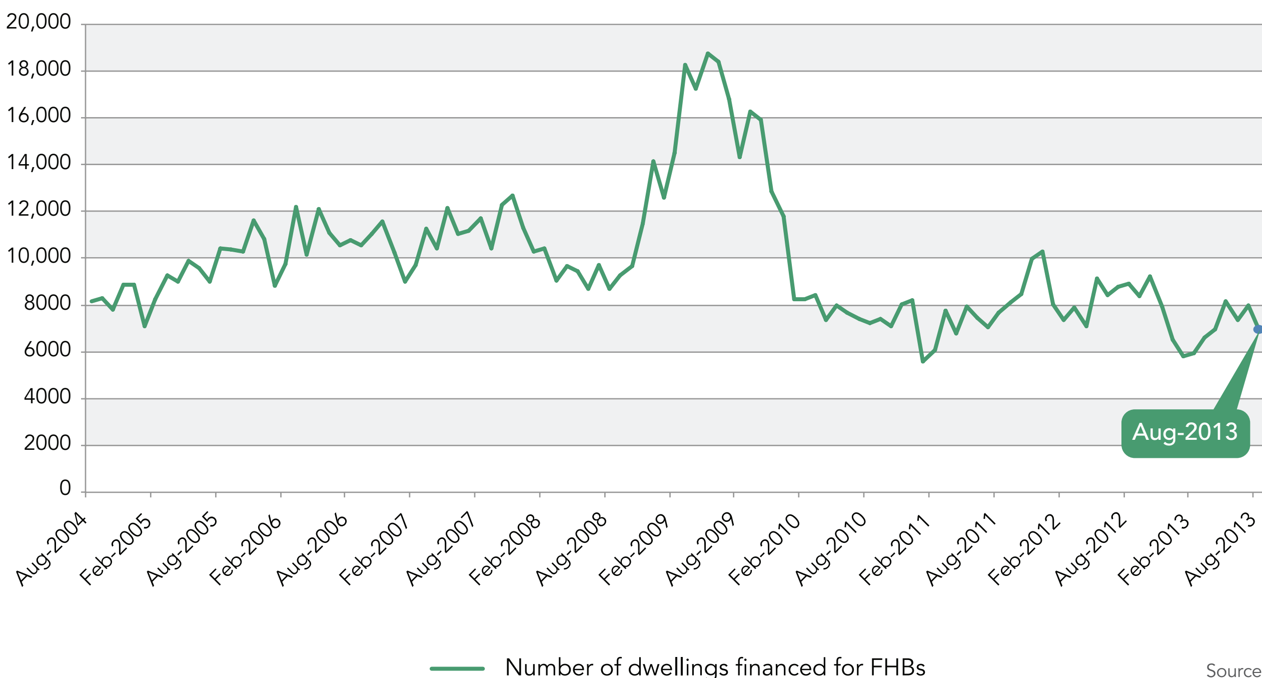
Although the low interest rate environment has improved housing affordability, data from the Australian Bureau of Statistics (ABS) show that FHBs made up only 13.7% of all dwellings financed in August 2013, the lowest proportion since April 2004. This reflects the impact of removing FHB incentives on existing dwellings in some states (see Table 1).

In contrast to the declining FHB market is the surging investor market. 2013 has been a strong year for investment property lending, with low interest rates decreasing servicing costs, and low vacancy rates pushing up rental yields.

Against this backdrop, lenders and brokers expect housing credit to continue growing at a moderate pace over the next five years, with soft economic conditions and regulatory impacts remaining key challenges. At the same time, the increasingly competitive market has led industry experts to believe lenders will become more innovative in order to chase market share.

The findings from this study highlight some of the opportunities and complex challenges the mortgage industry expects to face over the next five years.

Chart 1: First homebuyer confidence remains subdued



Source: ABS

Market outlook

To gain a forward looking perspective, lenders and brokers were surveyed on the challenges that will face the mortgage industry over the next five years. Although some challenges from the past five years were expected to continue testing the industry, the findings show that those lenders and brokers also believe a series of new trials lay ahead.

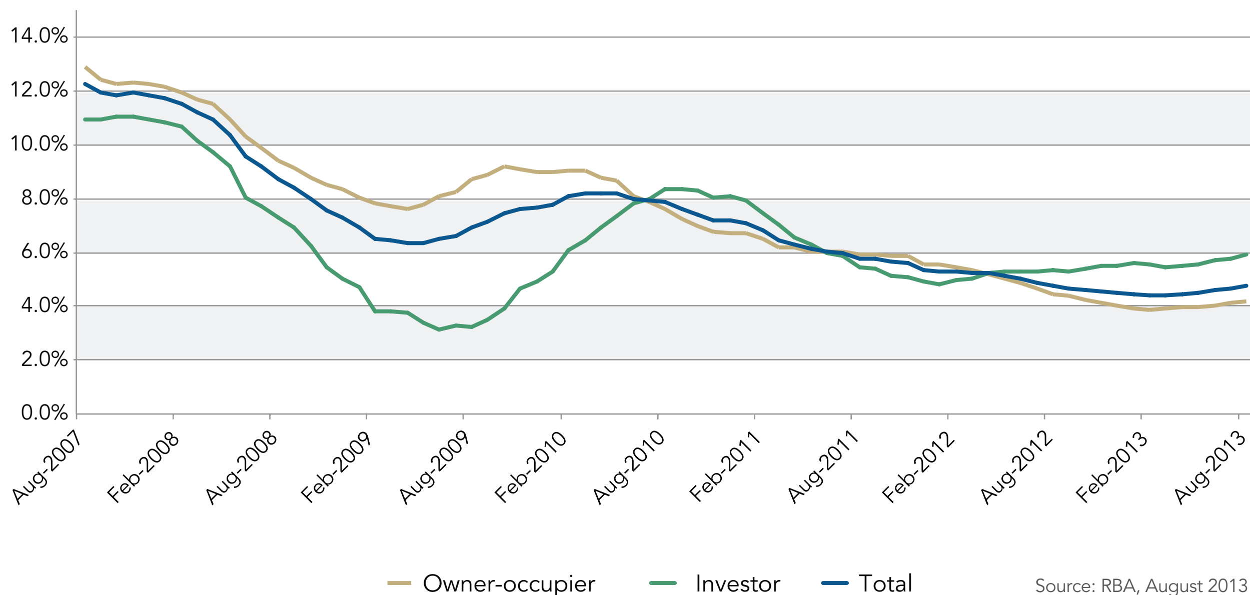
Slow credit demand will test the mortgage industry over the next few years

- Housing credit growth is expected to remain subdued over the next five years, with one in three lenders surveyed (33%) believing slow credit demand will continue to challenge the mortgage industry. Similarly, the consensus among industry experts is that "credit growth is going to continue at a reasonably modest pace" and that lenders will need to use "product, price, branding and service" to grow market share.
- Since June 2012, housing credit growth has trended below 5% year-on-year (see Chart 2). Although it has been moving upward since April 2013, according to the RBA as at 30 September 2013, industry experts note it remains below the double-digit growth seen in the lead up to the global financial crisis (GFC):

  "The predictions of 4.5% growth are starting to be revised upward. Having said that, I don't think we are going to experience double-digit growth in the next five to ten years – the days of double-digit growth have passed." – Lisa Claes, Executive Director, Distribution at ING DIRECT

- Housing credit growth has remained low despite the value of housing finance commitments increasing by 10% in the year to August 2013. This may reflect the corresponding trend of consumers paying down debt, with industry experts highlighting the difficulty of "managing your book in a lower growth environment" when "customers are paying back faster as well".
- Among those surveyed, mutuals (38%), followed by non-major banks (35%), are the most likely to believe slow credit demand will be a challenge over the coming years, which shows they are more prone to geographic and industry booms or declines than other lenders (see Chart 4).

