ANALYSIS

Mortgage delinquencies mount as more borrowers find their home is worth less than their loan

By business reporter Stephen Letts

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PHOTO: Falling prices mean homeowners are increasingly seeing the balance on their loans exceeding the value of the property. (ABC News: Alistair Kroie)

Buried deep in the ANZ's first-half results was a pretty disturbing story of just what is happening in the property market.

"We saw 500 or 600 families in this half get themselves into difficulties in terms of not being able to keep up with their payments," ANZ boss Shayne Elliott observed.

"That's a lot higher than we've seen in the past. So the question is, is this a trend? Is this a blip?"

Looking at ANZ's 90-plus day mortgage delinquencies chart, it certainly looks like a trend, not a blip.

Over the past four years, in virtually every state and territory, delinquencies have stepped up sequentially each year.

In Western Australia, it looks like a very worrying trend.

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Key points:

- ANZ says mortgage delinquencies are rising as households are "doing it tough" with low wage growth
- Falling house prices are exacerbating the problem, leading to borrowers owing more than their house is worth
- There is evidence banks are losing patience and forced selling of houses may pick up, hitting both the owner and the bank

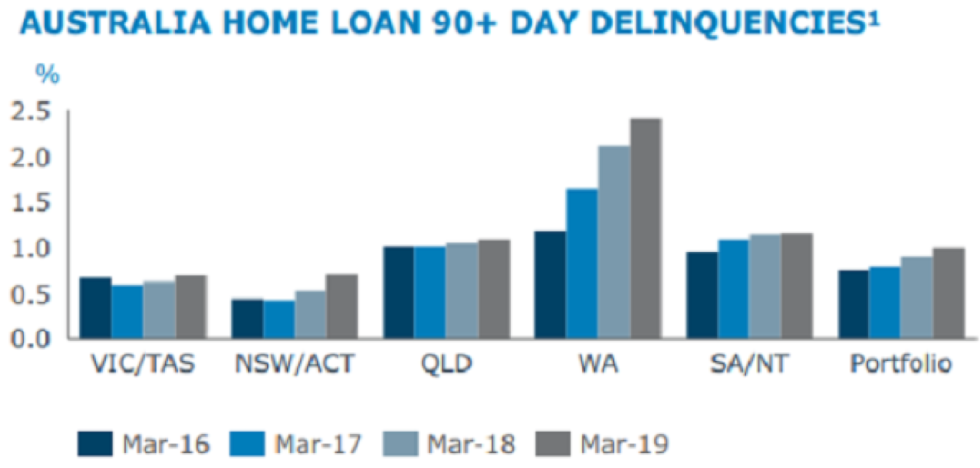


PHOTO: Home mortgage delinquencies are rising, with WA hit the hardest (Supplied: ANZ)

WA's boom and bust

WA is an interesting case study for the broader economy about the nexus between a slowing economy, rising unemployment and mortgage stress.

In 2012 the mining boom was in overdrive in the west.

The state economy was growing at almost 14 per cent year-on-year. The unemployment rate moved under 4 per cent and the mortgage delinquency rate, on ANZ's books at least, was under 0.5 per cent.

Stagger forward to 2018 and WA's economy barely grew — state domestic product was up just 0.3 per cent, unemployment had jumped to more than 6 per cent and delinquencies had risen five-fold.

WA property comprises 13 per cent of ANZ's mortgage portfolio and 30 per cent of its 90-plus day delinquencies.

The counterpoint is New South Wales and the ACT now with the strongest jobs market — unemployment has been holding steady at just above 4 per cent for a fair while.

Together they comprise around a third of ANZ's home loan book and less than a quarter of its distressed mortgages. Victoria and Tasmania combined have a similar profile.

ANZ wary of property lending

It doesn't take a lot of imagination to see what would happen if the jobless queues started lengthening in the eastern states.

"It was the best of times, it was the worst of times," is perhaps the Dickensian take in this tale of two economies.

"Unemployment's low. Interest rates are low. Inflation is low," Mr Elliott noted, "[but] wage growth is stubbornly low … so we're worried about families doing it a little bit tough out there."

