November 2011 | **Second Edition**

Home Grown

Mortgage Industry Perspectives

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Contents

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Charts

Executive summary

Lending growth slows in 2011, most lenders expect difficult year ahead with fewer first homebuyers and investors

- Majority of lenders have had some business growth over the past year, though wholesale lending has decreased
- Banks are performing the best out of the lender segments (banks, credit unions and building societies, brokers, wholesale lenders and originators).
- Lenders expect 2012 to be a difficult year, mostly due to underemployment in the market. Other factors include tight financing conditions
- For lenders who expect business growth in 2012, it's expected to be driven by a focus on channel strategy/distribution
- Lenders say the typical borrower in 2012 is expected to be mostly refinancers, with first homebuyers (FHBs) and investors expected to drop off (affordability continues to keep FHBs out of the market).

Western Australia and Queensland experience largest lending growth while South Australia/Tasmania see largest drop

- In the past year, Western Australia has seen the largest growth in lending, then Queensland, followed by Victoria and New South Wales, with South Australia and Tasmania having seen a drop in home lending.

Brokers testify to lending slowdown in 2011 but are more optimistic about 2012

- Brokers are more optimistic than lenders
- Have seen a drop in lending due to lack of borrowers, especially FHBs
- Brokers also expect refinancers to increase in 2012 and FHBs and upgraders to decrease
- Brokers have a better perception of lender service than in 2010
- Most brokers believe lenders can improve on technological innovation.

Online channel grows while borrowers want other channels to support the online option

- Three percent of FHBs applied for their loans online but 16% say would prefer to be able to do so
- Borrowers say the ideal online experience will be coupled with an in-person meeting and/or other contact options
- Most lenders want to grow this channel and two thirds will invest in it in the next year. Brokers are less likely to agree.
- Most lenders and brokers believe the online channel will cannibalise the branch channel

- More lenders than brokers believe the online channel will cannibalise the broker channel
- Channel popularity: online has seen the largest increase. Word-of-mouth and social media also considered important by many lenders/brokers
- Lenders prefer word-of-mouth marketing followed by the broker channel.

Legislative changes expected to impact the lending market while product innovation increasingly needed for key segments

- Lenders agree that tax incentives for investors play a large part in property investment
- Stamp duty changes may impact the FHB market
- Industry figures say that National Consumer Credit Protection (NCCP) legislation is causing brokers to leave or diversify into other products e.g. insurance
- Industry figures believe product innovation over the past year has been sluggish. Both brokers and lenders agree that more product innovation in lending is needed for FHBs. Brokers believe more innovation is needed in the self-employed borrower market.

In 2012
the typical borrower will be a refinancer and lenders expect a difficult year

FHBs
and investors are expected to decline

Key definitions

- **Banks:** Major banks; regional and smaller banks as well as foreign banks which operate within Australia while being headquartered outside of Australia (i.e. second tier)
- **CUBS:** Credit unions and building societies
- **Mortgage brokers:** A mortgage broker offers services which help borrowers apply for a mortgage loan by acting as an intermediary between the borrower and lender
- **Non-banks:** This refers to financial institutions which are not registered as Australian Deposit Taking Institutions (ADIs)—which include wholesale lenders and originators
  - **Wholesale lenders:** Wholesale lenders are institutions that provide mortgage funds to originators to lend. In some cases these wholesale lenders have a wider network than just originators, and they may also have their own distribution capabilities
  - **Originators:** An originator has access to mortgage funds via wholesale funding and in turn provides finance options to borrowers. An originator also manages a loan from inception through to post settlement.
- **First homebuyers (FHBs):** Borrowers who are looking to looking to purchase their first home, or who are paying off the mortgage on their first home
- **Investors:** Borrowers who hold, or are looking to take out, a mortgage on an investment property
- **Refinancers:** Borrowers who are switching their current mortgage from one lender to another.
- **Upgraders:** Borrowers who are looking to move to a new home and obtain a new mortgage on that property

Introduction

The *Home Grown: Mortgage Industry Perspectives* report presents the findings of two comprehensive mortgage market research surveys conducted online in August and September 2011. The study consisted of a quantitative survey of 200 people working for lending institutions and 300 brokers in addition to face-to-face interviews with a number of leading industry figures. This research has been combined to create a comprehensive overview of the opinions of lenders, brokers and industry figures towards the mortgage market in terms of lending volumes, changes within the market, borrower hardship and the outlook for lending.

This report builds on the inaugural *Home Grown* report, released in November 2010, as well as complementing our consumer research such as *Streets Ahead: Genworth Homebuyer Confidence Index* and the *Genworth International Mortgage Trends Report*. By providing a deep-dive into the various lender and broker perspectives of the market, we are able to provide a 360 degree view of the mortgage industry.

Market overview: uncertain growth conditions

The background to the brokers' and lenders' opinions is the changing conditions in the mortgage market over the past year, which has been marked by slow growth in all areas apart from refinancing, a slight rise in the cash rate, a fall in unemployment and a slight increase in affordability. It has also seen very divergent experiences among the different lenders and individual brokers, as local factors play a key role in performance.

Lending growth slow

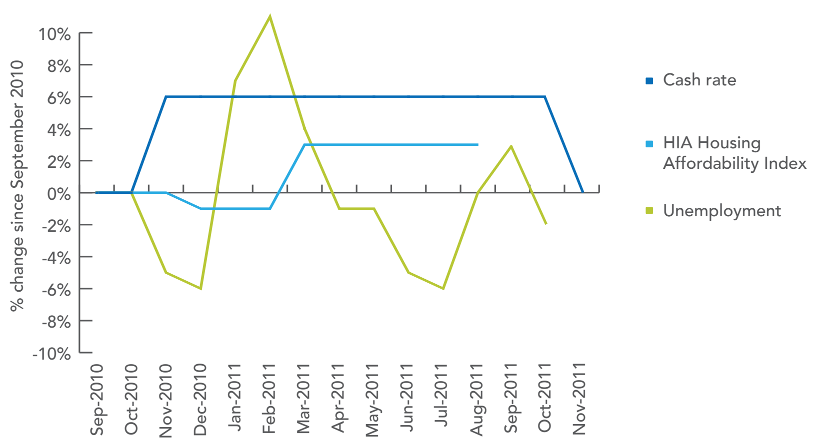
Increased consumer conservatism has had an effect on the mortgage market, along with uncertainty about future interest rate movement, low affordability and uncertainty about global economic conditions. Current mortgage borrowers are more likely than ever to be facing mortgage stress according to the September *Streets Ahead* report, and those who can meet repayments are focused on paying off debt as fast as possible. These factors have contributed to credit aggregates growing increasingly slowly in 2011, with August 2011 seeing the smallest year-on-year growth in owner-occupied credit aggregates on record (6.1%). New lending has suffered, with only lending commitments for refinancing seeing significant growth over the year to July 2011, at 28.7%. Refinancing activity has been fuelled by higher discounts and numerous bank offers targeting this segment. According to industry figures, 2011 created a 'perfect storm' for refinancers, with banks having available funding for lending and other sectors of the market remaining subdued.

Interest rates on the way down

The cash rate has stayed steady for the most part over 2010 and 2011, although much of 2011 was marked by the expectation that rates would increase. In the second half of 2011 this started to change, with many industry figures predicting a rate cut. November 2011 saw the first rate movement of the year, with the RBA cutting the cash rate 25 basis points. Prior to the rate cut, a large number of lenders had already started to cut their fixed rates, and following the rate cut all major lenders lowered their standard variable rates. Despite the lower fixed rates on offer, the popularity of fixed rate products has not increased. While fixed rate products rose in popularity to make up 8.9% of new mortgages in December

Economic indicators

Sources: ABS, RBA, HIA



2010, over 2011 they have fallen to just 5.6% in August. Industry figures predict rates will continue to fall in the medium term, and this may lead to a boost in consumer sentiment.

Housing affordability increasing

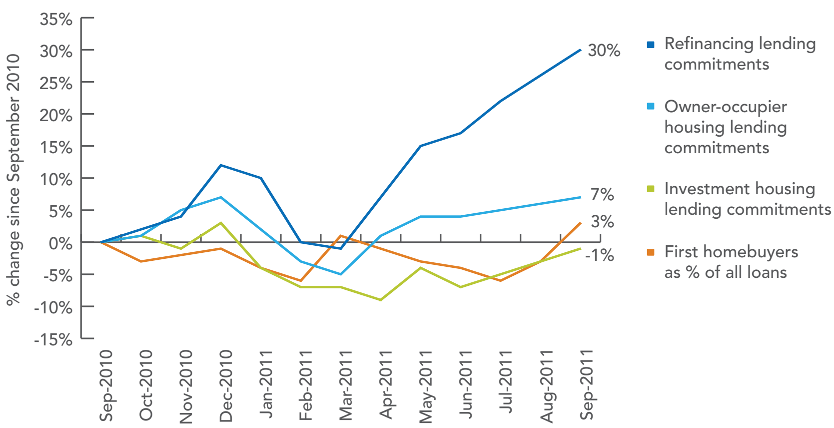
The strong housing market, combined with cash rate increases, pushed down affordability over 2009 and 2010. However, with current market conditions slow, and the cash rate remaining low, housing affordability has started to improve. The HIA Affordability Index increased by 3.8 points between June and July 2011, driven largely by falling house prices and an increase in the average wage. While this is good news for buyers looking to enter the market, growth has remained slow and Australian housing is still less affordable than it was in 2009. A low supply of housing is expected to keep house prices high. The proportion of FHBs in the market has remained low in 2011, hovering at around 15% (17% seen in 2010), as high prices and market uncertainty make it difficult to enter the market. This has fallen from the average of 26% seen in 2009, boosted by the Government's First Home Owner's Grant Boost, which may have produced a wake which some experts predict will subside in 2012.