Chart 2: Annual growth in housing credit



Source: RBA, August 2013

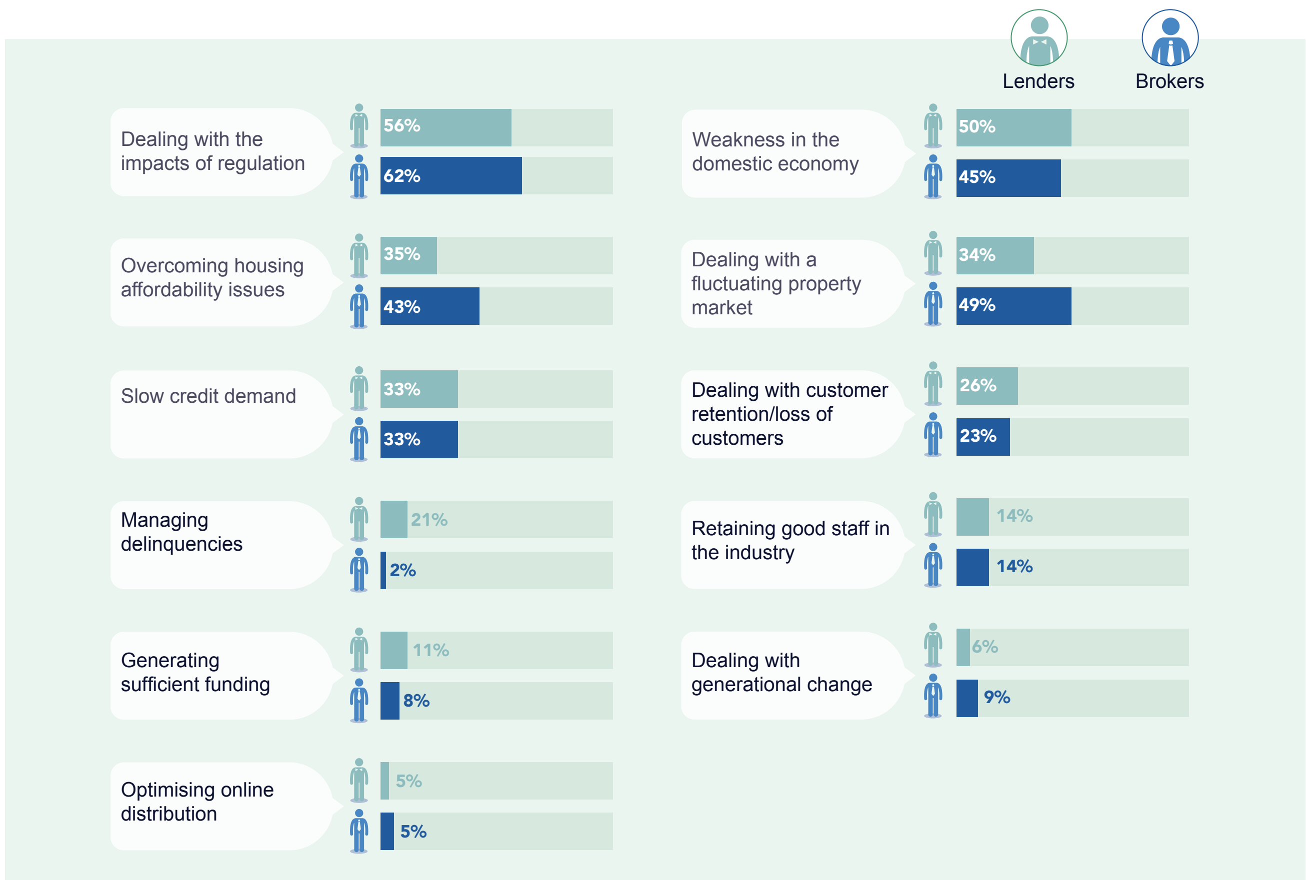
Lender segments stand divided in their experiences and expectations of the market

- In addition to subdued housing credit growth, lenders and brokers will also need to overcome a series of other challenges – some that will contribute towards slow credit demand and others that will occur as a result of it.
- Most lenders agree that ongoing regulation, soft economic conditions, and housing affordability have challenged the mortgage industry over the past five years (see Chart 4). However, opinions diverge between lender segments, reflective of competition and localised differences in the market.
- Three quarters of non-major banks (77%) and 52% of mutuals agree that weakness in the domestic economy was among the top three challenges the mortgage industry has faced over the past five years. In contrast, only 25% of major banks surveyed agree that the economy has tested the industry (see Chart 4).
- Instead, most major banks point to the impacts of regulation (63%) as the top challenge the mortgage industry has faced in this period. Some industry experts believe that there have been enough changes in the regulatory space:

"I would like to think that when the next financial services review occurs, it will decide that enough has been done in the mortgage industry already. There are other areas that need more attention." – Head of Mortgages, major bank

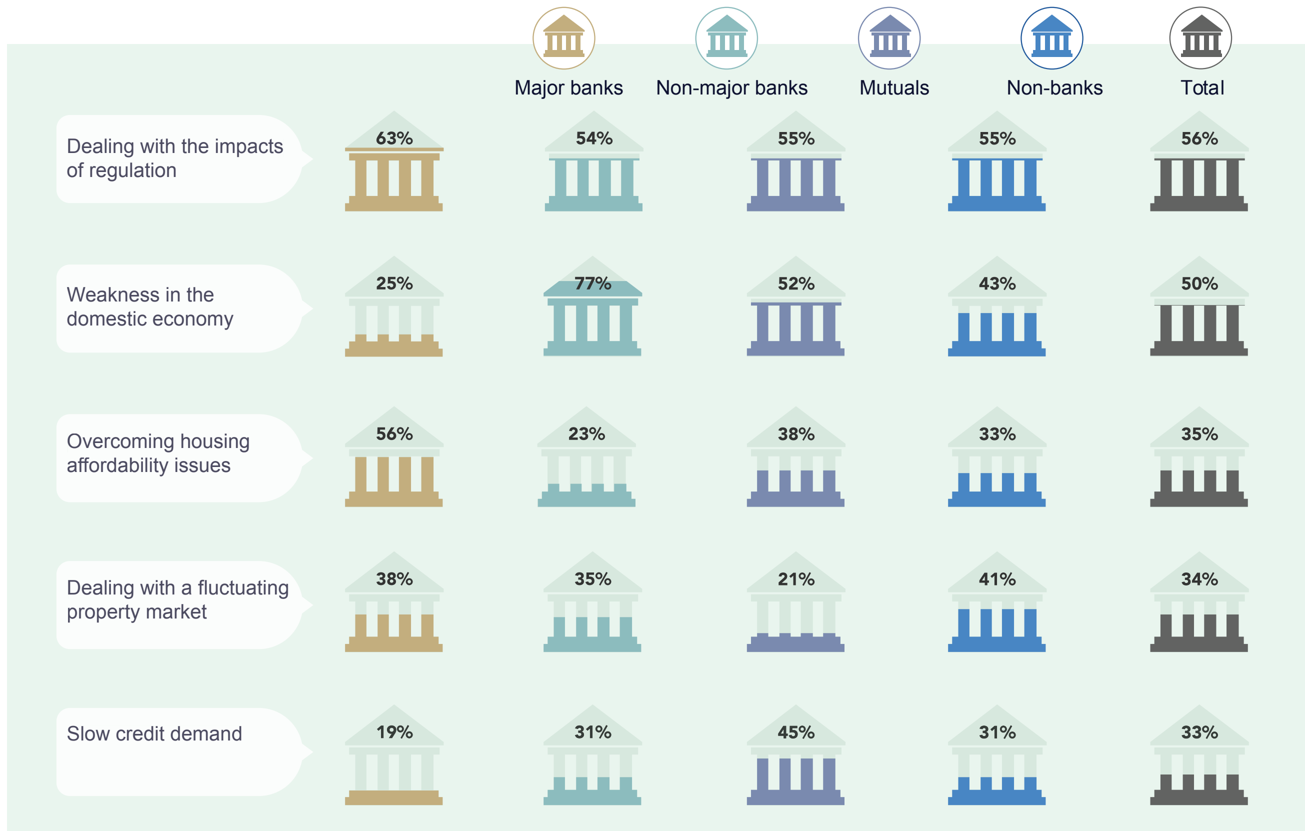
- Customer retention has also troubled some segments more than others. Nearly four in 10 mutuals (38%) and three in 10 (31%) non-major banks believe a loss of customers due to refinancing was among the top three industry challenges, compared with only 6% of major banks.
- Although major banks have been relatively untroubled by refinancing, they are more than twice as likely as the average lender to say that managing delinquencies and distribution channel conflicts have challenged them over the past five years.
- Looking forward, most lenders expect a weak domestic economy (43%) and housing affordability (37%) to continue challenging the industry over the next five years. Lenders also expect regulatory impacts to remain a challenge (37%), as ongoing changes are likely to affect the availability and cost of lending.

Chart 3: Looking back over the last five years, what do you believe have been the top three challenges that the mortgage industry has faced?



Source: Genworth

Chart 4: Looking back over the last five years, what do you believe have been the top three challenges that the mortgage industry has faced?