Of the big banks, ANZ has been the most wary about the property market and has throttled right back on lending.

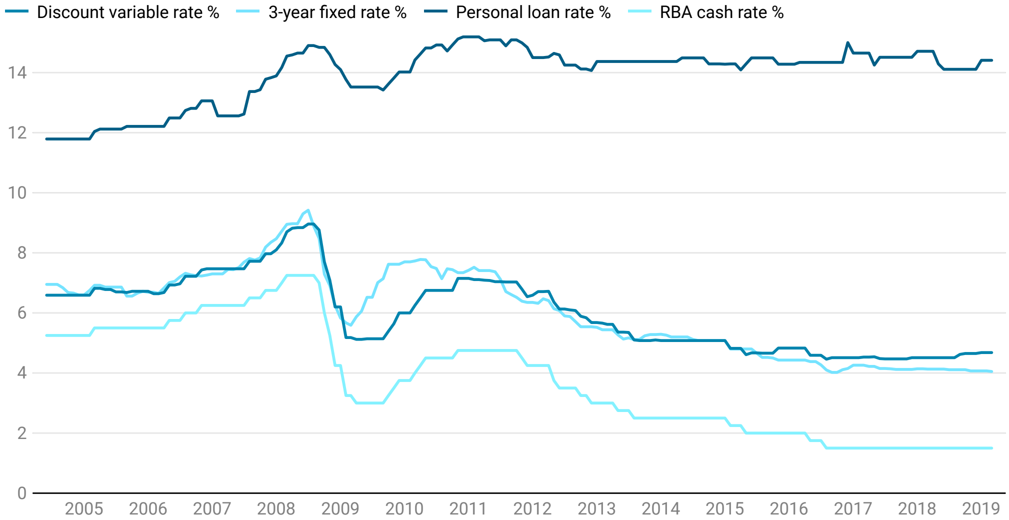
In the three months to April, ANZ home lending fell 3 per cent, compared to a 2 per cent rise across the other banks. Lending was far stronger in the more risk-embracing, less-regulated non-bank sector.

It's not the cost of borrowing that is causing the stress — homebuyers are currently enjoying the benefits of mortgage rates bumping along at historically low levels.

Storm warning

With storm clouds brewing over the domestic and global economies, could this be a good election to lose?

Cash rate v key lending rates



EMBED: Cash rate v key lending rates Jun 2004 to Mar 2019

Negative equity

The big problem is falling house prices.

They are slathering on extra layers of pain and risk for the increasing number of homebuyers who have discovered they have borrowed at, or beyond, their capability to repay.

Apart from anything else, falling prices act like loan-to-valuation (LVR) bracket creep, eroding existing borrowers equity pushing the ratio higher towards the magic number of 100, beyond which is negative equity territory.

In the previous quarter, leading up to the end of last year when the property price slide was just starting to accelerate, around 3 per cent of Westpac borrowers were nudged above the 80 per cent LVR level.

NAB's first half result reported another 3 per cent of borrowers had just been pushed up into the LVR bracket above 90 per cent. In other words their equity in the property was now less than 10 per cent and falling.

High LVR loans also generally require expensive mortgage insurance. It's peace of mind for the bank and an extra impost for the borrower.

The Reserve Bank recently raised "negative equity" — where the outstanding balance on the loan exceeds the value of the property it is secured to — as a growing concern.

Negative equity is a big problem for borrower and lender alike. Borrowers remain in debt if they are forced to sell, while the banks take a haircut too.

There is plenty of evidence showing falling income, or suddenly no income due to unemployment, are likely to trigger brutal defaults.

The latest house price and unemployment figures are far from comforting.

Unemployment edged back up to 5 per cent in March. Once again, a blip or trend?

Property outlook for 2019

Policymakers have embarked on the delicate task of deflating a property bubble without bursting it — this year we'll find out if they've succeeded.

Certainly, it was not a big jump, but worryingly unemployment doesn't seem to get much below these levels and there are still 680,000 Australians out of work, while hundreds of thousands more are desperately looking for extra hours.

