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Loans reach new depths

Low-doc mortgages were sold to struggling consumers and now many are worse off, reports **Tim Elliott**.

In late 2005, Mandy, a 55-year-old postal worker from the NSW Central Coast, heard an advertisement on her radio for a company called Professional Funding Group. The ad, offering credit to people having trouble making ends meet, was of great interest to Mandy, whose financial situation could best be described as disastrous.

Despite working 16 hours a day in two jobs, she and husband Keith, a truck driver, were several months behind on mortgage payments and owed thousands of dollars in tax, utility bills and credit card debt.

They had already tried and failed to sell their house – then valued at $380,000 – so decided to refinance with Professional Funding Group.

"And that," she says, "is when the real trouble began."

Professional Funding Group quickly found a lender, Challenger Mortgages, that issued the couple with a low-doc loan for $440,000. A low-doc (low-documentation) loan is designed to assist people who don't qualify for a standard, or prime, loan. They don't require the borrower to provide evidence of income, such as tax returns or payslips; in Mandy's case, a representative from Professional Funding simply asked for their income and assets. Professional Funding then obtained a valuation of the couple's house that, much to Mandy's surprise, came in at $560,000.

Low-doc loans also come with a higher rate of interest – 10.95 per cent in Mandy's case, as opposed to the standard 7 per cent or 8 per cent that applied then.

"This would've taken our repayments to $4300 a month, which wouldn't have made us any better off," she says.

"When I raised that, Professional Funding offered to drop the rate by 1 per cent after a year, provided we didn't default."

When a year passed and the rate remained the same, Mandy and Keith went to the Consumer Credit Legal Centre, which requested the complete loan documents from Challenger.

"It was pretty incredible," Alexandra Kelly, a solicitor with the centre, says. "It seems that not only did Professional Funding not have the authority to offer the 1 per cent decrease but they had grossly inflated the applicants' income and assets. Their incomes had up to $30,000 added to them and their personal assets were valued at $1 million, which is absolute rubbish. And for that, the broker got commissions and fees of almost $7000."

Michael Pula, director of Professional Funding, denies inflating the couples' income and claims they defaulted on their loan. The dispute, currently in mediation, demonstrates the dangers and challenges in this unregulated section of the credit market.

Every year the CCLC and other consumer agencies see hundreds of people who claim to have been exploited by rogue brokers. Prosecutions have, however, been relatively rare, thanks mainly to poor regulation. One notable exception is ACT broker Kelvin Skeers,

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who was convicted last year of "misleading and deceptive conduct" in writing a $365,000 low-doc loan for a 19-year-old homeless man called Arj Beeja.

"The predatory lending I see in Sydney makes Skeers look like an amateur," says Amy Kilpatrick, who represented Beeja and is now principal solicitor at the Public Interest Law Clearing House. "Brokers have filled in dodgy applications and lenders have turned a blind eye. It's been a systemic problem. It's happened both in the bank and non-bank sector. And already the banks and finance industry are saying: 'How could we have written low-doc loans? How could we have done something so silly?'"

Low-doc loans surfaced in the late 1990s but it wasn't until 2003 that they started to appear in large numbers, driven by the advent of non-bank lenders such as Bluestone, Liberty Financial and Wizard. By early last year, low-doc loans accounted for 8 per cent of the 5.3 million home loans in Australia. (The number is now thought to be about 5 per cent.)

A further 1 per cent was classified as non-conforming, that is, loans issued to people whose credit records were so bad they didn't even qualify for low-doc. At their peak, three out of four low-doc loans were issued by non-bank lenders, which, lacking branch networks, relied principally on brokers to write mortgages.

"The non-bank sector saw low-docs as a way of accessing the underbelly of the loan market," Martin North, managing consulting director Fujitsu Consulting, says. "They saw the rapid growth of subprime and low-doc loans in the US and they wanted a piece of that."

Unfortunately, growth of the market outpaced its regulation. There is still no licensing of mortgage brokers, except in Western Australia, and no obligation to disclose fees and commissions.

"Anyone can become a broker," North says. "You can put a shingle over your door and call yourself a broker, give advice and get a commission. And the bigger the loan, the bigger the commission, so that the incentives are not aligned to what's best for customers. As a result, 80,000 households were subject to predatory lending last year alone – 70,000 of those by brokers."