Source: Genworth

Brokers struggling with a fluctuating market

- It is generally agreed within the mortgage industry that brokers have written a higher proportion of loans in recent years. Although MFAA statistics show that brokers had a 43% share of home loans in 2012, some industry experts believe it has increased to about 45% in 2013. Since brokers have a strong influence on prospective homeowners, it is important to gain their perspective on the mortgage industry in addition to that of lenders'.
- Overall, brokers (62%) support the lender view that dealing with the impacts of regulation has been one of the top three challenges over the past five years. However, brokers more than lenders tend to say dealing with a fluctuating property market was among the top three challenges that the mortgage industry has faced over the past five years. Among those brokers surveyed, about one in two (49%) believe this has tested the industry, compared with one in three lenders (34%) (see Chart 3).
- Looking forward, almost half of all brokers (45%) believe overcoming housing affordability issues will be among the top challenges facing the mortgage industry over the next five years, followed by dealing with the changes in credit reporting (39%) and the impacts of regulation (34%). One industry expert highlights that complying with regulation means brokers have had to spend more time qualifying borrowers:

  "With the government turning the responsibility on brokers and lenders to ensure that borrowers can afford their loan… brokers have to spend on average two hours on a first interview rather than three-quarters of an hour, and a lot of that is to ensure that they comply [with regulation]." – John Symond, Executive Chairman at Aussie Home Loans

- Compared with lenders, a higher proportion of brokers believe faster property price growth will challenge the industry over the coming years (15% compared with 7%), while a lower proportion believe that weakness in the domestic economy (26% compared with 43%) or slow credit demand (17% compared with 33%) will challenge the industry (see Chart 5).
- Brokers who participated in an industry workshop run by Genworth believe that the trend towards a fee-for-service model in the broker industry will be a key concern over the coming years. The broker industry has been largely divided on this issue, but survey results show that one in five brokers already charge a flat or hourly fee for their services.

One in two brokers are seeing a drop off in first homebuyers

- Although low interest rates and short supply have worked in investors' favour, brokers, who typically deal with consumers trying to enter the property market, have seen a drop off in FHBs within their customer base. About one in two brokers surveyed (49%) have written fewer loans for FHBs, in terms of value, over the past 12 months, compared with 29% who reported they have written more loans.
- The impact on FHBs appears worse in some states than in others. A higher proportion of brokers who have written more loans for FHBs in the past year (28%) than brokers who have written fewer loans (6%) are from Western Australia. About a third of brokers who have written fewer loans for FHBs are from Victoria (33%) and a quarter of this group are from New South Wales (25%).
- According to ABS data, since first homeowner grants (FHOG), for established houses were removed in New South Wales and Queensland, FHB loans as a proportion of all new loans fell from 19.3% in September 2012 to 13.7% in August 2013. However, several industry experts question whether ABS data reflects only FHBs who have applied for a grant, which would understate the number of FHBs entering the property market. This implies FHBs who purchased established dwellings after the removal of government incentives, and therefore ineligible for a grant, may not have been registered as FHB loans. As one industry expert commented:

  "With interest rates where they are and grants changing… there would be a lot of FHBs coming into the market without attracting a grant." – Phil Naylor, CEO at MFAA

Lenders and brokers recognise the need to overcome housing affordability

- While Housing Industry Association (HIA) statistics suggest that affordability of mortgage repayments has improved, the rise in house prices and the removal of FHB concessions in some states have more than offset falling interest rates.
- Low housing affordability tends to place downward pressure on credit demand. More than one in three lenders (35%) and brokers (43%) agree overcoming housing affordability issues was among the top three challenges that have faced the mortgage industry over the past five years, and a similar proportion believe that it will continue to challenge the industry over the next five years.
- The HIA-CBA Housing Affordability Index indicates affordability continued to improve over the June 2013 quarter, with the proportion of income needed to meet mortgage repayments falling by 1.2% to 28.7%. However, affordability has increased mostly because of the falling interest rate environment, which means it is likely to decrease when the interest rate easing cycle ends.
- Meanwhile, house prices in capital cities reached a record high in September 2013. According to the RP Data-Rismark Combined Capital Cities Index, house prices rose by 1.6% in September 2013 - 0.7% higher than the previous record high recorded in October 2010 – to be up by 5.5% over the year, mostly due to strong growth in Sydney and Melbourne. Despite strong growth in house prices, industry experts believe concerns about a property bubble are premature, given the fall in prices following the GFC:

  "We are currently seeing some house price appreciation, [but] I think it's a cyclical house price appreciation rather than a bubble." – Jamie McPhee, CEO at ME Bank

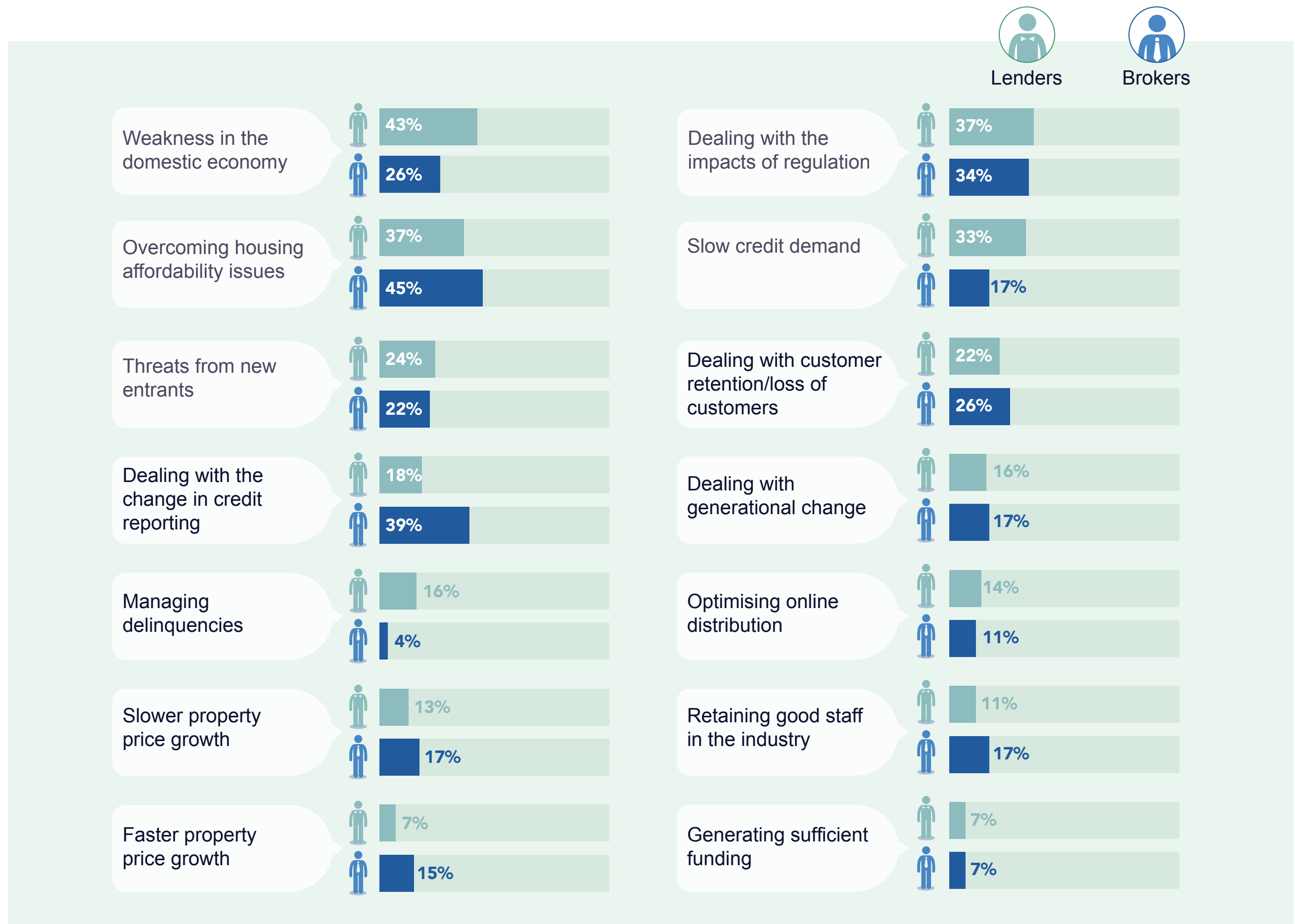
  "While mortgage clearance rates have certainly increased, all that is doing, in my opinion, is helping a market that is not operating or growing at the levels we have historically seen over the past 10 or 20 years." – Executive Director, non-major bank

- This is also noted in the RP Data Property Capital Markets Spring 2013 Report, which shows that despite increasing by 3.8% in the year to June 2013, capital city house prices remained 2.9% below their historic high levels. The report also shows rising house prices have been accompanied by a rise in the number of sales, which suggests the recent growth in property values is likely to be sustainable.

"We are currently seeing some house price appreciation, [but] I think it's a cyclical house price appreciation rather than a bubble."