April home prices slid again to be down more than 7 per cent over the year, the worst result since the GFC and near the worst on record.

'No bottom in sight'

UBS economist George Tharenou said not only was it a bad result, but it was also likely to get worse as "there was no bottom in sight".

"The peak-to-trough decline in prices is around 8 per cent, worse than the GFC, and near the largest for at least 55 years when REIA [Real Estate Institute of Australia] data for Sydney started," Mr Tharenou said.

> "Looking ahead, we expect price falls to reach 14 per cent, causing a negative wealth effect on consumption."

Ouch. Mr Tharneou is not alone in forecasting further declines.

The big global credit rating agency Moody's, which devotes a considerable amount of time and energy to studying the risks building up in the likes of the big four banks, earlier this month forecast house prices had another 10 per cent to fall nationally.

Within that broad calculation, there are parts of Melbourne and Sydney likely to experience even sharper falls of more than 15 per cent into next year, Moody's argued.

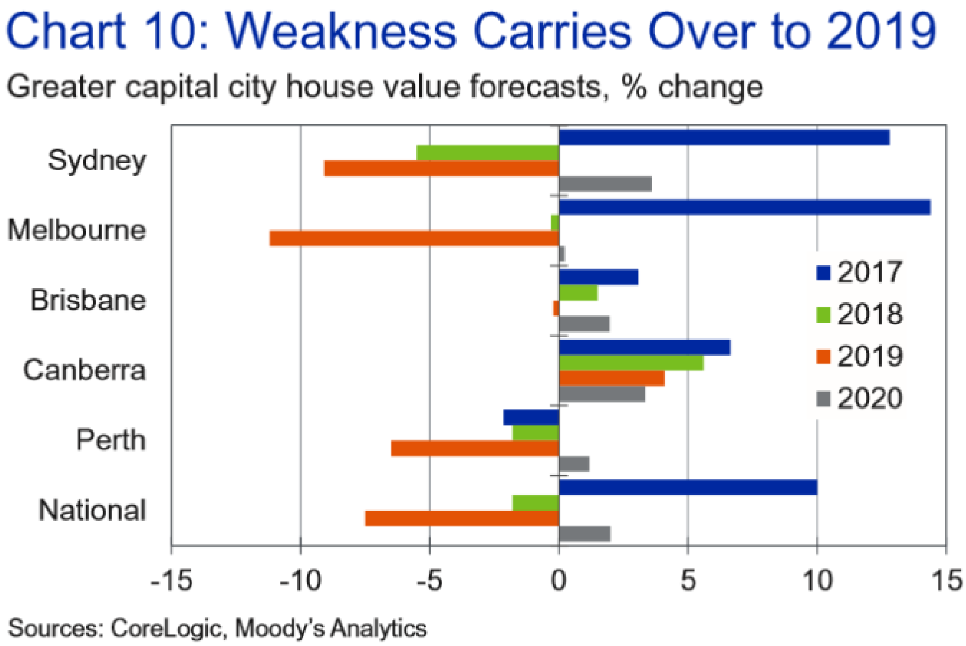


PHOTO: Moody's is expecting bigger house price falls in 2019 than 2018, but a rebound in most cities in 2020. (Supplied: Moody's)

So what would further declines of the magnitude envisaged by UBS and Moody's mean for homeowners who are starting to feel stressed with repayments?

Morgan Stanley's bank analyst Richard Wiles crunched the numbers and said the headwinds from negative equity were growing.

"All else being equal, we estimate that if house prices fall a further 5 per cent, then around 4.5 per cent of mortgages will be in negative equity," he said.

"This rises to 7.5 per cent in negative equity given 10 per cent house price falls, or 18 per cent given 20 per cent house price falls."

Once again, Western Australia — which was way ahead of the curve in not only rising unemployment but also falling house prices — has the highest percentage of homeowners bogged down in the negative equity mire.

