

A note about a banks RISK of providing a loan to buy a home to live in.

Risk is the short term of what is common to all for profit business that is referred to as :

“THE RISK OF DOING BUSINESS FOR REWARD”

REWARD is the profit produced by providing a superior product and/or service at a competitive price while competing with other like businesses.

RISK in the banking industry risk has two components :

RISK A : The risk that a customer will not be able to repay the loan provided by the bank for some unforeseen event such as becoming unemployed as a result of accident , sickness or redundancy etc. **Risk A** is assessed and provided for in the banks financial accounts as “ Loan Impairment” and provides for recovery of realised losses as a result of a risk A event. The provision is monitored and adjusted in line with current and historic accounting results and forward budgeting . Recent published accounts by Commbank indicate an adequate provision for realised losses is between 1.60 % to 1.80% of total interest bearing assets and reflects a responsible and well administered lending policy .

RISK B: Is the risk that the value of a property held for security will fall in the market place and the bank will not recover the loan as a result of a Risk A event. **Risk B is borne by the banks customer** and the dollar value of the risk is the deposit paid.

BASELINE INTEREST RATE :

The big4banks have assessed and agreed (collusion) that the risk of a properties value falling in the market place by 40% (**Risk B**) of the contracted sale price is highly unlikely and have established a **base line interest rate** that includes a component to recover the dollar value of the provision for Loan impairment expense (**Risk A**) as provided for in the banks financial accounts . As the deposit paid by the customer reduces from 40% to 5% the banks ratio of loan compared to the contracted sale price <LVR ratio> the bank adds a loading to the loan impairment charge included in the the base interest rate to provide for the banks increased exposure to a **risk A event** . The banks appetite for risk does not extend beyond a minimum deposit of 20% of the contracted sale price and will not provide a loan unless the banks exposure to risk is recoverable from either Lenders Mortgage Insurance or the Government First Home Buyers guarantee that enables a bank to loan 90% to 95% of the contracted sale price of the property without risk of loss to the bank as a result of a Risk A event. The home buyers risk of loss (risk B) is reduced to 5% or 10% of any shortfall in repayment of the loan after the sale of the secured property.

That creates several problems ?

A bank may now provide a loan to 95% of the value of a property held for security and stretch a loan to a customers absolute ability to repay such loan without any risk of loss to the bank , despite that the customers interest rate includes a charge for loan impairment and risk loading . (Price gouging ?)

The interest rate charged to a loan protected by LMI or Govt Guarantee should revert to :

The base line interest rate 5.59% less loan impairment 1.60% = 3.99%

QED:	Interest charged	3.99%
	less banks target interest margin	2.00%
	banks cost of interest	1.99% (net bank standard variable rate is 1.55%)

(Inspection of a banks cash flows including return and re investment of mortgage principal would confirm the 1.99% estimate)

Question for the treasurer.

The bank may now provide a loan to 95% of the value of a property held for security .

The bank determines the value of the property held for security and does not disclose that value. (It is not the sale price)

The Government is insuring potential losses on loans that are subject to the banks estimated value of a property.

QUESTION 1: To protect the Government and home buyers should all loans be subject to an independent licensed valuation provided to the Government and the home buyer. **YES / NO**

NOTE : The chart herein indicates the banks risk of loss as a result of a **RISK A event** is (2.55%) the home buyers share of risk is **RISK B** (5.25% of the loan) and the Government Insurance is (15%) = Total provision for losses 22.80% .

QUESTION 2: When the combined risk of the bank and the homebuyer is 7.80% why is it that the government is prepared to increase the total provision for loss to **22.80%** of the loan outstanding including accrued interest and recovery costs ?

NOTE : The excessive provision for loss of 22.80 % is required by the banks to extend credit to the maximum ability of a homebuyer to meet inflated market prices and protect themselves should house prices crash.

PROBLEM : The Government is reducing the home buyers risk of loss to 5% of any shortfall in recovery of the loan outstanding including accrued interest and recovery costs and increasing the banks provision for loss as a result of a **RISK A event** to 22.80% , despite the bank is at liberty to value the property to meet the market and drive prices upwards without the risk of doing business. **That is not how business is done in a free market !**
The bank is not constrained by risk and yet is free to value the security property to justify the loan .

SOLUTION : All loans guaranteed by the government must be subject to a certified valuers certificate provided to the purchaser of the property and the Government. **Refer to note re sharing risk with the Government ...a new way forward !**