Addressed To:
General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority

Revision to Prudential Practice Guide APG 223 Residential Mortgage Lending

Dear General Manager

Thank you for allowing individual submissions from the public.

I would probably represent the younger cohort of the population.

My submission outlines just a few points and suggests some other ideas. I don't believe removing the floor rate is fair nor appropriate.

Even though the group of council of financial regulators have the best interests of the economy, I don't believe the economy is well balanced across different cohorts of the population. Debt levels are high, wages growth low, and home ownership is falling for the younger generation. We (the younger generation) may end up being the first cohort to be worse off than our parents.

Floor Rate

The consultation paper mentions that lower interest rates are likely to occur for a longer period.

Home loans are a medium to long term investment of 20 to 30 years. If low wage increases continue or even deflate as may be expected with a downturn, then people's ability to build a buffer leave's them more vulnerable to rapid interest rates rises. Removing or lowering the floor rate will just see more 'new' people take on debt leaving a particular cohort of the population vulnerable to rising rates when they occur.

Lowering the floor will result the in new debt being capitalised into higher property prices. This will have the unintended consequence of increasing LVR's as savings deposits will become a lower percentage to the value of the property. So there is no real gain for new buyers. But there is further gain for existing owners who use equity from their home, who wish to buy an investment property.

Leaving the floor rate at 7% may mean sacrificing short term gains, but places the customers and the economy in a more robust position in the medium to long term.

The number of loans approved that are limited by the floor rate is currently 10% to 15% (RBA). And this is based on floor rates comfortably above 7%. This indicates there is spare capacity and that the floor rate is not significantly constraining lending.

The 7% floor rate has worked well, and changing it again does not bode well for APRA's reputation.

Utilising spare capacity of the current floor rate is more appropriate.

Differentiating Products

APRA discusses that different standard variable rates for owner occupiers versus investors makes a single floor rate more binding for owner occupiers and less though for investors.

I would consider removing "comfortably above the floor rate" for owner occupier loans, but retain it for investor loans.

This allows some minor differentiation of at least 0.25% in the floor rate. This aligns with the RBA's data that shows a 0.25% to 0.5% differentiation already exists. Hence the removal of 'comfortably above' for owner occupiers is appropriate.

The RBA's statistics on loans is shown in the following table as of April 2019.

Reserve Bank of Australia – Lending data April 2019	Investor	Owner Occupier	Difference
Lending rates; Housing loans; Banks; Variable; Standard;	5.94%	5.37%	**0.58%**
Lending rates; Housing loans; Banks; Variable; Discounted;	5.25%	4.68%	**0.58%**
Lending rates; Housing loans; Banks; 3-year fixed;	4.24%	3.99%	**0.25%**

Intergenerational Equity

There is also an equity aspect to changing the floor rate.

Recent rapid price rises in property have meant falling home ownership especially for younger people. Lowering the floor rate will not help in alleviating this problem.

Those who do buy will ultimately be led to buy at the very top of the long term interest rate cycle, with no upside to equity increase in their property but all the downside exposure of rising interest rates.

Having a fixed floor rate as a permanent feature helps ensure some inter-generational equity and minimises financial stress to borrowers in the case of financial shocks and rapidly changing circumstances.

Tax System

With the recent election over, there are unlikely to be changes to negative gearing and capital gains tax in the immediate future, even though previous inquiries such as the Henry Tax Review and Financial System Inquiry have called for changes. This is favourable for property.

Tax cuts should be implemented first and monitored before changes to lending. Tax cuts apply to the whole population. This increases their income and generates spending on the whole economy.

Recent media suggests the property market is stabilising anyway.