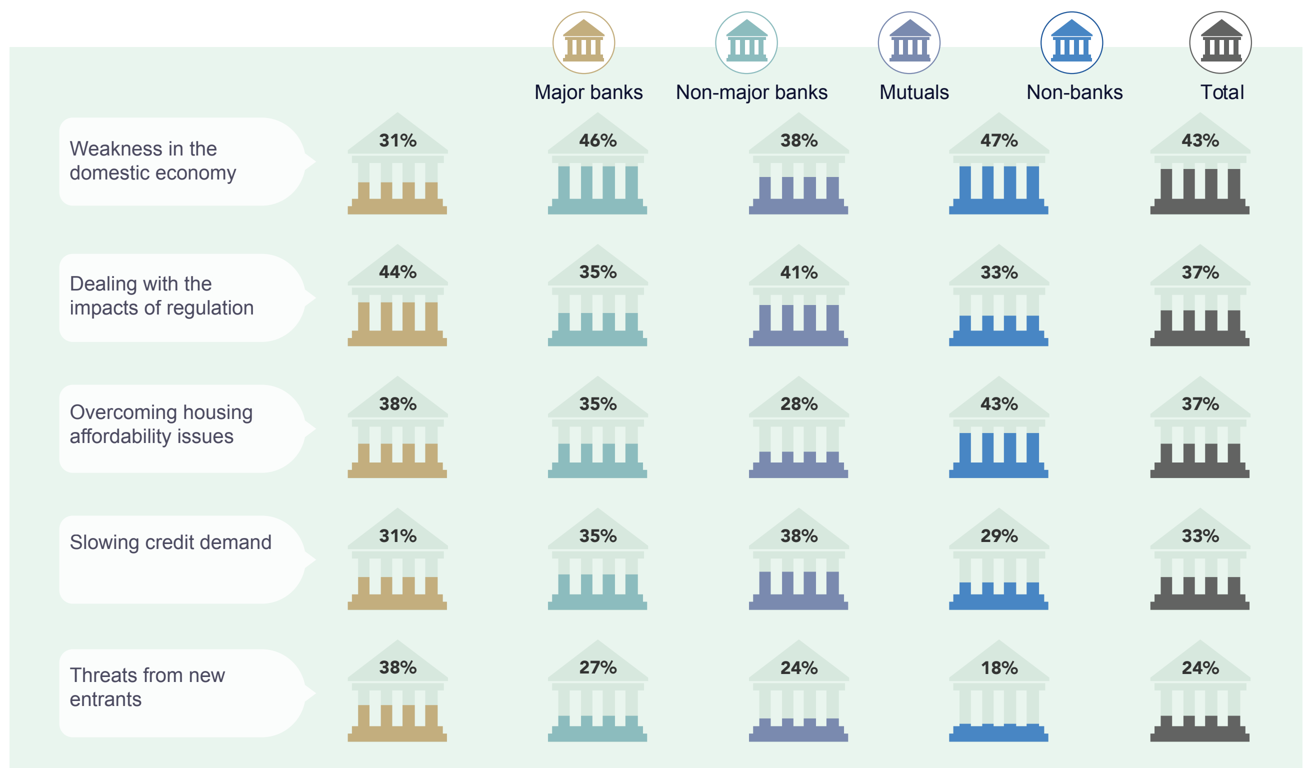
– Jamie McPhee, CEO at ME Bank

Chart 5: Thinking about the next five years, what would you say are likely to be the top three challenges facing the mortgage industry?



Source: Genworth

Chart 6: Thinking about the next five years, what would you say are likely to be the top three challenges facing the mortgage industry?



Source: Genworth

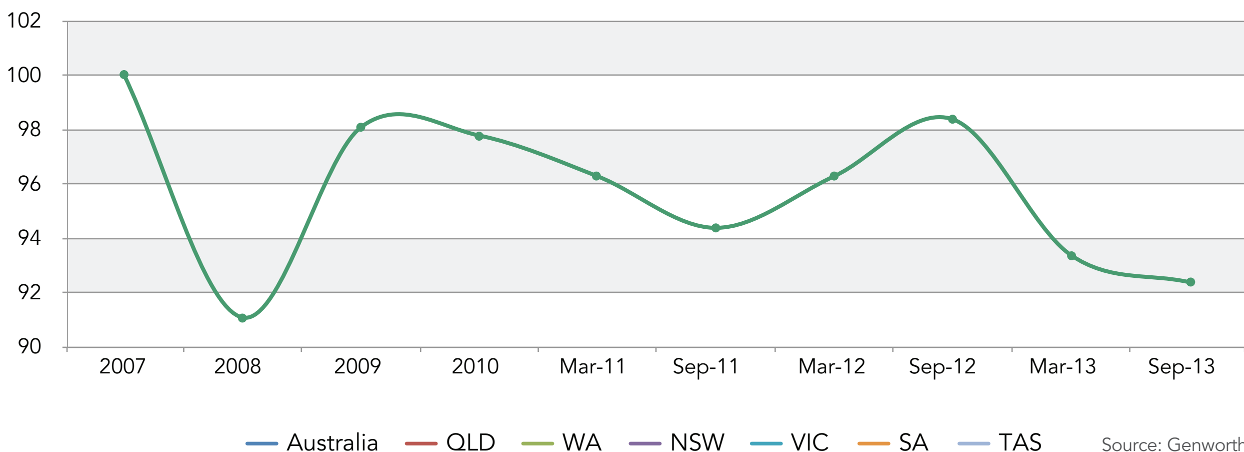
Consumer sentiment and behaviour

Consumer sentiment, as measured by the Westpac-Melbourne Consumer Sentiment Index, reflects buying intentions for major household items among consumers, which can either bolster or undermine growth in the mortgage market. In addition to lenders and brokers, homeowners and prospective homeowners were surveyed in the Genworth Streets Ahead report to add another perspective to the outlook for the mortgage industry, and the challenges or opportunities that are likely to arise from their behaviour.

Underemployment eroding the impact of falling rates

- Job security is a key component of consumer sentiment, as well as an indicator of the outlook for the mortgage industry. Homeowners who have experienced un-or-underemployment are more likely to struggle to meet mortgage repayments, while those who expect these changes tend to have low appetites for credit. With ABS data showing the seasonally adjusted underemployment rate rose by 10.7% to 7.8% in the year to August 2013, underemployment has eroded the positive impact of lower mortgage repayments.
- Owing to increased levels of mortgage stress, the Genworth Homebuyer Confidence Index fell to one of its lowest levels in September 2013 (see Chart 7). According to the Streets Ahead survey results, the proportion of homeowners who have struggled to meet their mortgage repayments in the past year increased from 23% to 26% between March and September 2013. Of this proportion, 32% of homeowners struggled because of underemployment in September 2013, compared with 28% in March 2013.
- Underemployment has challenged homeowners in some states more than in others. In Western Australia, one lender has seen "more overpayments, less mortgage stress… very, very low [level of delinquencies] in Western Australia". This is in line with Western Australia's lower than average underemployment rate of 6.5%.