Consumer sentiment

Low consumer sentiment has been affecting the mortgage market and the economy more generally. The *Genworth Homebuyer Confidence Index* has been falling since 2010, with the natural disasters in early 2011 having a marked impact. While borrowers are recovering from the effects of these disasters, high mortgage stress levels have been weighing on confidence over 2011. Global economic factors are also causing uncertainty in Australia. The *Genworth International Mortgage Trends Report (IMTR)* released in June 2011, showed that Australians remain better placed to cope with their debt levels than borrowers in many other countries. In fact according to the *Genworth IMTR*, 45% of Australian borrowers are overpaying their mortgage, compared to an eight-country average of 26% (across Australia, Canada, India, Ireland, Italy, Mexico, the UK and the US).

Change in the housing market

Source: ABS



2011: credit demand diminishes

It is clear that economic signs have been mixed over the past year, with one industry figure interviewed for the report describing it as "a game of two halves", with the market "patchy" since December last year. This mixed economy has affected lenders' business, with different segments seeing different impacts.

Majority of lenders still seeing growth, but it is slipping

Perhaps reflective of the uncertain conditions, lenders surveyed by Genworth in August and September 2011 were divided in their experiences. On the one hand, 52% of lenders surveyed believed that the volume of residential loans had increased from 2010 to 2011, while 34% believed lending volumes had decreased. While the majority of lenders surveyed had seen business growth in the last year, this proportion had decreased from the 2010 survey, in which 60% of lenders believed that volumes had increased and only 25% had seen a decrease in lending volumes. Industry figures put this down to localised differences in mortgage demand. Credit unions and building societies in particular are prone to local (geographic) or member (specific groups) influences that may have been booming or in decline.

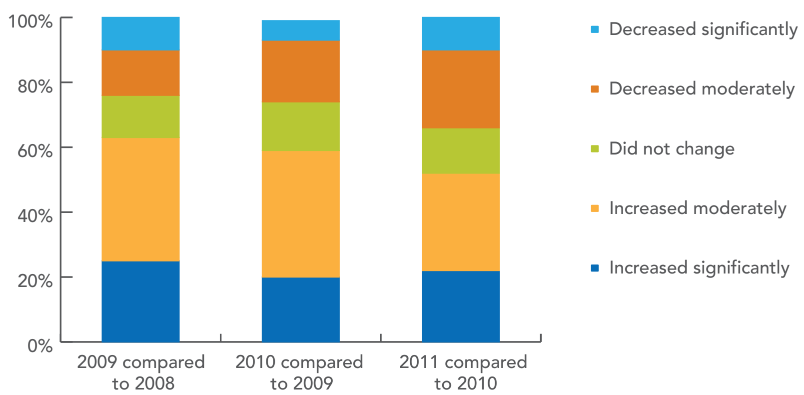
Surveyed lenders who had experienced a decrease in business were likely to put it down to increased competition among lenders, as well as a lack of buyers in the market- particularly FHBs. On the other hand, lenders who had experienced an increase in volume were likely to put it down to lender initiatives such as an expanded product offering or a focus on loan volumes. With many lenders targeting refinancers with their product offerings, growth in lender business is not based on market growth but on enticing customers from other lenders. While this has buoyed lending over the past year, it is not good news for growth in the market over the long term.

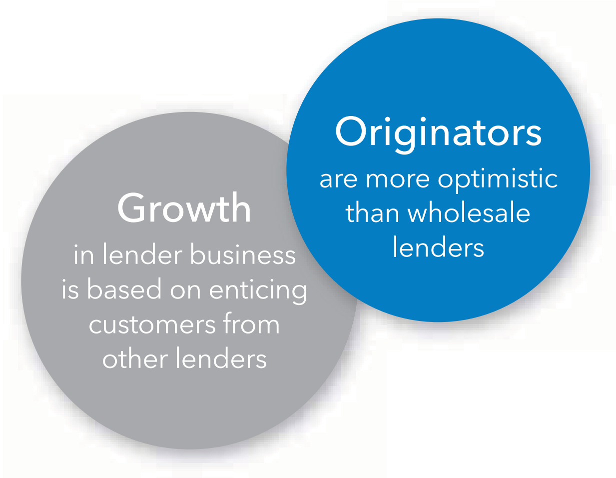
Banks prosper in 2011

While the large banks weathered the storm of the financial crisis fairly well, the increase in competition and offers from second tier lenders have meant that they have to fight to hold onto market share even though they are the most well-off lender segment. Of those large banks surveyed, 59% said that lending volumes have increased in 2011 relative to 2010, compared to 58% who felt volumes had increased in the

How has your business performed in the last year?

Source: RFi





2010 survey. Only 29% of banks surveyed had seen a decrease in business over 2011. Smaller banks have been more likely to struggle with funding, however there have been a number of new small bank offerings on the market.

Credit unions and building societies experience average growth

Among CUBS surveyed, slightly more than half (51%) had experienced an increase in lending volumes over 2011, in line with the average, while 39% had experienced a decrease. This high variation in experience may be down to the fact that CUBS are highly susceptible to local factors. Credit unions and building societies surveyed in 2010 saw 59% experiencing an increase in lending in 2010 and 28% experiencing a decrease.

Industry figures have suggested that CUBS have performed better than these results suggest, with above system growth over the year, but that CUBS tend to demonstrate "undue pessimism", possibly because of their high exposure to the retail market.

Wholesale lenders suffer

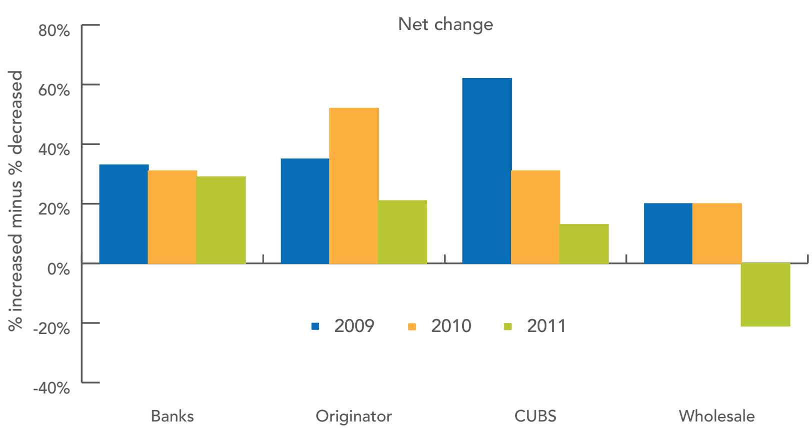
Lender experiences over the past year have also been mixed, and different lender segments have faced very different conditions. In both the 2010 and 2011 surveys, wholesale lenders were the most likely to have seen a decrease in business over the past year, at 43% in 2011 and 33% in 2010. Only 21% of wholesale lenders surveyed had seen an increase in business between 2010 and 2011, but all of these had seen a significant increase.

Originators more pessimistic than in 2010

Originators have become more pessimistic about lending volumes since 2010, with the proportion saying that volumes had increased in the last year falling from 67% in 2010 to 52% in 2011. Likewise, the proportion of those surveyed experiencing a decrease in volumes increased from 15% in 2010 to 31% in 2011. As in 2010, originators remain more positive about lending than wholesale lenders, despite funding coming from the same source, but the 'head in the sand' mentality that industry figures noted in 2010, where originators ignored the

How has your business performed over the last year?

Source: RFi



negative signs in the market including the poor performance of wholesalers, appears to have been replaced by a more realistic view of the market.

