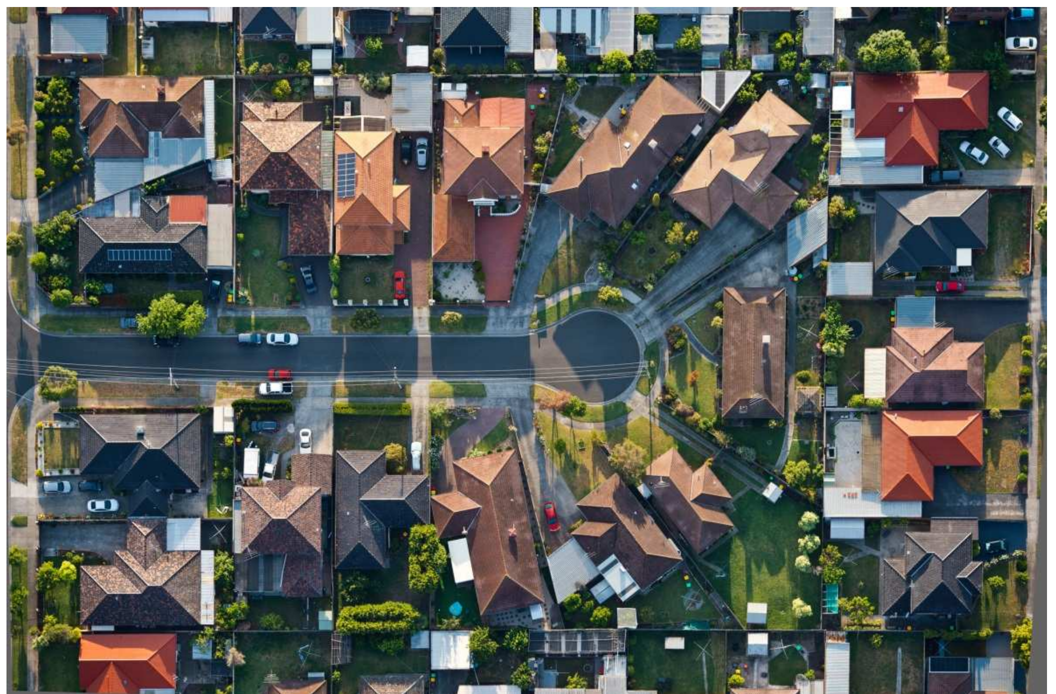
PwC Financial Services Regulatory Practice

31 March 2017

Regulatory Update: APRA maintains their focus on Mortgage lending

APRA's announcement of further quantitative and qualitative controls over high risk lending continues their response to ever-increasing home prices, growing household debt, and slow income growth. No specific mention of a housing 'bubble', but with monetary policy no longer proving an effective control on lending growth, APRA is continuing its role in shaping the Australian lending market.



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Key Points

- Limit the flow of new interest-only lending to 30% of new residential mortgage lending, combined with;
  - Strict internal limits on interest-only lending at LVRs above 80%
  - Strong scrutiny and justification of interest-only lending at LVRs above 90%.
- Manage lending to investors to remain **comfortably** below the benchmark of 10% growth
- Continued focus on serviceability metrics, including interest rate and net income buffers
- Growth of warehousing facilities for other ADI's is on APRA's 'watch-list'

Our View

This announcement of further restrictions on Mortgage lending will come as no surprise to many in the industry, with Wayne Byres consistently focussing on this issue in recent speeches.

"We have many supervisory challenges at present, but there is no doubt that monitoring conditions in the Australian housing market remains high on our priority list. We have lifted our supervisory intensity in a number of ways, including reinforcing stronger lending standards and seeking in particular to moderate the rapid growth in lending to investors.
...
However, strong competitive pressures are producing higher rates of lending growth again. This is occurring at a time when household debt levels are already high and household income growth is subdued. The cost of housing finance is also more likely to rise than fall. We therefore see no room for complacency, and mortgage lending will inevitably remain a very important issue for us for the foreseeable future." W Byres, 2 March 2017

These changes are intended to be risk focussed, and try to move lending away from high-risk categories, felt by some to be fuelling the house price increases across Australia, particularly in Sydney which has seen 18% annual growth. Interest rates are expected to stay low for the foreseeable future, so APRA is continuing with their focus on controlling specific types of lending growth.

Interest Only Lending:

At 40% of lending portfolios IO lending is considered higher risk and APRA will look into any new lending with a fine-toothed comb. In particular, borrowers looking for 90%+ LTV loans are going to find their options are very limited.

For the moment they have left implementation approaches in the hands of ADI's, but their comment around 'including additional quantitative benchmarks if appropriate' leaves the door open for more stringent rules if they do not feel ADI's are responding efficiently and effectively.

Investor Lending:

Leaving the investor loan growth benchmark at 10% is somewhat of a pleasant surprise to the industry. There was an expectation that with the recent surge in lending this limit may be reduced, but it seems APRA is happy that other controls will act to reduce lending where necessary.

There is a stick in the threat of 'an immediate review of the adequacy of the ADI's capital requirements' should they breach this limit, so a prudent margin will need to be maintained by all ADI's. APRAs tolerance for even small breaches of the 10% is clearly limited.

Serviceability Assessments:

While recognising a significant improvement in ADIs method of assessing loan serviceability APRA are clear that some of the minimums, such as interest rates, included in the recent APG223 changes should be seen as minimum expectations, and not simply the default setting. Internal policies, and systems, need sufficient flexibility to reflect the lending environment.

This is another challenge to banks dealing with old and inflexible technology architecture, multiple systems and a variety of distribution methods. The need for flexible lending systems, which can be adjusted for changes in policies, regulations and macroeconomic factors will continue to drive technology spend.

What's next?

APRA have called out the increasing level of warehousing facilities being offered by large banks to the smaller lenders. Maintaining quality of underwriting, and ensuring these portfolios do not grow faster than the ADIs own portfolio will be on APRAs radar. The concern is clearly that smaller lenders will simply step into the space left by the larger players, something that APRA would prefer to avoid. Another area to watch is how non-bank lenders, who don't face the same restrictions, respond to these changes.

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