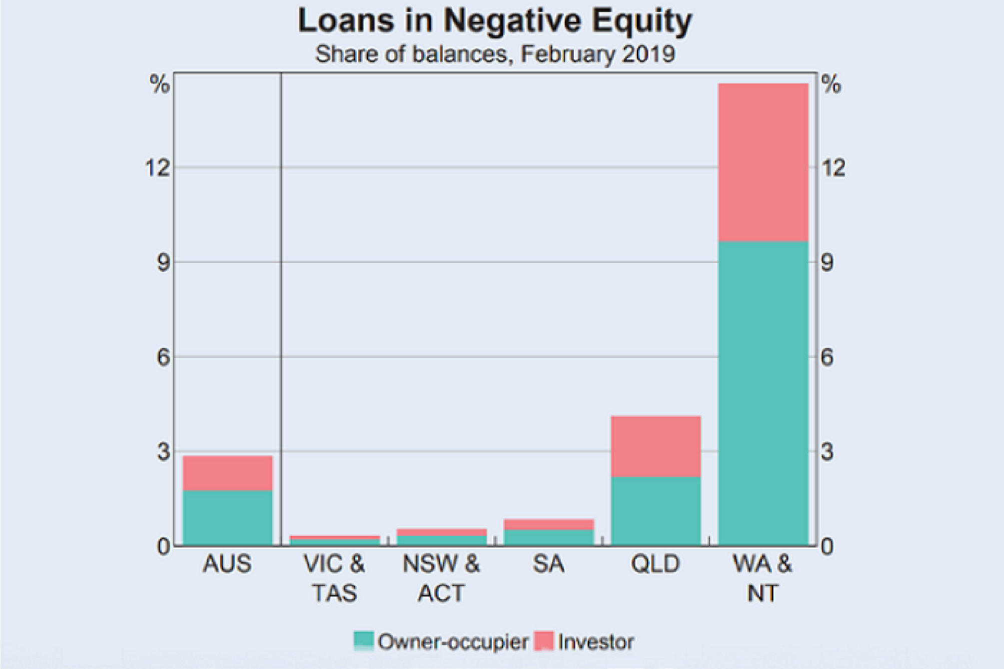


PHOTO: Morgan Stanley estimates if house prices fall another 10pc then the number of home-owners with properties worth less their loan would more than double (Supplied: RBA)

Cashflow and credit crunch

The unnerving feeling of living with negative equity in your house is more than likely to depress consumer spending, according to Mr Wiles.

The RBA's recent financial stability review found other evidence of household finances under pressure.

It noted while total mortgage payments remained at around 12 per cent of income, voluntary principal payments were down to 1.5 per cent from 3.5 per cent in 2015.

"This aligns with our view of households facing a cash flow and credit crunch," Mr Wiles said.

As well, banks appear to be losing patience and are now maintaining tighter management of non-performing housing loans.

"The RBA dataset shows that the 120-plus day mortgage arrears bucket has risen faster than 60 to 90-day or 90 to 120-day, suggesting non-performing loans are taking longer to resolve," Mr Wiles said.

> "However, RBA thinks the banks are now shortening the process given falling house prices, which could lead to more forced selling."

Rates and the AUD in 2019

What will interest rates and the Aussie dollar do in 2019? Business reporter Michael Janda asked half a dozen experts to get their views on the outlook.

Forced selling, negative equity; it's a very unhappy and expensive relationship breakdown for all concerned.

Rate cuts

A rate cut or two could certainly ease the squeeze, particularly in households stifled by weak wage growth and cost of living increases.

But it may be at the margin. A full 25-basis-point cut would equate to around a $510 saving for borrowers with a $300,000 loan.

It's a given banks would not pass on the full cut, and something in the order of 15 to 20 basis points would be more likely to be passed on.

Two cuts would probably deliver a saving of $600 to $800 a year on an average loan.

Jobs at risk as house prices fall

The cuts would also probably help arrest the price slump as well, but it all might be too late for many, particularly if — as part of the vicious cycle in housing downturns — construction work dries up and unemployment rises.

Job advertisement data indicates the banking royal commission and house price falls may have already curtailed career opportunities in finance, construction and retail.

Topics: business-economics-and-finance, economic-trends, banking, housing-industry, australia

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