Chart 7: Genworth Homebuyer Confidence Index



Source: Genworth

Table 1: Changes to first homeowner grants

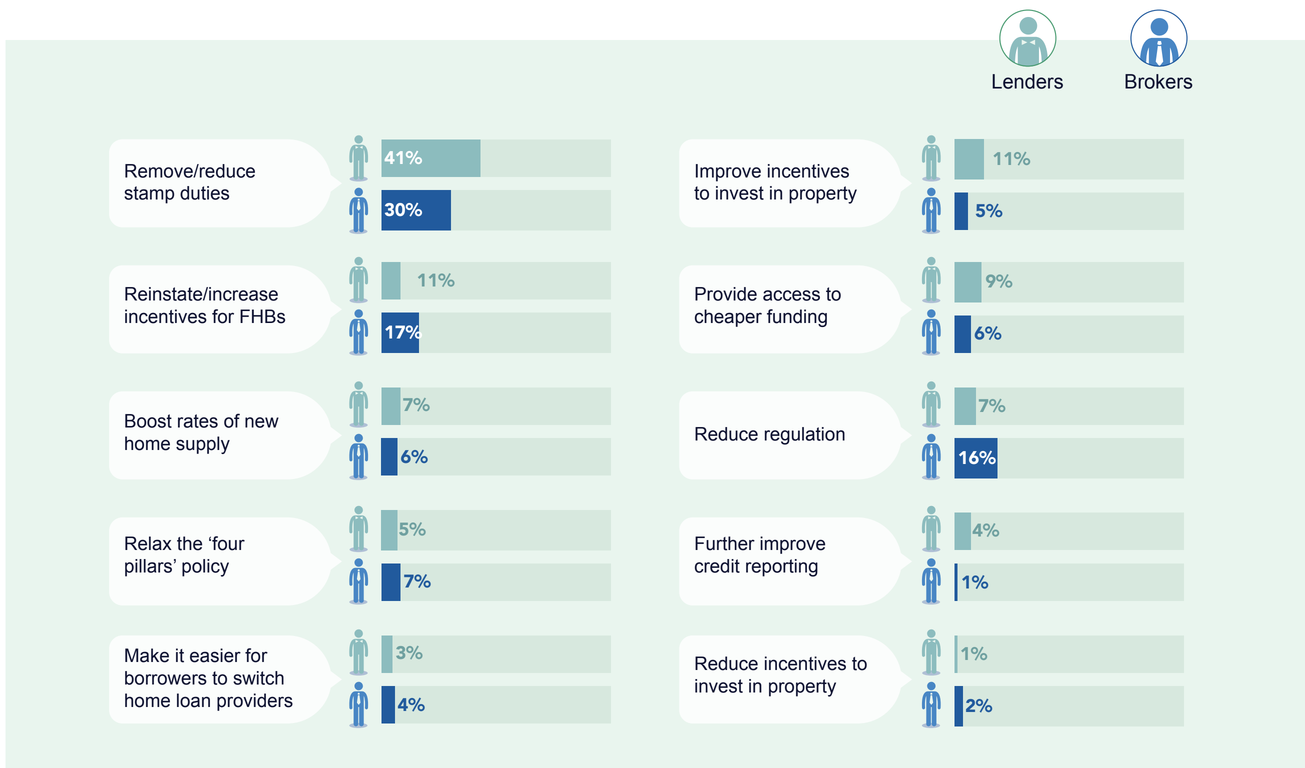
	New South Wales
Jan-12	Stamp duty waiver on established homes removed
Oct-12	$7000 FHOGs for established homes removed
	FHOG of $7000 increased to $15,000 for new homes valued up to $650,000
	Northern Territory
Dec-12	FHOG increased from $7000 to $25,000 for new homes in an urban area
	FHOG increased to $12,000 for established homes in an urban area
	Queensland
Sep-12	$7000 FHOG for established homes removed
	FHOG of $7000 increased to $15,000 for new homes valued up to $750,000
	South Australia
Oct-12	FHOG on new homes increased from $7000 to $15,000
Nov-12	FHOG on established homes reduced from $7000 to $5000
Jul-14	FHOG on established homes will be removed
	Tasmania
Jan-13	$8000 FHB Boost for new homes introduced
Jul-14	FHOG of $7000 for established homes and FHB Boost of $8000 on new homes will be removed
	FHOG of $7000 for only new homes will be introduced
	Victoria
Jan-10	$7000 FHOG for new and established homes capped on properties valued up to $750,000
Jul-10	Bonus for new homes increased to $13,000, and regional bonus increased to $6500
	$2000 bonus for established homes removed
Jul-11	Stamp duty reduced by 20% on new and established homes
Jun-12	Bonus of $13,000 for new homes and regional bonus of $6500 removed
Jan-13	Stamp duty reduced further by 10% on new and established homes
Jul-13	FHOG of $7000 for established homes removed
	FHOG for new homes increased from $7000 to $10,000
	Western Australia
Dec-09	$7000 FHOG for new and established dwellings capped on properties valued up to $750,000
Sep-13	FHOG for established homes reduced from $7000 to $3000
	FHOG for new homes increased from $7000 to $10,000.

Helping consumers reach the unreachable

- In addition to job insecurity, the growing perception that homeownership is unrealistic is also likely to affect the mortgage industry negatively, as non-property owners may be more likely to reject the Australian dream and no longer aspire to buy their first home. Almost one in two consumers (46%) believe homeownership is unrealistic for most Australians these days, according to the Genworth Streets Ahead survey (September 2013).
- Overcoming this perception may challenge non-major banks and mutuals more than other lender groups - of those surveyed, non-major banks' and mutuals' main bank customers are the most likely to consider homeownership unrealistic (50%), while major banks' customers are the least likely to consider it unrealistic (45%).
- In examining the reasons behind this pessimism, house prices are largely to blame, with over one in four (29%) consumers believing this is the biggest barrier to home ownership. In contrast, only 9% of those surveyed believe the difficulty of meeting mortgage repayments is holding non-property owners back from buying a home.
- Higher house prices, along with changing government incentives, means prospective homeowners need to save longer for a deposit. Among non-property owners who are planning to buy property in the next year, 28% have not entered the market because they have been unable to save a sufficient deposit.
- Most lenders (41%) agree removing or reducing stamp duties will be the one government change that would benefit the mortgage market, followed by reinstating or increasing incentives for FHBs (11%) (see Chart 8). Brokers tend to agree with lenders that removing or reducing stamp duties will benefit the mortgage market (30%), while participants in a broker industry workshop suggested deferring stamp duty until sale or spreading it over five years would be of benefit.
- Other industry experts argue that addressing supply by "releasing more land", "encouraging high density development and high density living", and "investing in infrastructure in these [developments] so that [consumers] will want to in live in them" will benefit the market more than incentivising demand – which will only "keep pushing up the prices on existing supply". As one industry expert highlights:

  "Housing grants… fuel the property market, and the ultimate beneficiaries are the sellers." – John Symond, Executive Chairman at Aussie Home Loans

Chart 8: Over the next five years, if state or federal government could make one change to benefit the mortgage market what would it be?



Source: Genworth

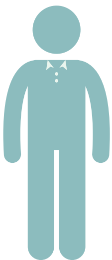
Ageing population set to change the mortgage industry

- The changing demographic landscape is another headwind that lenders expect will have an impact on the mortgage industry. The proportion of lenders that rate dealing with generational change as the biggest challenge facing the mortgage industry over the next five years is significantly higher than the proportion that rate it as the biggest challenge over the past five years (6% compared with 1%) (see Charts 3 and 5). Among lenders that rate generational change as the biggest challenge facing the industry, two in three believes the ageing population will have the biggest impact (65%).
- With ABS population forecasts showing nearly one in five Australians will be of retirement age by 2023, 31% of lenders surveyed expect to see more products marketed toward retirees over the next five years. Based on verbatim responses, this will result in "better packages for self-managed super funds", "more flexibility in accessing [self-managed super] funds", and "improved access to home equity with cheaper reverse mortgages".
- The self-managed super fund (SMSF) category is the fastest growing sector in the Australian superannuation industry, with ATO statistics showing the number of SMSFs increased by 7.1% in the year ending June 2013. About 6% of property owners have taken out a mortgage through their SMSF, according to the Genworth Streets Ahead September 2013 survey, while another 5% said they are likely to buy property through their SMSF in the next year. However, "the level at which people are setting up SMSFs doesn't make sense" to some industry experts in the mortgage industry:

  "When you are using your superannuation to gear into property that is worth more than the fund itself, and that [fund] is your retirement savings, then that's a concern" – Lisa Claes, Executive Director, Distribution at ING DIRECT

- As a higher proportion of consumers move into retirement, a new crop of prospective homeowners will emerge from the generational change, although one industry expert notes this may lead to slower credit demand:

  "We could see less demand for mortgages… Generation Ys are more comfortable with renting, and property prices are so high it's almost unachievable for a lot of them. They're also living at home [with their parents] later. Buying a home may not be the great Aussie dream [anymore]." – Head of Mortgages, major bank



"We could see less demand for mortgages… Generation Ys are more comfortable with renting, and property prices are so high it's almost unachievable for a lot of them. They're also living at home [with their parents] later. Buying a home may not be the great Aussie dream [anymore]."

– Head of Mortgages, major bank

Competitive landscape

The competitive landscape in Australia has been subject to much commentary in recent years. By global standards, Australia's banking sector is relatively concentrated with the four major banks holding 67% of main bank relationships among consumers surveyed in the Genworth Streets Ahead September 2013 survey. The GFC, as well as the difficulties that non-bank lenders faced to secure funding, exacerbated this situation. Against this backdrop, increased competition is expected to arise from online lenders and second-tier regional banks.

The playing field is levelling

- From a mortgage market perspective, the playing field does appear to be levelling, with the rise in residential mortgage backed securities supporting increased competition. This has led some lenders to believe "the smaller players will take more [of the market]", while some industry experts note competition from second-tier lenders has increased over the past year:

  "Access to funding markets has improved and [second-tier lenders] have stepped up their activity quite significantly… They are a lot more competitive today than in the past few years." – Clive van Horen, General Manager Home Loans at CBA

- Similarly, an industry expert from leading broker group AFG has seen increased competition among lenders, also owing to "banks' [reduced] funding costs":

  "Lenders are very keen to lend [and] we are seeing immense competition among not only major banks, but also non-major banks in the share of our business. This has translated into better deals for customers." – Mark Hewitt, General Manager at AFG

- However, while there is optimism, other industry experts are quick to point out that competition is "unlikely to return to the levels seen prior to the GFC… because of the state of the securitisation market".

- Industry experts also believe that it is unlikely non-banks will regain the 15% share of mortgages they held before the GFC. However, one industry expert believes that with help, non-banks could achieve a similar share of the market to their Canadian counterparts:

  "In Canada, comparable lenders [to non-banks] are at 10 to 11% of the market – with appropriate and securitised funding, non-banks could reach this [level] in Australia." – Phil Naylor, CEO at MFAA

Lenders pessimistic about the outlook for mutuals

- Australian mutuals have continuously demonstrated their resilience to challenging economic conditions by focusing on their strengths in customer service and satisfaction. As 'the fifth pillar' of Australian retail banking, their performance over the coming years will no doubt impact the competitive outlook for the mortgage industry.