Change in borrower segments to 2011

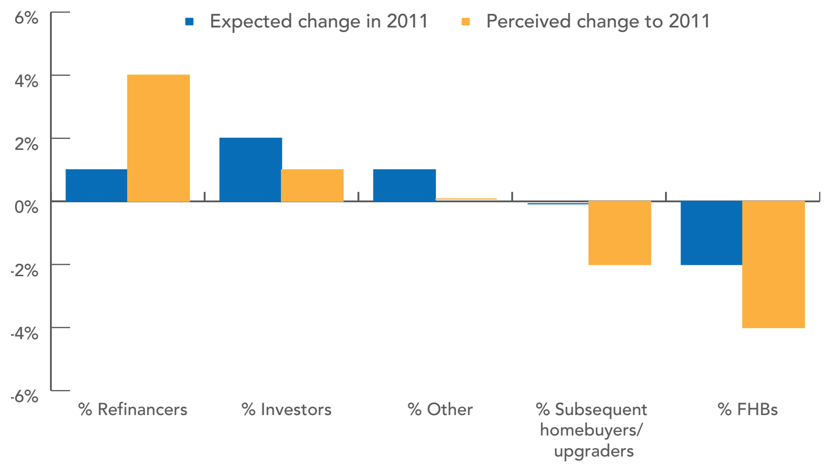
Future growth in the market is dependent on demand from borrowers, as well as supply. The type of borrowers who have been active in the market has seen some change over the past year. Lenders' expectations of which segments would make up the mortgage market in 2011 have largely come true, with refinancers and investors seen as making up an increasing proportion of new business in 2011 according to surveyed lenders. However, growth in refinancing has surpassed expectations, seeing the largest growth in 2011 ahead of investors, who were expected to see the strongest growth. Investors saw lower than expected growth, while upgraders and FHBs declined in line with expectations. The 'price war' among major lenders has contributed to the growth in refinancing activity, but industry figures noted that this aggressive pricing may not be sustainable in the long-term, and may attract less 'sticky' borrowers.

A price war among major lenders has led to growth in refinancing

But it could attract less 'sticky' borrowers

Change in the mortgage market over 2011

Source: RFi



2011: targeting tomorrow's borrower

Reflecting the experience of the last 12 months, lenders expectations differ among different lender types, although most see similar factors as likely to be at play in the year ahead.

Predictions of lending volumes

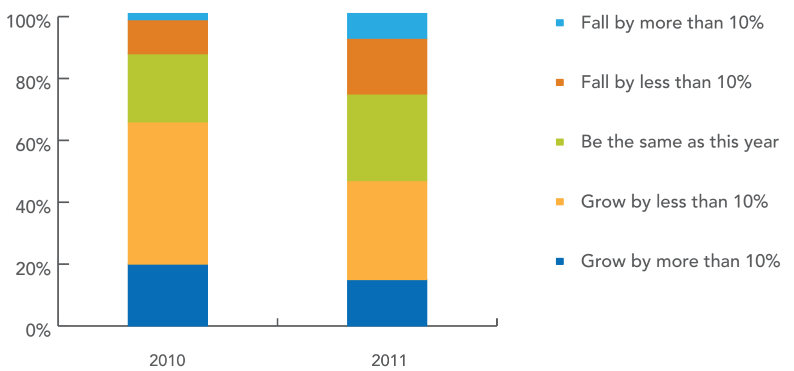
With mortgage volumes declining over the past year, lenders are increasingly pessimistic about the year ahead. While 65% of lenders surveyed in 2010 expected some growth in the mortgage market in the year to come, only 46% of lenders surveyed in 2011 expect growth in 2012. Confidence in the property market is expected to have the largest positive effect on the market in 2012. On the other hand, 28% of surveyed lenders expect lending to remain at 2011 levels in 2012 and 26% expect the market to contract. Lenders were most likely to see underemployment as having a negative impact on the property market in the coming year. While unemployment figures have remained low, industry figures indicated that local variations meant that there were likely to be "pockets of underemployment", particularly in manufacturing and retail dependant areas such as Tasmania.

According to ABS data, bank lending has been relatively steady over the past year, with bank-held lending commitments growing 4% from July 2010 to July 2011, while building societies' lending commitments grew 2% in this period. Building societies have experienced volatility over this period, with banks seeing slower and steadier growth. Wholesalers and other lenders, on the other hand, have seen falls in lending commitments between July 2010 and July 2011, of 50% and 7% respectively. Wholesale lenders' business has been steadily declining over the past few years.

With credit demand subdued, and the mortgage market boosted mainly by refinancing activity, all lender segments have struggled to see growth, and for many lenders growth has come through enticing customers away from competitors with attractive discounts. The major banks have offered a number of attractive deals for refinancers in recent months, which may have had the effect of shifting some customers from non-banks to banks. According to one second tier lender, greater credit demand would reduce the need for a

Looking forward, how do you think the Australian mortgage market will perform in the coming year, relative to the past year?

Source: RFi



'price war' and enable smaller lenders to be more competitive again. Another issue for non-banks is the continuing problem of funding, with increased conservatism among investors translating into less readily available access to securitisation. Non-banks are also unable to access cheaper funding from deposits, and industry figures note that they will not benefit from the recent introduction of covered bonds by some lenders, making it harder for them to supply credit to consumers.

Banks least optimistic despite strong performance in 2011

Despite the fact that banks were the second most optimistic lender segment looking towards 2011, and the most likely to have seen their business grow over the last year, they are now the least optimistic segment. Only 36% of surveyed banks expect the market to grow in 2012 and 42% expect it to contract. Banks expect underemployment and unemployment to have the strongest negative impacts on the market in the coming year, which is likely due to the regional impacts of slow retail and manufacturing growth noted by some industry figures.

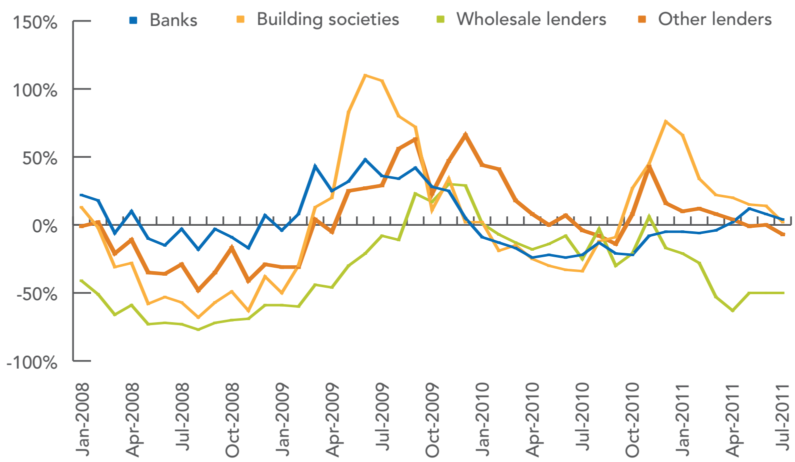
Banks have seen increasing access to funding in the past year, which has affected not only banks but the whole market: 55% of surveyed lenders agreed that bank lenders having a higher availability of funds would impact the market in the coming year. Clearly, the banks do not think that the greater availability of funding will be enough to offset low credit demand in the coming year. In interviews with industry figures, a recurring theme was the advantage that banks have relative to smaller lenders and non-bank players, through the benefits of scale from a funding perspective and cheaper funding sources through their deposit customers.

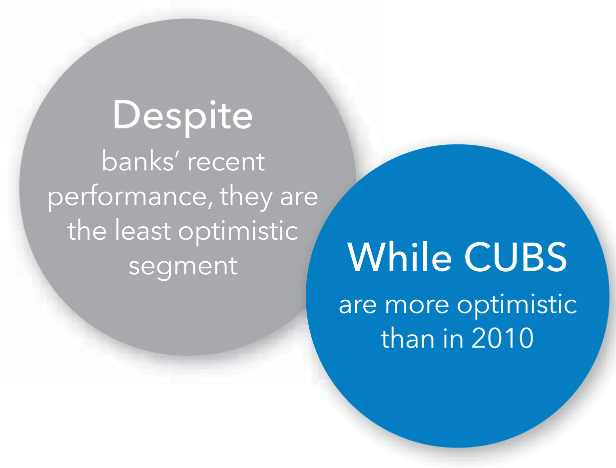
Credit unions and building societies (CUBS) unlikely to believe the market will grow in 2012

Credit unions and building societies (CUBS) and banks are equally unlikely to believe the market will grow in 2012, at 36%, though CUBS are less likely to believe the market will contract, with only 28% of those surveyed expecting it to do so. This leaves 36% of surveyed CUBS who think that the market will not change in the next year.

Year-on-year change in lending commitments

Source: ABS





Credit unions and building societies surveyed are more optimistic than they were in 2010, when only 16% predicted market growth and 60% thought the market would contract. As one industry figure noted, the CUBS experience has been particularly fragmented, with CUBS vulnerable to local factors.

Wholesale lenders expect the market to pick up

As in 2010, 57% of surveyed wholesale lenders expected the market to grow in the coming year, despite the poor performance of wholesale lending business in 2010 and 2011. Only 14% of surveyed wholesale lenders expect the market to contract in 2012, while 29% believe that it will remain unchanged. Industry figures indicated that funding constraints were likely to ease in the coming year as markets start to become more comfortable with risk, provided that events in Europe and the US did not worsen and cause a second global downturn. The Australian economy is particularly susceptible to changes in the Chinese economy, so industry figures are particularly mindful that this is subject to change.