Broker legislation in other states is linked to the Uniform Consumer Credit Code, which applies only to consumer credit – anyone wanting to circumvent it simply disguises their mortgage as a "business loan". The Mortgage and Finance Association of Australia (formerly the Mortgage Industry Association of Australia) and Finance Brokers Association of Australia boast was expelled from the MFAA in 2004, following an investigation into one of his brokers by the NSW fraud squad. No charges were laid.

ALC wrote a business loan for $120,000. As this wasn't what she'd asked for, Lane's client refused to sign it.

"Now she is being sued for $6000 in brokerage fees, even though she didn't take the loan," Lane says. "Not only that but Riotto has lodged a caveat on her home, meaning she can't sell it without paying him first."

Riotto denies he is seeking a brokerage fee, just "out of pocket expenses and payment for our time". He also claims Lane's client provided "false and misleading information".

Bogus low-docs are only part of the problem; far more important, say brokers, was the reluctance of lenders, both bank and non-bank, to tighten lending standards, even in the face of the emerging sub-prime crisis.

"Low-docs were popular because they were easy to get approved," broker Justin Doobov, of Intelligent Finance, says. "Why? Because there was never any checking of income details, not even from the big lenders. So long as the borrower had an ABN, even for a day, that was enough. Westpac and RAMS didn't even check if you had an ABN, so long as you said you were self-employed, that was enough."

A spokesman for Westpac, David Lording, denies this, claiming the bank considered "low doc loans to be prime loans" and so "applied very much the same credit criteria. We look at the borrower's credit history, how much they are earning, and their ability to repay."

But an email obtained by Money shows this was not always the case. Dated May 20, 2008, the email states "whilst self-employed status is declared by the customer in their loan application, this information is not validated during the loan approval process". The email warns brokers that, from the end of May, additional customer information would be required and that this information would be validated by Westpac.

Lording, who would not comment on the email, says regardless of the validation processes, low-doc mortgages only comprise 8 per cent of Westpac's loan book. Indeed, the comparatively small percentage of low-doc loans in Australia is often cited by the Reserve Bank and big lenders, who claim any comparison to the US subprime crisis is unfounded.

It's true subprime and low-doc loans are not, strictly speaking, analogous: for a start, subprime mortgages commonly featured low introductory interest rate periods ("teaser rates") whereas low-docs usually don't. Australian lenders also appear to have been more conservative than their US cousins, with Australian non-conforming loans having an average loan-to-value ratio of 75 per cent, as opposed to 85 per cent in the US.

However, low-docs and sub-prime loans are similar in at least one important regard: both were predicated on a rising property market.

"It was an asset bubble mentality," Steven Keen, an associate professor of economics at the University of Western Sydney, says.

"The assumption was that if the borrower couldn't afford the repayments, it didn't matter because they could always sell the place for a profit on the rising market.

"Borrowers and lenders played this game and brokers did, too, because they were making huge money on the fees. The trouble is that we now have many loans that were written on the back of the property market and in no way connected to the repayment capacity of the borrower."

That model has now collapsed. House prices are in decline with Australian Bureau of Statistics figures showing a 1.8 per cent drop in the latest quarter, its steepest decline in 30 years.

Unemployment, meanwhile, has edged up to 4.3 per cent. Arrears rates for low-doc loans have always been double that for prime loans; now those defaults are becoming foreclosures as lenders move in, anxious to recoup their security before it evaporates. About 4000 writs of possession were issued last year in NSW alone but according to Roger Mendelson, chief executive of Australia's largest private debt collector, Prushka, the real repossession rate is at least five times higher, "because 80 per cent of bank-pressured sales are conducted by the vendors".

ANZ economist Warren Hogan expects unemployment to reach 6.5 per cent in 2010, while North is predicting a further 20 per cent drop in house prices, all of which spells disaster for overstretched borrowers.

"I'm really worried," Kilpatrick says. "I would like to say, 'Everyone, don't frigging panic!' but I really don't know, because I'm talking to people on the ground losing their homes and there's lots of them."

For now, it seems, easy credit is a thing of the past. In September, the low-doc loan was officially pronounced "dead", by none other than Aussie Home Loans founder John Symond. But, as usual, rumours of the death have been exaggerated.

For those desperate to refinance there will always be brokers such as Riotto, whose ALC is still selling debt to those already drowning in it.

"Perhaps the unpaid bills have caught up to you and the debt collectors are knocking?" their on-hold message tells callers. "Don't spend your valuable time scrambling for papers. Ask now about our low-doc loans."