- However, most lenders did not have a positive outlook for mutuals. Of those surveyed, only 16% of lenders are optimistic about the prospects for building societies, while about one in four are optimistic about the prospects for mutual banks (24%) and credit unions (27%). In contrast, higher proportions of lenders are optimistic about the prospects for wholesale funders (29%), regional banks (39%), online banks (66%) and major banks (59%).

- On the other hand, brokers are more likely than lenders to believe that the outlook for mutuals is positive, with higher proportions of brokers than lenders saying they are optimistic about the prospects for all mutuals over the next five years.

- Although credit unions are the most likely to be optimistic about their own prospects (39%), they are also among the most likely to be pessimistic (39% compared with the average of 31%), which is perhaps reflective of the fragmented nature of the segment and the fact that many rely on localised regions or borrower associations.

"In Canada, comparable lenders [to non-banks] are at 10 to 11% of the market – with appropriate and securitised funding, non-banks could reach this [level] in Australia."

– Phil Naylor, CEO at MFAA

Consumer perceptions of lender groups

- RFi research shows that brand perception is a key driver of mortgage purchasing decisions. Overcoming consumer perceptions will be the key to improving the outlook for credit unions and building societies over the next five years – only 35% of prospective FHBs surveyed are comfortable with borrowing from a building society, and just 40% are comfortable with a credit union.
- Prospective FHBs may be mostly unfamiliar with credit unions and building societies. Based on verbatim responses, lack of trust is the most common reason for discomfort among those surveyed. This stems from a perception that credit unions and building societies are not as 'safe' as banks:

  "I believe they are less secure and more likely to collapse [than banks]."

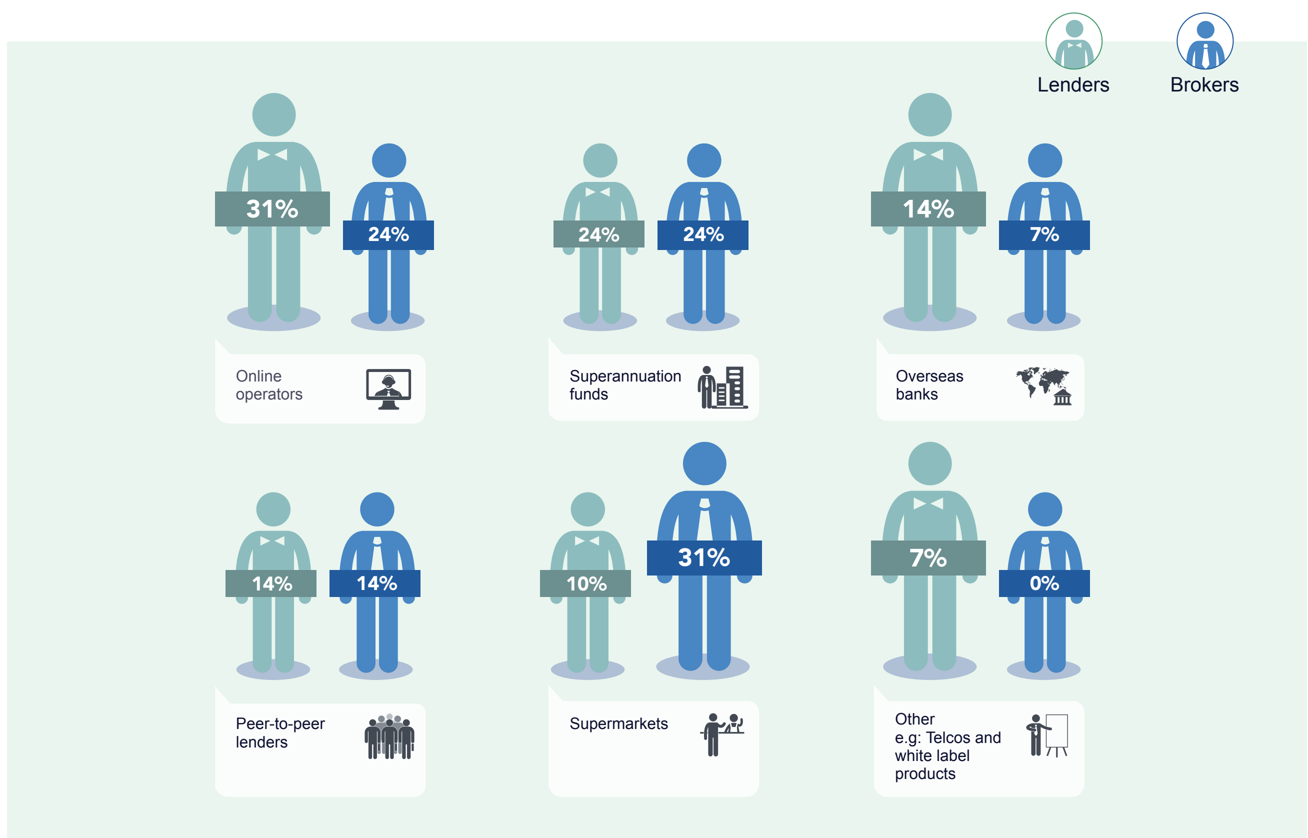
  "I see them as more unreliable than some of the other lending institutions."

- Notably, among prospective FHBs who are uncomfortable with borrowing from a credit union or building society, nearly three in four (73%) consider a major bank their main banking provider.
- Similarly, while most consumers who are uncomfortable with borrowing from foreign banks said they "prefer to support local or national banks", a large proportion are also unfamiliar with this lender group, with many believing foreign banks are unregulated:

  "Foreign banks don't have a good reputation for stability and they don't operate under the same regulations as Australian banks."

  "They have fewer regulations than Australian banks."

Chart 9: What type of new entrant do you believe will have the biggest impact on the mortgage industry?



Source: Genworth

Low consumer awareness of mutual banks

- The Competitive and Sustainable Banking System reforms in 2010 offered credit unions and building societies with Tier 1 capital of at least $50 million the opportunity to position themselves as banks while still being owned by their members.
- Several credit unions and building societies have taken steps toward overcoming negative consumer perceptions by trading as mutual banks. However, more than half of consumers surveyed (63%) are unaware that some credit unions and building societies have become mutual banks. Major bank customers (32%) are the least likely to be aware that some credit unions and building societies have made this change.
- While most consumers (61%) indicate they would be neither more likely nor less likely to consider taking out products with credit unions and building societies if it became a mutual bank, there is a sizeable opportunity for mutual banks to win customers by raising awareness of their change – 29% of major bank customers and 28% of non-major bank customers said they would be more likely to consider a credit union or building society if it were a mutual bank.

New entrants concern major banks

- While the major banks have a dominant market share of mortgages, increasing competition from non-banks in the payments space has led to much speculation about the threat of new entrants in the mortgage industry. Some industry experts are hesitant to believe it is more than speculation, arguing new entrants will need more than a strong brand to enter the Australian mortgage market:

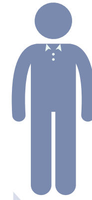
  "There's been a threat of new entrants for a while, but it hasn't happened… I tend to think you need to have a strong brand, you need to have experience in home loans, you need to have distribution capacity, and you need to have strong products. Some of these new players… they might have some of these strengths, but not enough to be major threats." – Head of Mortgages, major bank

- About one in four lenders (24%) rate the threat of new entrants among the top three challenges facing the mortgage industry over the next five years. Of this proportion, 31% believe tech giants such as Google and Facebook could have the biggest impact, followed by 24% who believe superannuation funds pose the largest threat.
- However, some in the industry believe that the size of the Australian mortgage market is not persuasive enough to attract global tech companies such as Google and Facebook, with one expert saying competition will come from current players, rather than new entrants:

  "There is a chance, but if you were looking at markets to get into, why would you bother with one that has a population of 23 million? It's too small." – Head of Mortgages, non-major bank

  "The competition will continue to come from existing players that have developed something new or learned something from [global tech companies] in terms of how they work with customers and how they develop propositions." – Head of mortgages, major bank

- Brokers are more likely than lenders to believe that the threat of new entrants will come from closer quarters, with 31% stating that the supermarkets posed the largest threat. This may reflect Australian supermarket groups, Coles and Woolworths, following a global trend of moving into financial services, with Coles having recently applied for an Authorised Deposit-taking Institution (ADI) license.