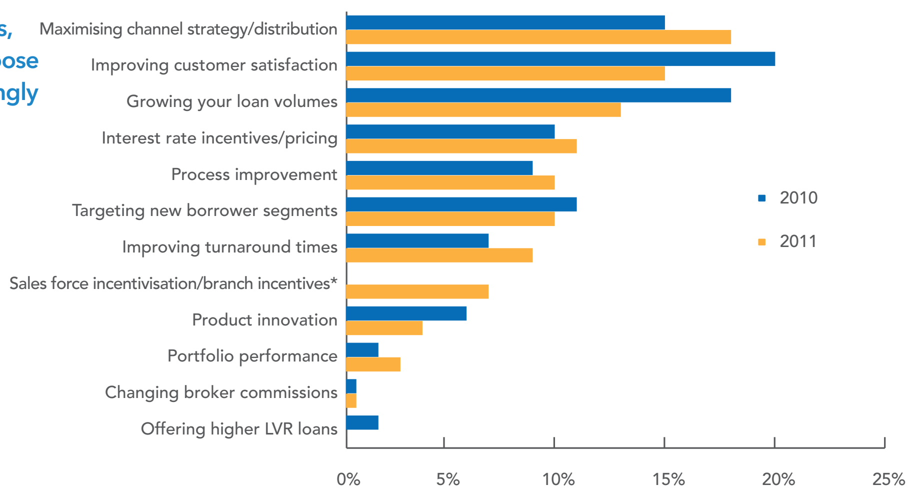
Originators the eternal optimists

As in 2010, despite the pessimism of the wholesale lenders, originators are the most likely to expect lending volumes to increase over the next year, with 62% of surveyed originators expecting the market to grow in 2012. Originators expect confidence in the residential property market to have the largest positive impact on lending volumes in the coming year, in line with the average. On the other hand, 13% of surveyed originators expect lending volumes to decrease in the coming year, and 25% expect them to remain unchanged. Several lenders have white label offerings, and industry figures have indicated their desire to differentiate these in order to find a market, which they expect will generate business in this segment in the future.

Bearing in mind your growth aspirations, please look at the following list and choose the three that you will rely on most strongly to achieve these aspirations:

*Not an option in 2010

Source: RFi



Drivers of growth

For those lenders who are expecting growth over the coming year, the key drivers of growth have shifted. In 2010 lenders were most likely to be focusing on improving customer satisfaction to drive growth, followed by growing loan volumes. In 2011 these shifted to second and third priorities respectively, overtaken by a focus on channel strategy and distribution.

Interest rate incentives were also a more popular strategy in 2011, possibly influenced by the rate-competitive environment. However, interviews with industry figures suggest that the current rate focus is unsustainable, and the competitive pressure on rates is likely to ease sometime in the coming year.

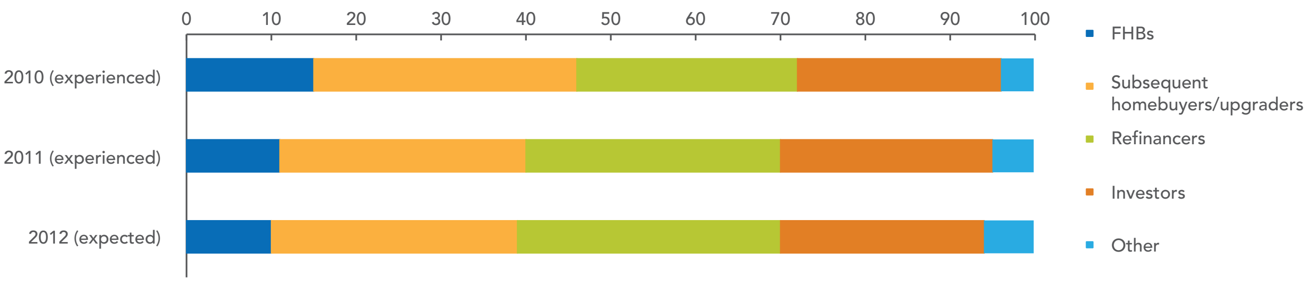
Expected change in make-up of market/borrower segments in 2012

Growth over the coming year is tied to borrower demand, as well as lender initiatives. On average, lenders reported that refinancers were the biggest borrower segment in 2011, making up 30% of business. Upgraders followed closely with 29%, investors made up 25% of business on average while FHBs accounted for only 11% of business. Surveyed lenders expect refinancing to continue to make up the lion's share of lending in 2011, increasing slightly to an average of 31% of new business, while FHB and investor activity is expected to continue to decrease. Other borrowers are also expected to make up a slightly larger proportion of new lending in the coming year.

The key customers for banks over the coming year are upgraders and refinancers, who are expected to make up 29% and 27% of lending respectively in 2012. Surveyed banks expect upgraders to see the largest business increase and FHBs to see the largest decrease. In fact, all lender segments expect to see a decrease in FHB business in 2012. With steady house prices, one industry figure expects that upgrading will start to appeal to borrowers again if economic conditions remain positive, while affordability issues will continue to keep many FHBs out of the market.

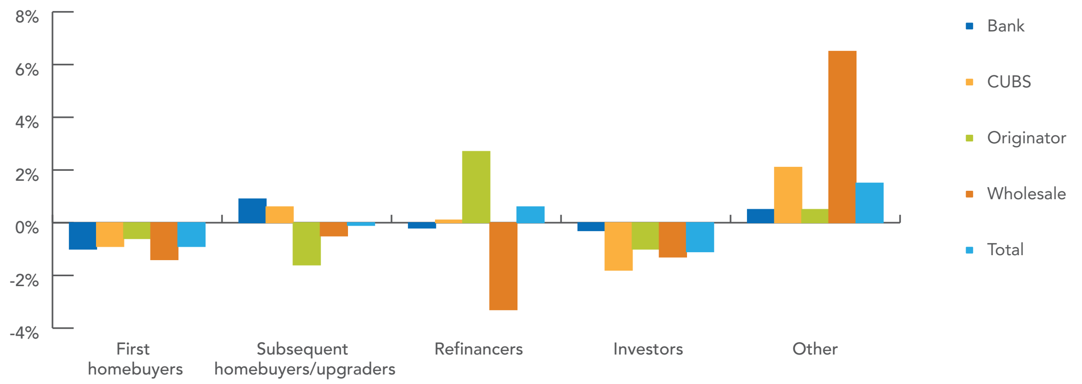
Percentage of business made up by borrower segments

Source: RFi



Expected change in borrower segments in 2012 (%)

Source: RFi



Credit unions and building societies are expecting the largest decrease in investors, with this segment expected to make up an average of 16% of business for surveyed CUBS in 2012. Upgraders are expected to be the main source of lending for surveyed CUBS, and are expected to make up 38% of business, followed by refinancers at 28%.

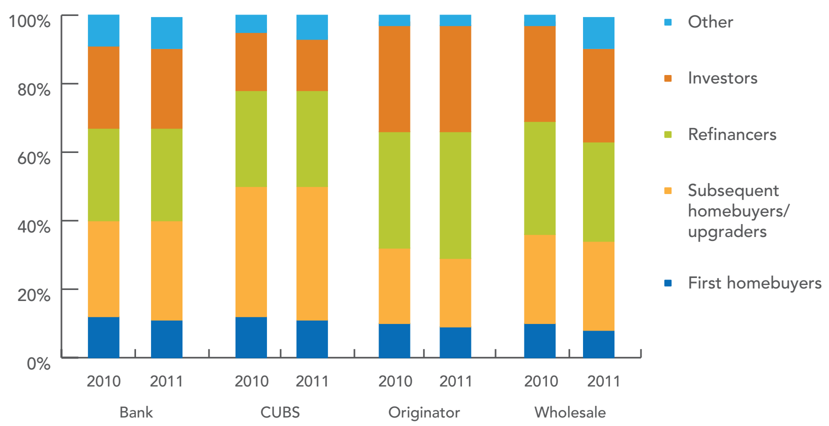
Wholesale lenders surveyed expect their main source of business to be refinancers, at 29% of lending, followed closely by investors at 27%. While refinancers are expected to make up the bulk of their business, wholesale lenders expected the proportion of business written for refinancers to drop, with an increase expected in 'other' lending. Industry figures indicated that wholesale lenders are increasingly diversifying their business to target niche segments, such as construction, overseas investment, real estate agents and Self Managed Super Funds (SMSFs), recognising that they need to compete in ways other than price. This appears to be driving the expected increase in 'other' lending.

Refinancers are also expected to be the main source of lending for originators, with an increase over 2011 levels to 37%. Surveyed originators expect upgraders to see the largest fall in the proportion of business they make up, down to 20% and behind investors who are expected to make up 31% of business for originators in 2012. In 2011 refinancing was the key area of growth in the market, but going into 2012 lenders are polarised about the future of this segment, with originators expecting growth in this segment but wholesale lenders are expecting it to decline. This view was echoed in industry interviews conducted, with views about the state of refinancing being mixed.

One lender interviewed said that the increasing conservatism of borrowers was leading to a desire to "put things in order" and simplify finances by consolidating debts, which is likely to have been a strong driver of refinancing. Refinancing incentives have been another driver, but it is unclear how sustainable this pricing structure is for lenders.

Borrower make-up of lender business – current vs. expected

Source: RFi



State-by-state comparison

State highlights

As different types of lenders have had different experiences of the market over the past year, conditions have also varied between the states and territories. Local factors, such as the natural disasters in Queensland and the mining boom in Western Australia, have contributed to this effect, as have other changes in the markets such as changes to stamp duty taxes in Victoria.

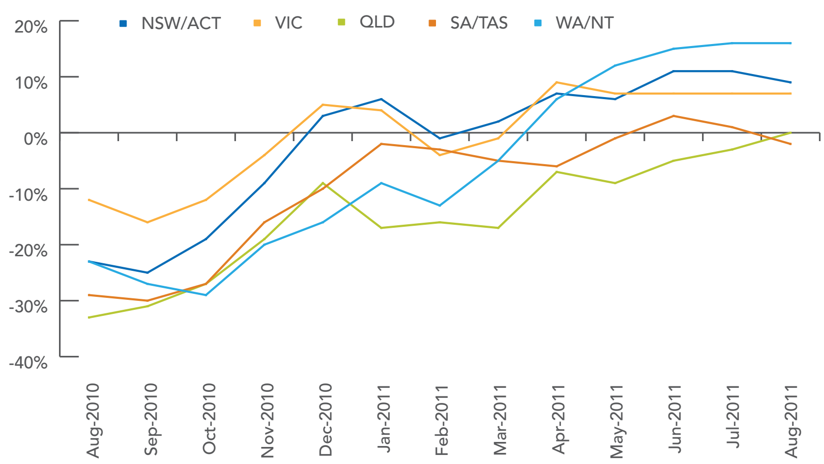
While all states and territories have seen a similar pattern of change in lending commitments over the past three years, marked by a decline over 2010 followed by a slight recovery in 2011, there are also differences between the experiences of each state. Between January and August 2011, Western Australia/Northern Territory saw the largest growth in number of lending commitments, at 10%, followed by Queensland at 8%. Victoria has seen more subdued growth over this period, of 4%, while New South Wales (NSW)/Australian Capital Territory (ACT) saw a slight (less than 1%) fall and South Australia/Tasmania fell 6%. Industry figures point out that there are also differences "town to town, city to city, suburb to suburb", with the performance of different industries more relevant to the states' economies than geographical differences.

New South Wales/Australian Capital Territory

- New South Wales/Australian Capital Territory lenders expect refinancers to make up the largest proportion of lending in 2012, at 32%, while FHBs were expected to decrease to 11% of the market
- Only 29% of NSW/ACT lenders had seen a decrease in lending over 2011, while 57% had seen an increase
- Forty-eight per cent of NSW/ACT lenders expect an increase in new lending in 2012, and 23% expect a decrease
- Industry figures note that while there are positive signs for lending in NSW, affordability in Sydney is likely to continue to act as a deterrent, particularly for FHBs.

Year on year growth in lending commitments by states and territories

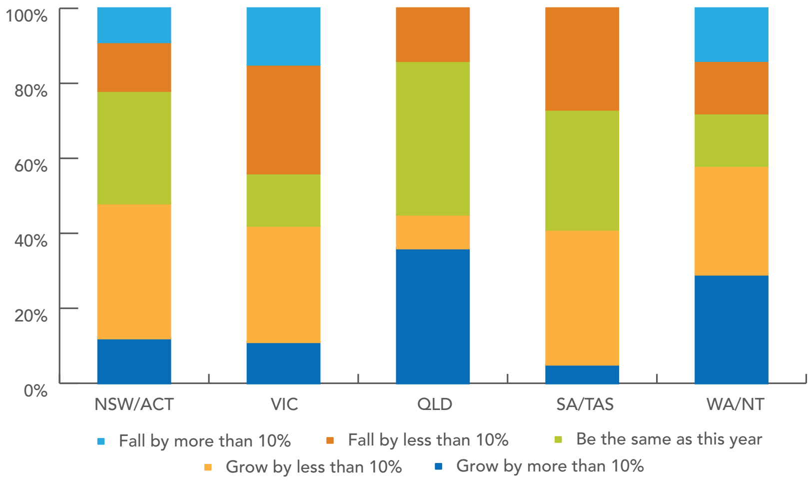
Source: ABS



Looking forward, how do you think the Australian mortgage market will perform in the coming year, relative to this year? (By performance we mean the volume of new lending)

*Small sample size (N<20); indicative only

Source: RFi



Victoria

- Victorian lenders were the most likely to expect the Australian market to fall in 2012, at 43%, although they were split equally between expecting a fall in new lending and expecting an increase
- Victorian lenders expect an increase in refinancer and other lending, and surveyed Victorian lenders expect refinancers to make up the bulk of lending in 2012, at 29%
- While Victoria has historically been a strong performer, industry figures say that signs suggest the market is cooling off.

South Australia/Tasmania

- South Australia/Tasmania expected most of their business to come from upgraders, at 35%, with growth in both the refinancer and investor segments
- Among the lenders surveyed, South Australia/Tasmania lenders were the most likely to have seen an increase in lending volumes over 2011, at 62%, and the least likely to have seen a decrease, at 27%
- Looking to 2012, South Australia/Tasmania lenders were not so optimistic, and were the least likely to expect lending volumes to increase, at 41%. 27% of SA/TAS lenders surveyed expected the market to fall in 2012
- Different economic factors in South Australia and Tasmania are likely to impact on the housing market. Industry figures pointed to the Olympic Dam project in South Australia as likely to provide a boost to employment and the real estate market there, while Tasmania's dependence on retail could lead to the market experiencing difficulties in that state.

Queensland

- Forty-eight per cent of surveyed Queensland lenders had seen a decrease in lending volumes, second only to Western Australia/Northern Territory
- Queensland lenders were least likely to expect the market to fall in 2012, at 14%, and the most likely to expect growth of more than 10%, at 36%, possibly due to the expected effects of recovery from the natural disasters of early 2011
- Refinancers are expected to see the largest growth in Queensland lending in 2012, although surveyed Queensland lenders expected investors to make up more of the market, at 33%
- While industry figures believe that the Queensland market is still recovering from floods, they also point to investments in natural resources as a possible driver of growth.

Western Australia/Northern Territory

- Western Australia and the Northern Territory combined were the hardest hit in 2011, with 56% of those surveyed seeing lending volumes decrease
- Despite this, 57% of Western Australia/Northern Territory lenders surveyed expect the market to grow in 2012, while 29% thought lending would fall
- Western Australia/Northern Territory lenders expected the biggest increase in business to come from upgraders, who they expect to make up 38% of business in 2012
- Industry figures see particularly mixed fortunes for the Western Australia property market, with Perth expected to see subdued growth but the north-west in particular set to benefit from expected mining projects bringing growth to the areas.

The voice of the broker

In order to fully reflect the mortgage industry, it is important to look at the brokers' point of view as well as the lenders. Though in many ways brokers and lenders have seen similar changes and have similar expectations, they also face different challenges.

Strong outlook on the property market

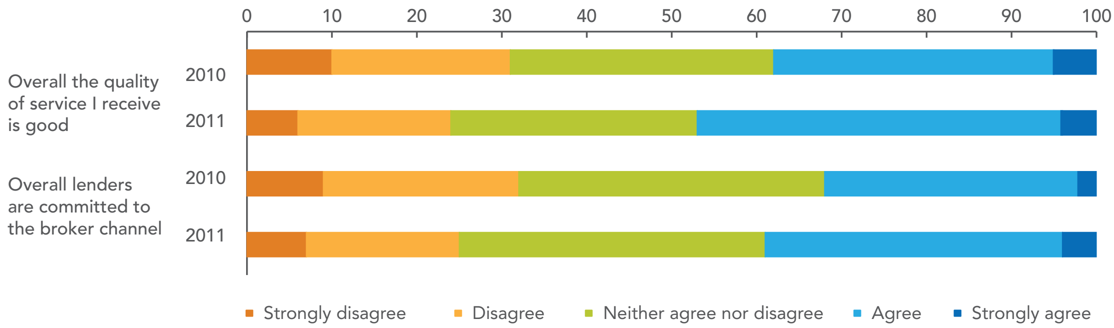
Looking at their overall business, 44% of surveyed brokers said that lending increased over 2011 compared to 52% of surveyed lenders, though 32% of brokers had seen a decrease compared to 34% of lenders. Brokers are less likely to have seen an increase in lending than they were in 2010, when 57% of brokers surveyed said that volumes had increased over the past year. Despite the setbacks, brokers are optimistic; 57% expect some degree of increase in lending volumes in 2012 compared to 46% of lenders. Industry figures supported the view that the demand for brokers would continue to be strong going forward, and while noting that NCCP may have increased the workload of brokers, they also indicated that it was a positive development for the industry as a whole, improving the professional image of brokers and quality of business.

The main reason brokers gave for seeing a decrease in lending was the lack of borrowers, particularly FHBs—in line with lenders. On the other hand, potential borrowers' increased willingness to approach brokers and the number of refinancers in the market were most likely to have contributed to an increase in lending volumes. Like lenders, brokers expect underemployment to have the strongest negative impact on lending volumes in 2012, while confidence in the property market is expected to have the largest positive impact.