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Distribution dynamics

The distribution landscape in the mortgage market has experienced significant changes over the past decade, with technological developments allowing lenders to adopt new sales, retention and pricing strategies. While the Australian mortgage industry is still finding its feet in the online and mobile space, it is widely believed among industry experts that lenders who find ways to use technology for simplifying the mortgage application process or enhancing the customer experience will push ahead of their competition:

> *"[Significant] investment is needed to fundamentally change how [lenders] interact with customers… and there's a lot of legacy in systems at [banks] - if [a competitor] were to radically redevelop the customer experience or onboarding experience, they could do really, really well." – Head of Mortgages, major bank*

Broker influence expected to grow

- While consumers continue to value face-to-face contact, the branch channel is gradually losing its ground to the broker channel. Roughly one in two lenders expect the volume of mortgages sold through brokers to increase over the next five years (52%) (see Chart 10).

  "Approximately 78% of new loans are funded by the big four [banks], but approximately 45% of new loans are accessed through intermediaries such as brokers and financial planners." – Executive Director, non-major bank

- Industry experts suggest that brokers have a positive influence on competition in the mortgage market, as consumers turn to them for objective advice:

  "Brokers can provide a valuable credit advice service to consumers. I think that's the attraction for consumers to deal with brokers." – Phil Naylor, CEO at MFAA

- However, perhaps reflective of brokers' growing influence, some industry experts believe "brokers need to be more professional, better trained, and more careful with the advice they provide to customers".

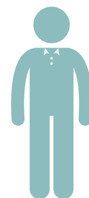
- Although industry experts agree brokers' influence will continue to grow, they also believe the rise in online and mobile channels will be the biggest obstacle for the broker industry:

  "[There are] some challenges for the lending and broker industry, with digital being a big one… There is a big shift in the way [consumers] access data, research properties and mortgages, and so it's important for lenders and brokers to embrace this digitisation in their own business strategies." – Clive van Horen, General Manager Home Loans at CBA

- At the same time, another industry expert acknowledges that while consumers have become more tech-savvy, they still value face-to-face contact with a broker.

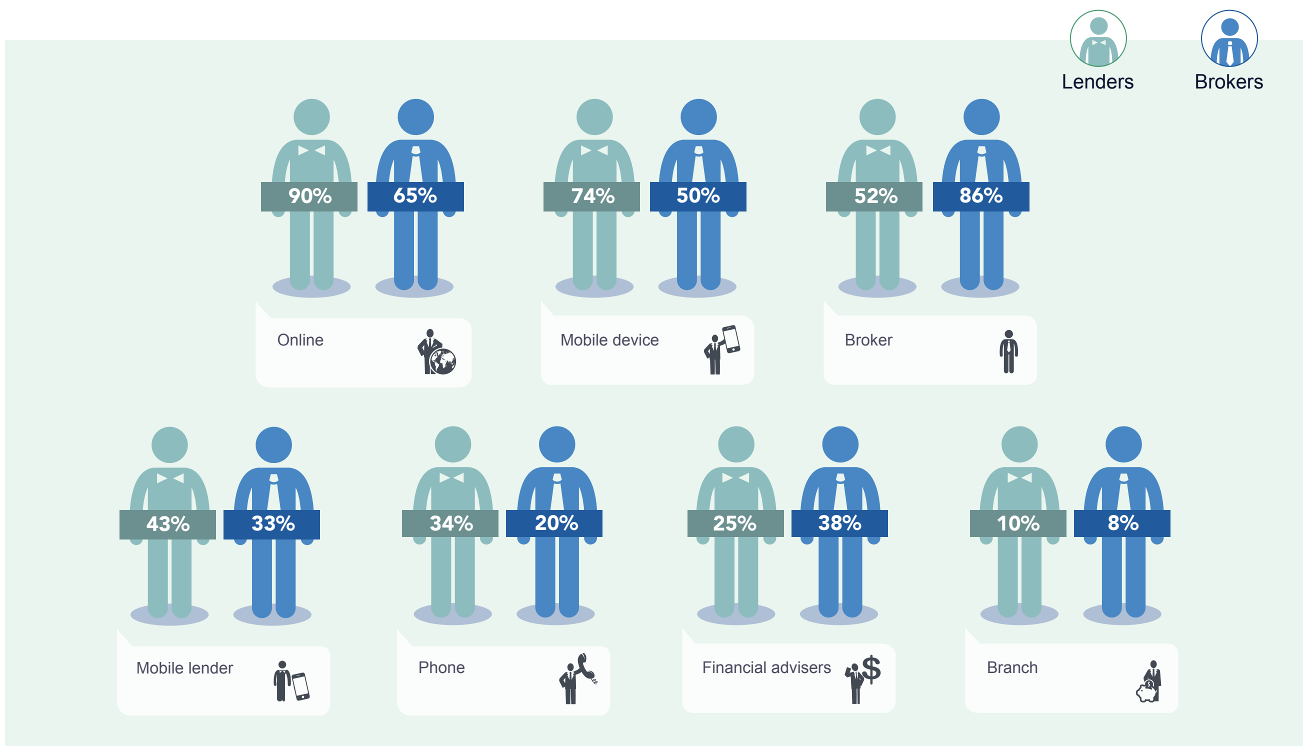
  "These days, [consumers] tend to do a lot more research before they go see a broker, and in some cases, they may go to a broker just to validate their own opinion. So there's a lot of information available out there about home loans… but in the main, consumers still want to see a broker face-to-face." – Mark Hewitt, General Manager at AFG

- In addition to brokers, lenders also expect consumers to seek face-to-face contact from mobile lenders. Among those surveyed, 42% of lenders believe the volume of mortgages sold via the mobile lender channel will increase over the next five years. Major banks (63%) and non-major banks (46%) are the most likely to believe sales will increase via this channel.



> *"[There are] some challenges for the lending and broker industry, with digital being a big one… There is a big shift in the way [consumers] access data, research properties and mortgages, and so it's important for lenders and brokers to embrace this digitisation in their own business strategies."*
>
> *– Clive van Horen, General Manager Home Loans at CBA*

Chart 10: Over the next five years, do you expect the volume of mortgages sold via the following channels to increase?



Source: Genworth

Online opportunities for lenders

- The internet has changed the way lenders interact with borrowers, with two in five lenders agreeing the mortgage industry has seen a great deal of innovation in terms of online presence and functionality over the past five years (43%). As such, an overview of mortgage distribution would be incomplete without insight into the industry's perspectives on digital opportunities.

- Lenders expect that borrowers will increasingly use online and mobile channels to apply for mortgages, with 90% expecting an increase in the volume of mortgages sold through online channels over the next five years, and 74% expecting an increase in the volume sold through mobile devices. Most brokers surveyed also believe the volume of mortgages sold through online channels (65%) and mobile devices (50%) will increase over the next five years (see Chart 10).

- Industry experts agree that "the automatic online loan is a long way away" as mortgages are "too complicated for digital channels." However, it is also noted that lenders who manage to simplify the process will have a competitive advantage:

  "It is complex today, and I think that's because we are still thinking and dealing as bankers… that will change because we will simplify things, and the people that do will have greater market share than the people that don't." – Jamie McPhee, CEO at ME Bank

- Growth in sales via the online channel and mobile devices is expected to come at the expense of sales through the branch channel. Of those surveyed, 43% of lenders expected the volume of mortgages sold via branches to decrease over the next five years, while a higher proportion of brokers (57%) expected the same.

- However, one industry expert believes consumers will continue to place high value on face-to-face contact when taking out a mortgage, and that more transactions, as opposed to more applications, will be made via digital channels:

  "Where the trade-off will happen is… increasingly, transaction-based activities will migrate from branches to digital. The lower value… activities integral to obtaining a mortgage [such as] determining affordability [and] comparing offerings will also increasingly migrate to digital. Strategic advice and aligning suitability of offering to specific customer needs will continue to benefit from human interaction, which will underwrite the longevity of the broker channel." – Lisa Claes, Executive Director at ING DIRECT

Outlook on innovation

Having explored trends in the market, including credit demand, consumer sentiment and channel distribution, it is also important to understand the industry's perspective on the key areas that demand innovation, which also sheds light on how priorities differ between brokers and lenders.

Lenders more optimistic than brokers about innovation

- Most lenders are optimistic about the level of innovation we will see in mortgages over the next five years (72%). Product development (30%), credit assessment (28%) and customer analytics (19%) were the top three areas that lenders believed most needed innovation (see Chart 9). Mutuals were the only lender group that believe it is more important for lenders to innovate product distribution (21%) than customer analytics (17%).
- On the other hand, only 39% of brokers surveyed are optimistic about the level of innovation they will see in mortgages over the coming five years. Of those surveyed, brokers believe broker servicing (26%), which can include new product offerings or services such as online platforms, or improved approval and settlement times, is the most important area that mortgage lenders need to innovate, followed by credit assessment (23%), and product development (20%) (see Chart 11).

Chart 11: Over the next five years, in which of the following areas do you think it is most important that mortgage lenders innovate?