Brokers surveyed expect an increase in business for refinancers and investors over the next 18 months, to 31% and 25% of lending respectively. On the other hand, brokers expect lending for FHBs and upgraders to decrease, to 20% and 22% respectively. First homebuyers still make up a much larger proportion of broker business than they do for lenders. Surveyed brokers felt that borrowers were most likely to come to them to find a better deal or for guidance, and this is likely to be more highly valued by FHBs who are less confident about negotiating the property market on their own.

Brokers' responses to the following statements:

Source: RFi



Service and innovation

After a perceived turning away from the broker channel, lenders appear to have started to improve brokers' opinions towards them and improve their service. In 2011, 48% of surveyed brokers agree that lenders provide them with good service, up from 38% in 2010, and 39% agree that lenders are committed to the broker channel, up from 32% in 2010. This is a strong improvement, and industry figures, both brokers and lenders, mentioned the commitment of lenders to the broker channel. Still, almost a quarter of brokers surveyed disagreed that lenders provided good service, and a quarter did not agree that lenders were committed to the broker channel. With a large number of lenders feeling that online is likely to cannibalise the broker channel in the future, this relationship could worsen, and channel conflict is likely to become a bigger problem for brokers in future, even though most do not believe it poses a threat currently.

According to brokers, the key area of improvement with regards to lender service is loan processing, with 86% of surveyed brokers nominating this as a key area in need of service improvement. Training and lead generation are also in need of improvement with 43% and 42% of brokers respectively seeing need for improved service in these areas.

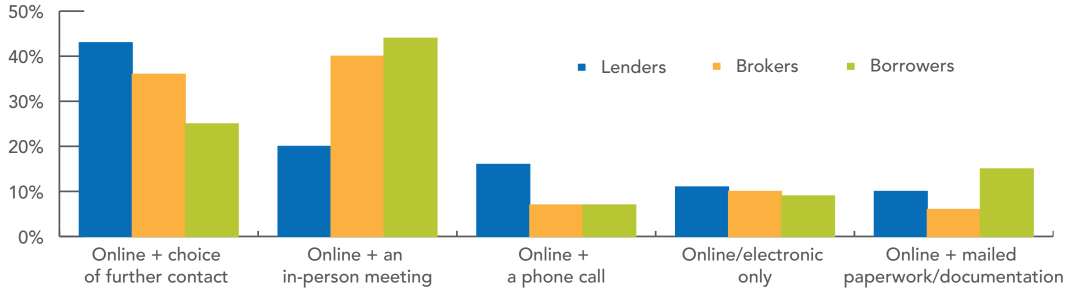
Brokers were most likely to believe that FHBs would benefit from product innovation, in line with lenders. However, brokers also felt that more innovation was needed to help self-employed borrowers, with 24% of those surveyed saying these borrowers would most benefit from innovation compared to 9% of lenders. When asked about technological innovation, 94% of brokers see scope for improvement, 85% of surveyed brokers state that lenders should focus on innovation in processing technology, while 74% state that lenders should focus on innovation for broker portals.

57%
of brokers are optimistic about an increase in lending volumes

Only 46%
of lenders think similarly

What do you consider to be the optimal online application experience?

Source: RFi



The online market

The consumer perspective

The existing market for online mortgage application is small, but likely to grow. According to data collected for the *Streets Ahead* report, only 3% of borrowers had applied for their home loan online but 16% of potential FHBs said they would prefer to do so when they took out their mortgage.

When asked about their ideal online application experience, 44% of surveyed borrowers said it would combine online with an in-person meeting, but 25% preferred the choice of further contact options. Brokers were also most likely to believe online combined with an in-person meeting would provide the most optimal experience, at 40%, but lenders were more likely to select online followed by a customer's choice of further contact, at 43%.

Lenders and brokers perspectives on the future of online

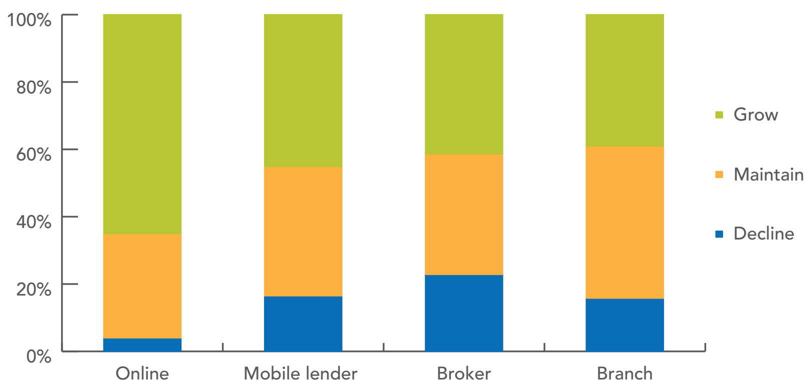
Lenders are likely to be planning to grow their use of the online channel, with 65% planning to do so. Wholesale lenders and originators are the most likely to be planning to grow their use of online. In order to grow the online channel, more than two thirds of all lenders surveyed are planning to invest in online distribution in the coming year. While brokers are also looking to increase use of the online channel, they are slightly less likely to do so than lenders, with 58% of those surveyed intending to grow their use of online channels and 57% planning to invest in online distribution.

Both brokers and lenders are likely to believe the online channel will cannibalise the branch, at 40% and 39% respectively. However, 36% of lenders surveyed believe the online channel will cannibalise the broker channel, compared to just 22% of brokers. Industry figures felt that the online channel had some way to go before it became truly effective.

A high proportion of both lenders and brokers surveyed said that the online channel would not cannibalise other distribution channels going forward. This may reflect the recognition that other channels will still be needed, since a high proportion of lenders, brokers and borrowers believed that further contact was needed even with an online

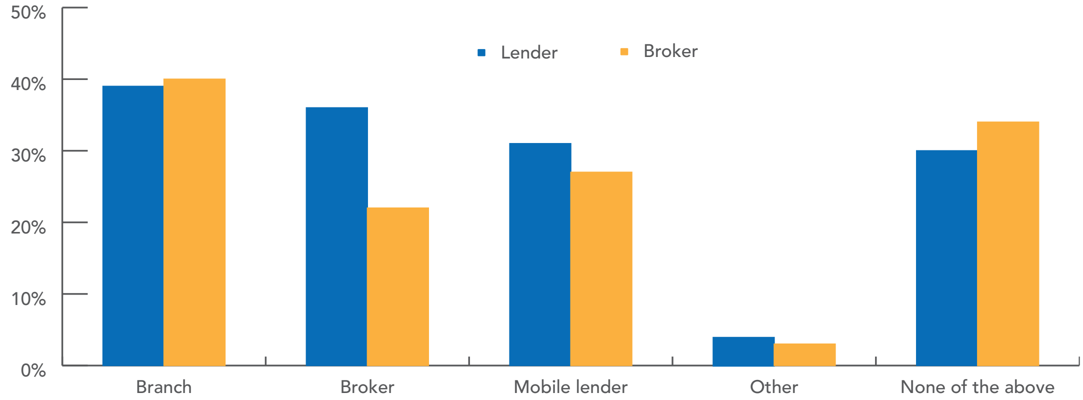
Looking forward to 2012, how are consumers looking to change the way they use the following channels with regard to home loans?

Source: RFi



Which of the following channels do you expect the online channel to cannibalise in the next 12 months?

Source: RFi



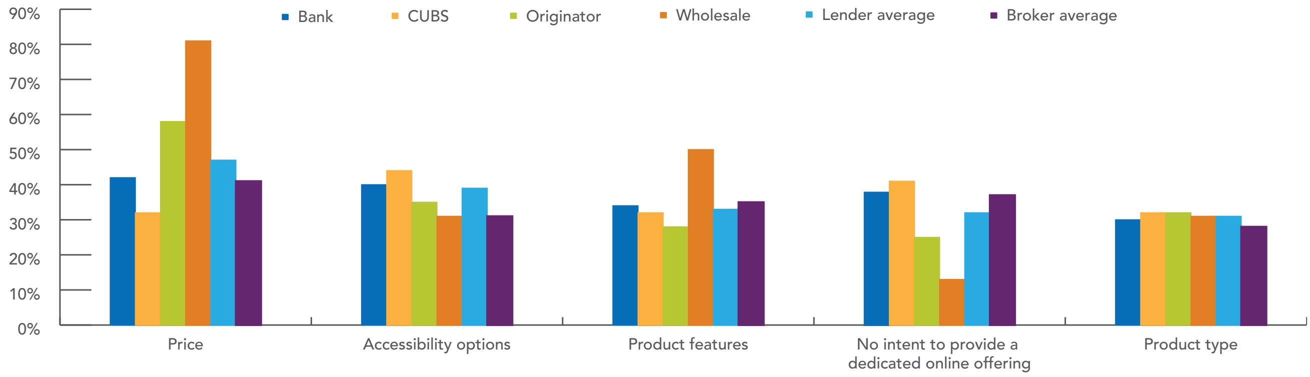
application, and many borrowers indicating that they would prefer a mix of online and face-to-face. As one industry figure put it, buying a home is the largest investment most people make, and they still want affirmation of their decision from a person during the process. Alternatively, lenders may be looking to attract new segments through these channels, and use them to generate more growth, though the current environment suggests that overall growth is likely to be subdued.

When looking at the online experience, both lenders and brokers are likely to agree that lenders should differentiate on price when providing online home loans. However, brokers are less likely to believe that lenders need to do anything to differentiate their online offering, potentially reflecting concern about the damage this could do to broker business.

Of all the segments, originators and wholesale lenders were the most likely to believe lenders should differentiate their product online, particularly in terms of price. Credit unions and building societies, by contrast, were less likely to differentiate online, and those who did were looking to differentiate in terms of accessibility. This suggests a different approach to the mortgage market among different segments. One industry figure pointed to both the customer focus of smaller institutions and the relative 'nimbleness' in their ability to embrace innovation as a key competitive factor for these lenders, rather than price.

Do you believe that lenders should differentiate any of the following when providing home loans online?

Source: RFi



Issues impacting the market

While the performance of the economy and changes in consumer sentiment are likely to affect the performance of the mortgage market in the coming year, there are other factors that are also likely to come into play. Changes in regulation, product innovation and the use of technology are all likely to impact on the market and on mortgage lenders.

Possible changes to tax create barriers for investors

Recent media speculation has centred around one possible regulatory change; the possibility of removing tax concessions for negatively geared investment properties. Interviews with industry figures suggest that this is unlikely to occur due to the negative political and economic effects. Survey results highlighted these possible negative effects, with 76% of lenders believing that tax concessions play an important role in investors' decision to invest in property, above rental returns or capital gains. More than half believe that if such changes came into effect, investors would be likely to sell their investment property and pay off their mortgage.

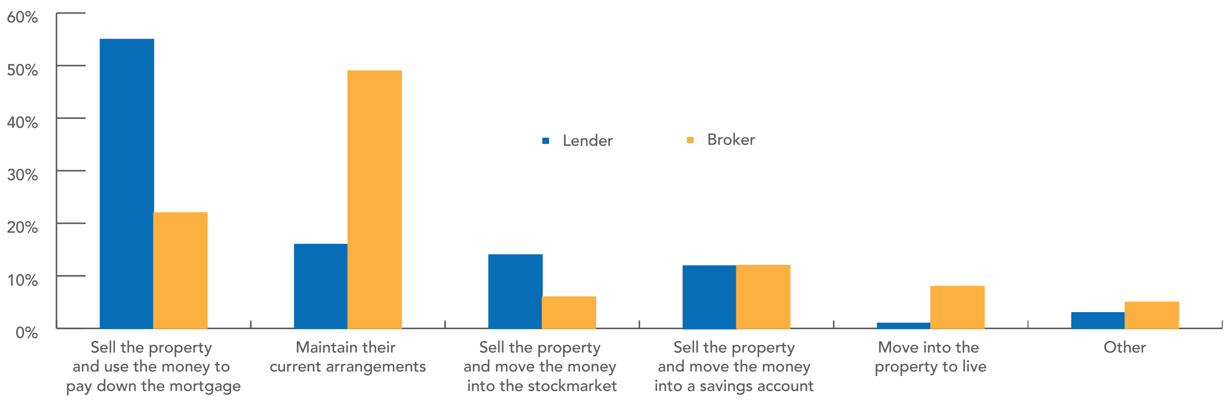
However, results of the *Streets Ahead* survey of consumers show that this is not necessarily an accurate prediction of consumer behaviour. When property investors who were aware of the tax concessions linked to negative gearing were asked about the importance of various factors in their decision to invest, only 55% felt tax concessions linked to negative gearing were important, behind capital gains and rental returns. Furthermore, when asked what they would do if tax concessions were removed, almost half of all investors surveyed said they would maintain their current arrangements, and one in five said they would sell off the property to pay down the mortgage. Overall, 39% of investors said they would sell their property if tax concessions for negative gearing were removed, compared to the 81% that lenders expected to sell in the same circumstances.

Stamp duty changes to keep first homebuyers out of the market

While negative gearing changes are still a rumour, changes to stamp duty are in the works in several states. The NSW

Media speculation has centred on the possibility of removing tax concessions for negatively geared investment properties. What would be the most likely response if such concessions were to be scrapped?

Source: RFi



Government has announced it wants to remove the stamp duty waiver (currently available on properties up to $600,000 for FHBs) on existing properties, meaning it would only be available on new properties and construction loans. While this would constitute a continued boost to the construction industry, it means many FHBs will face added costs if they are looking to enter the market in 2012. First homebuyers in NSW have also seen several changes in eligibility for the grant, with the NSW Government introducing a $750,000 cap in January 2010, which they later increased to $835,000. There has been some speculation in the media that this will drive a small FHB boom in the last few months of 2011 as FHBs try to get in ahead of the changes, but no lenders surveyed thought that FHBs would see an increase in the coming year. Queensland cut stamp duty concessions for borrowers other than FHBs in July 2011, and is phasing out stamp duty concessions on FHB properties over $510,000, while Tasmania cut all stamp duty concessions for FHBs in June 2011.

On the other hand, in July 2011 Victoria introduced a 20% stamp duty discount for FHBs on properties up to $600,000. The stamp duty discount is planned to increase incrementally, reaching 50% in September 2014. Victoria also introduced stamp duty concessions for some pensioners, seniors and concession card holders.

National Consumer Credit Protection Act and responsible lending

While changes to tax concessions for investors is still speculative, other regulatory changes around responsible lending have been introduced in the past few years. The NCCP introduced licensing requirements for brokers which came into effect in January 2011, with a licence required from July 2011. Since then, ASIC has released a number of documents further clarifying their requirements. Along with a licensing requirement, NCCP has introduced greater information gathering requirements around determining the suitability of a loan for a borrower.

Interviews with industry figures suggest that this legislation has already started to affect the broking industry, with some brokers leaving the market and an increased burden of work required for each application for remaining brokers. While overall the regulation was seen as a positive thing, resulting in a higher quality of brokers and an improved image for the industry, many brokers had diversified in order to stay profitable due to the increased work burden. Survey results bear this out, and point to further diversification to come. In 2010, 88% of brokers surveyed were looking to cross-sell products to borrowers along with mortgages, and this increased slightly to 91% in 2011. Brokers were most likely to be looking to sell insurance products, particularly life insurance and income protection insurance, which 72% of brokers surveyed were planning to offer in 2011.

Word-of-mouth is key in marketing

With the growth outlook for the coming year uncertain, reaching potential borrowers is key for lenders. Overall, surveyed lenders' preferred marketing channels were unchanged since 2010, with word-of-mouth considered most important by surveyed lenders, followed by the broker network. However, there were some changes, and both these channels had decreased in importance over the past year, as did the branch network. Online, TV, social media and direct

mail all saw increases in importance, with online seeing the largest increase. On the other hand, word-of-mouth was more important for brokers and had increased in importance over the past year.

Overall, 98% of brokers surveyed state that word-of-mouth is a valuable marketing channel to grow their business, (69% believe it is the most important) and 59% consider social media to be important (4% believe it is the most important). Lenders also value word-of-mouth, with 70% of those surveyed believing it is an important marketing channel (24% believe it is the most important) and 31% valuing social media (3% believe it is the most important). The difference in importance placed on word-of-mouth and social media suggests that social media is being underutilised as a marketing channel, and comments by industry figures suggest a certain degree of caution is being exercised towards social media, as well as uncertainty as to how to best use it in the mortgage space.

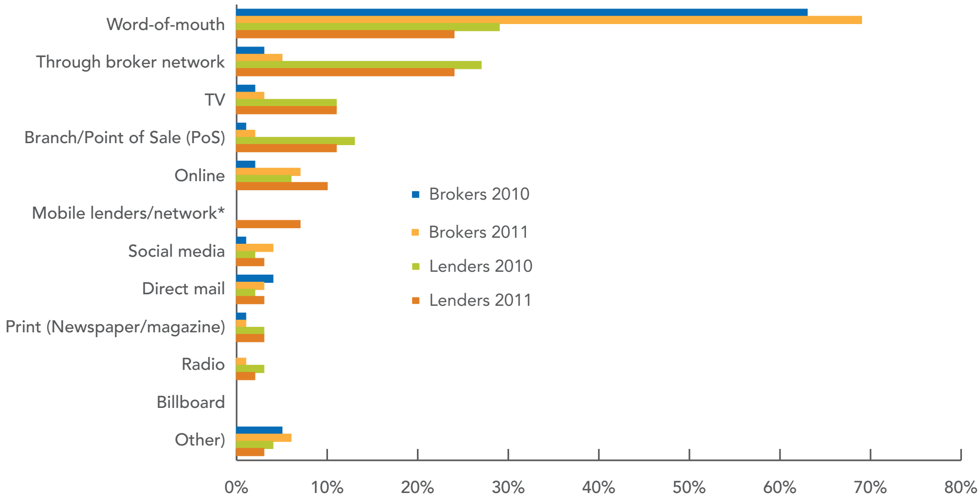
Service innovation from technology and processing