Source: Genworth

Innovation in personalisation

- About one in two lenders believe it is likely that there will be more personalised mortgage products over the next five years, such as customised home loans (48%) where borrowers can 'cherry pick' features and benefits, and product packages (40%) where home loans will be packaged with other banking products (see Chart 12). Some lenders have already introduced product packages, with one industry expert noting its popularity among consumers:

  "Most of our flows come through our [mortgage] package… I think it's simpler for customers to buy, simpler to understand, and the all-in-one fee makes them attractive because of the discount [customers] receive when they take out a package." – Head of Mortgages, major bank

- More than one in four lenders (27%) also expects to see more product innovation for FHBs, particularly in the savings space. Most lenders think there will be either "changes to the genuine savings requirements" or "products to assist FHBs with savings" such as "saving plans with incentives to buy property". One industry expert agrees that prospective FHBs need to be incentivised to save for property:

  "The government needs to create the right behaviour by incentivising FHBs to save, rather than not save and just give up [on homeownership]. One way they can do that would be to give tax incentives for savings toward first homes." – John Symond, Executive Chairman at Aussie Home Loans

- Rather than saving plans, brokers who participated in an industry workshop believe FHBs need a "HECS-like" mortgage product with lower interest rates, while other lenders expect a return to "100% LVR loans" and an increase in "shared equity products". However, some industry experts believe that while shared equity products tend to be popular when house prices surge, it is unlikely that they will be popular when prices fall to normal levels of growth:

  "While shared equity has its place when prices are going up, when prices revert to a growth rate that is in line with GDP.... I'm not sure share equity will be hugely popular with banks or customers. It's always been a niche that is not worth the complexity." – Head of Mortgages, major bank

- On the other hand, brokers expect to see more product innovation for self-employed borrowers (33%) than for FHBs (26%) (see Chart 12). Based on verbatim responses, brokers believe there will be a rise in "low-doc loans" and "business offset accounts for personal mortgages" for self-employed borrowers.

- Brokers also stress the need for innovation in credit assessment for this segment, with some of those surveyed noting self-employed borrowers are subject to stricter lending standards.

  "The way that banks' policies determine income for self-employed borrowers should be reviewed… At the moment, there appears to be a harsher assessment hurdle for self-employed borrowers."

- Most brokers suggested there should be more flexible credit assessment policies such as "the ability to address serviceability on a case-by-case basis" rather than only "averaging the last two years income".

  "The ability to address serviceability on a case-by-case basis – risk-weighted pricing, with a 12 month review based on behavioural scoring for discounted pricing"

- Innovation in service offerings may also lie in a convergence between mortgage brokering and financial planning, although most industry experts admit it will be difficult as companies need to have the "right skill and mind set" to "get the model right". One industry expert believes the difficulty of such mergers stems from the difference between mortgage brokering customers and financial planning clients:

  "Brokers often deal with younger people such as FHBs… these people generally aren't interested in financial planners yet and financial planners tend not to be interested in them." – Phil Naylor, CEO at MFAA

"The government needs to create the right behaviour by incentivising FHBs to save, rather than not save and just give up [on homeownership]. One way they can do that would be to give tax incentives for savings toward first homes."

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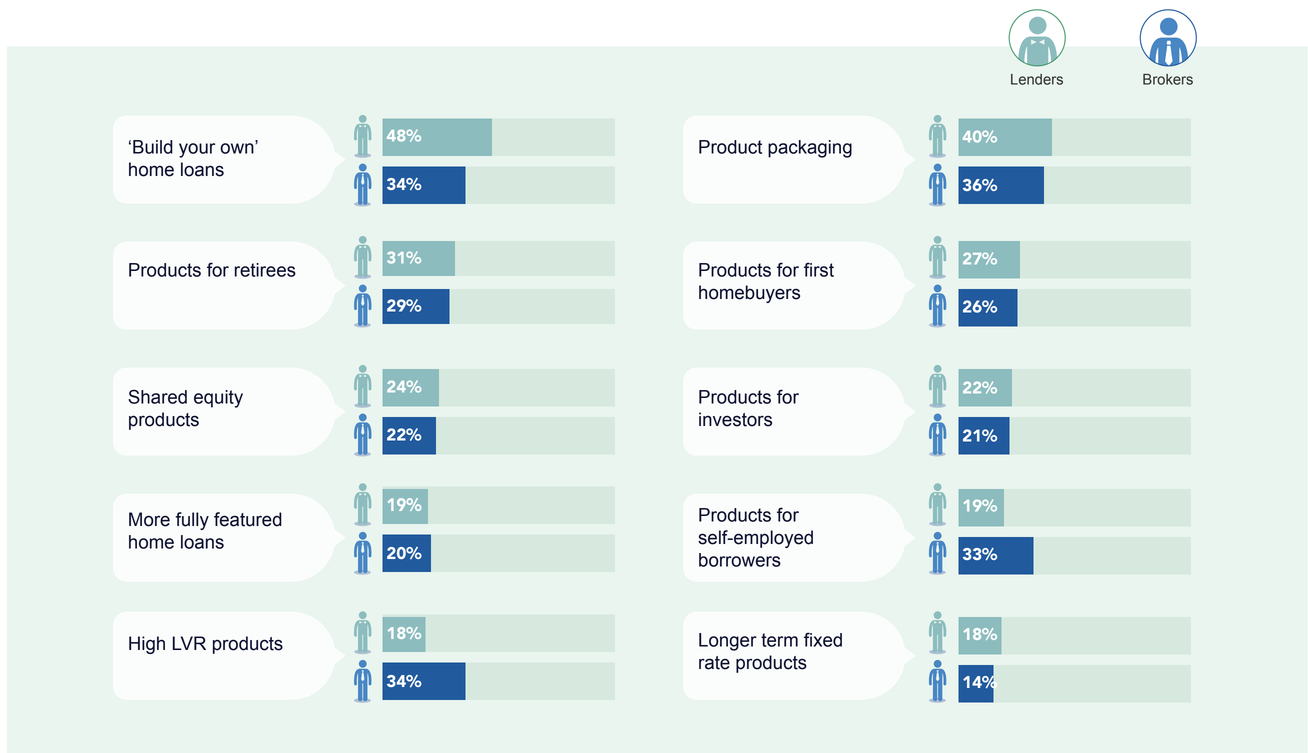
Chart 12: Over the next five years, which of the following types of innovation/development do you think we are most likely to see more of?



Source: Genworth

Industry divided on comprehensive reporting

- Australia's credit reporting system has been unchanged for over two decades, and is one of the few systems in the world that use only negative credit information, according to credit bureau Veda. Perhaps reflective of this lack of change, only 16% of lenders surveyed believe the mortgage industry has seen innovation in its credit assessment practices over the past five years. Furthermore, almost one in three lenders (28%) think credit assessment to be the most important area that lenders need to innovate over the next five years.

- While comprehensive credit reporting is expected to increase lenders' ability to differentiate between high risk and low risk borrowers, and so improve their loan portfolio performance, industry experts are divided in their views on its benefits, with one industry expert saying:

  "It's not that black and white. You can lose money on a 60% loan with the wrong borrower and make money on a 90% loan with the right borrower." – Executive Director, non-major bank

- Another industry expert commented that it is uncertain whether all major lenders would contribute data for comprehensive reporting, as it may benefit their competitors more than themselves:

  "Not many people are going to get a comprehensive report. Someone... who is small would see the benefit; someone like a CBA wouldn't see much benefit." – Head of Mortgages, non-major bank

- On the other hand, from a consumer perspective, one industry expert believes comprehensive reporting will help more consumers understand their personal credit rating:

  "Comprehensive reporting is a positive. We're one of the few countries that have only negative reporting. In the US, consumers understand what their personal credit rating is and it is quite an important piece of information for consumers who are making financial decisions." – Jamie McPhee, CEO at ME Bank

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Methodology

This study consisted of online surveys of 122 people who work at lending institutions, 182 brokers as well as 40 brokers who attended Genworth's annual broker workshop and 12 in-depth interviews with a broad range of industry experts including those from major banks, non-major lenders, broker groups, industry groups and property market data service providers.

It also consists of an online survey of consumers which formed the basis for the September edition of the Genworth Streets Ahead report.

About Genworth and RFi

Genworth

Genworth Australia is the leading provider of Lenders Mortgage Insurance (LMI) in the Australian residential mortgage market. For almost 50 years, Genworth and its predecessor business has been supporting the Australian mortgage industry by prudently enabling borrowers to purchase a home with less than a 20% deposit. By utilising LMI, lenders are able to provide loans to these borrowers with small deposits at market competitive interest rates. In partnership with over 100 lenders, Genworth helps borrowers to get into their homes sooner and keeps them there by working with lenders to provide solutions if borrowers encounter hardship. Genworth Australia currently has in the order of 330 employees nationwide, offices in all major cities, and approximately AU$3.6 billion of investments under management in Australia (excluding accrued interest).

For more information visit genworth.com.au

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