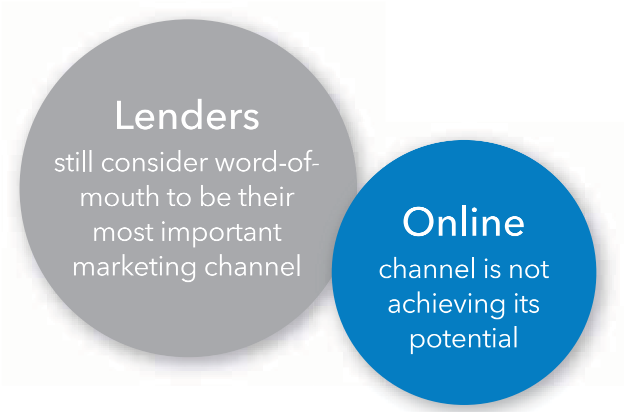
In terms of both service and technology innovation within lenders, the survey indicates that both brokers and lenders agree that there needs to be more of a focus on processing, with 86% of brokers and 55% of lenders saying it is the service area in most need of improvement, and 85% of brokers and 70% of lenders believing it is the technology area to focus on. One industry figure noted that there is potential to reduce the period between approval and exchange of contracts by using technology effectively. Brokers believed broker portals should be the second highest technology priority for lenders, though this was further down on the list of lender considerations. Interviews with industry figures show that the use of online channels to communicate between lenders and brokers has already been progressing over the past few years, while the use of the online channel to attract borrowers is still not living up to its potential.

In growing your business, which marketing channels do you consider to be the most important?

*Not an option in 2010

Source: RFi





Innovation in processing technology has the ability to deliver a number of advantages for banks, including speeding up the application process and reducing human interaction, thus increasing efficiency, and minimising costs. A more efficient process also has the advantage of minimising the number of potential borrowers who drop out during the process, maximising sales and improving service to borrowers. An industry figure pointed to technological improvements such as cloud computing as having a role to play in this space.

Product innovation

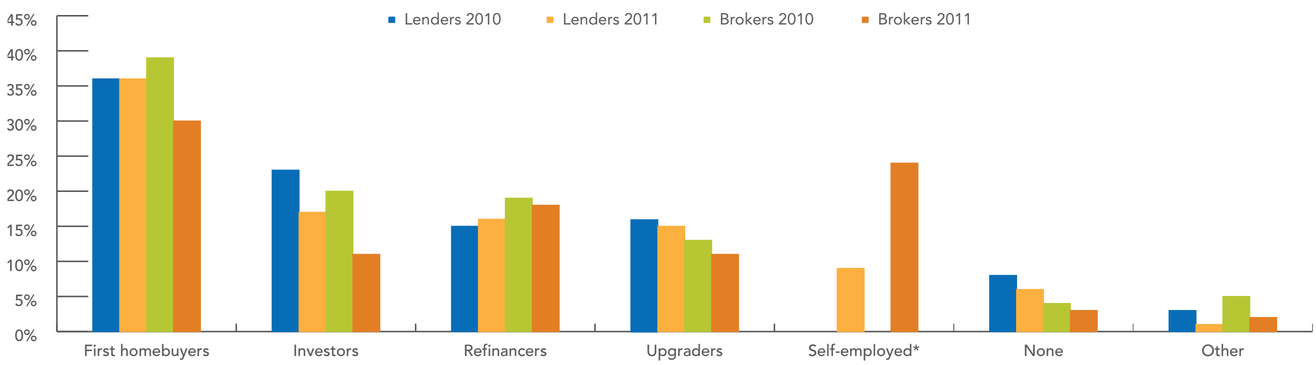
According to interviews with industry figures, product innovation has been slow over the past year, with very little 'true' product innovation in the market. Most innovation has been directed at the margins of the market, in the areas of higher LVRs and flexibility in risk and lending policy. Going forward, both brokers and lenders agree that FHBs would most benefit from future product innovation, with brokers also seeing a need for innovation in products for self-employed borrowers.

First homebuyers are likely to be helped by products that help them overcome the need for a large deposit, such as higher LVR products or shared equity products, as well as innovations to help with costs such as fee and rate discounts and deferred Lenders Mortgage Insurance premiums. Brokers suggested more flexibility in income reporting for self-employed borrowers, higher LVR loans for self-employed borrowers with strong documentation, as well as more understanding of small to medium enterprises and possibly a repayment system that takes seasonal fluctuations into account. Despite the perceived need for innovation, industry figures indicate that they do not expect much product innovation in the coming year, indicating specifically that increased regulation around lending will make it difficult to innovate further in the self-employed and Low Doc space.

Which one of the following types of borrowers do you believe would benefit most from product innovation?

*Not an option in 2010

Source: RFi



Conclusions

The property market has been slow to grow over 2011, with FHBs experiencing particular difficulty as affordability issues and the removal of stamp duty waiver incentives in some states were likely to continue to keep FHBs out of the market, and no lenders are expecting a great influx in FHBs over 2012. But signs have been mixed, with some signs of strength in the Australian market and some indicators of weakness. This is mostly down to two things: the patchwork nature of the economy, with different states, segments and industries having different experiences; and the uncertainty around the direction of the global economy, particularly with the problems being experienced by Europe and the US.

Refinancing has been the one main area of growth over 2011, although lenders are mixed in their opinions of whether this will continue over the next year. This strong refinancing activity has been a particular advantage for the banks, both the majors and the second tier, who have offered several pricing incentives to attract new business. Many of the smaller banks, as well as the CUBS and non-bank lenders, have recognised the difficulties of competing on price, and instead have looked to differentiate themselves in other ways, such as their service proposition, aligning themselves with a specific community or industry groups, or going after niche markets such as construction, SMSFs or self-employed borrowers. In pursuing these different strategies, lenders are creating even more of a patchwork market, tied to a number of distinct groups.

In terms of innovation, the focus seems to be on technology rather than product features over the next year, with processing technology, Skype and mobile banking mentioned as some of the possible changes, along with a greater focus on online. Social media is also seen as important by several industry figures, but as with other technology changes most lenders are unsure how to make the best use of it at present. This uncertainty also spread to the topic of product innovation, with several lenders expressing a desire for product innovation, especially for FHBs, but most unsure how to proceed. Shared equity products were mentioned by several lenders as a possible solution, but one whose implementation had not yet been worked out. Overall, innovation is expected to be slow in the near future.

The prevailing mood looking to 2012 is of uncertainty and caution. Surveyed lenders expect poorer market conditions, with unemployment a key concern. Interviews with industry figures show a cautious optimism towards the coming year, although this very much depends on the global economy remaining stable. One industry figure described it as "the most volatile time I've seen in my forty years of banking", and there is general concern expressed over the effects of a collapse in overseas economies on unemployment and the general economy in Australia. Industry figures also expected the patchwork effect to continue, with market conditions differing significantly on a local level due to reliance on different industries. For this reason, each lender is expected to face very different circumstances in the coming year, as they target different segments and different communities.

About Genworth

As a leading provider of lenders mortgage insurance in Australia, Genworth works in partnership with over 120 lenders to make the dream of home ownership more accessible to borrowers. Genworth has been insuring mortgages in Australia since 1965. Through our partnerships with lenders in the Australian mortgage market we continue to provide a unique insight into mortgage trends throughout the country. Our financial strength is underpinned by our A$3.3 billion investment portfolio under management in Australia.

For more information visit **genworth.com.au**

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About RFi

RFi specialises in business intelligence and is a leading provider of specialised strategic research, market intelligence, and advisory services to financial services institutions in key global markets. Headquartered in Sydney, Australia, and with offices in London and Singapore, RFi consistently provides clients with tailored advice and independent intelligence relevant to their specific markets.

RFi's insight enables clients to identify customer needs and preferences, opportunities or threats in the competitive landscape and how best to address these issues to gain competitive advantage.

For more information visit **rfintelligence.com.au**

Methodology

The Home Grown: Mortgage Industry Perspectives report is produced by RFi on behalf of Genworth. It presents the results of one of the most comprehensive surveys of mortgage market participants conducted in Australia.

To formulate the report, RFi conducted an online survey in August and September 2011 of over 200 industry professionals working for lenders in the areas of product, strategy and credit risk, and surveyed 300 brokers.

To supplement this, a series of in-depth face-to-face and telephone interviews with leading industry commentators from various segments and some trade associations was conducted.

Notes

This independent report is based on survey results of 200 people working for lenders and 300 brokers and does not represent the views and opinions of Genworth. While the information contained in this report is current as at the date of publication, it is subject to change without notice. Genworth is under no obligation to update the information or correct any inaccuracy which may become apparent at a later date. Permissions should be sought from Genworth for use of this report by third parties. Genworth does not take any responsibility for reliance on the information contained in this report, nor for its accuracy or completeness.

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