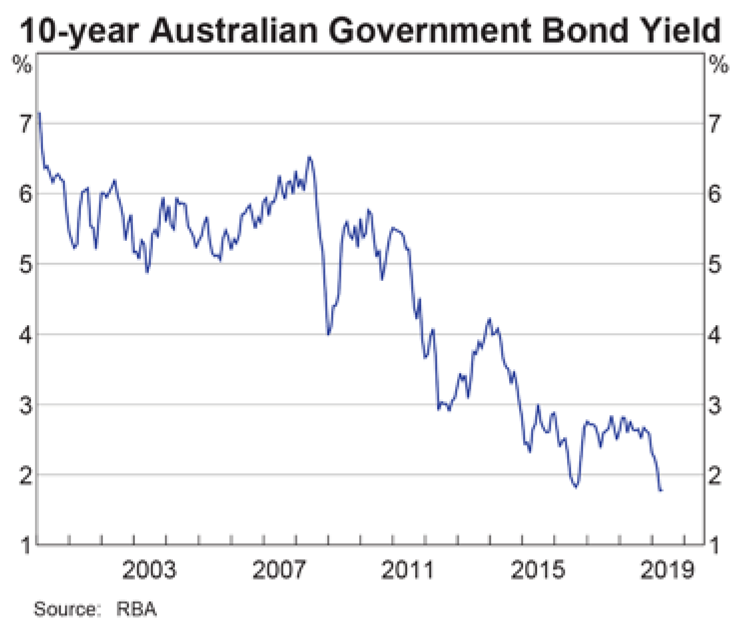
Discount Rates for Infrastructure

I would question the governments push to reduce floor rates for residential lending. Why is it not reviewing infrastructure discount rates on federal and state government treasuries that could direct transport and utilities to spend more? Lower discount rates would bring forward infrastructure spending. This way the need to boost the economy as debt is shared across everyone, rather than a concentrated cohort of the population, especially younger people.

My engineering workplace has reduced its discount rate by only 0.4% in recent years. Typically discounting is at 7% p.a. Infrastructure Australia considers projects with a 7% real return. This already includes inflation, so the discount is really 9.5%p.a.

The Australian 10year bond yield is currently about 2% as shown in the figure below. Surely it would be appropriate to adjust discount rates significantly relative to long term Bond rates.

Long life assets with a 100 year life should be considered with a lower discount rate of 3-5%, not 7-10%. As has been stated in APRA's paper, the low interest rate environment is expected to persist for longer than originally envisaged.



Nation Building Infrastructure

The most obvious infrastructure projects to sustain jobs would be to drought proof Australia from climate change, and the approaching droughts in multiple cities.

Projects would include short term quick wins such as subsidies for example rainwater tanks and household efficiency upgrades through to medium term 2-10 year projects such as recycling, further desalination along the coast with interconnector pipelines either inland or through the inland. Both city and country would prosper.

The bureau of meteorology website shows the dam levels for each capital city. Sydney, Melbourne, Perth and Adelaide are almost all below 50% level. Country areas are even worse.

Table of Current Water Storages for Australian Capital Cities – Bureau of Meteorology

Australian Capital Cities	Storage Level
Sydney	53.4%
Melbourne	49.6%
Brisbane	68.4%
Perth	39.9%
Adelaide	42.5%
Hobart	75.7%
Canberra	57.3%
Darwin	74.6%

Suggested word changes

ATTACHMENT A – EXTRACT OF PRUDENTIAL PRACTICE GUIDE APG 223 RESIDENTIAL MORTGAGE LENDING

33. In addition, a prudent ADI would use the interest rate buffer in conjunction with an interest rate floor, to ensure that the interest rate buffer used is adequate when the ADI is operating in a low interest rate environment. Prudent serviceability policies should incorporate a minimum floor assessment interest rate of at least seven per cent for owner occupier loans. Again, a prudent ADI would implement a minimum floor rate comfortably above this level for investor loans.

Summary of Submission

Lending Guidance

- Retain the 7% floor as permanent.
- Utilise spare capacity
    - only 10-15% of loans are limited by the floor rate
- To differentiate products:
    - Remove “comfortably above” for owner occupier loan products.
    - Retain “comfortably above” for investor loan products

Other Considerations

- Inter-Generational Equity is an issue.
- Consider tax cuts and interest rate cuts first as they apply to everyone.
- Prioritise lowering discount rates for infrastructure. This would inject billions into the economy and help sustain and create jobs.
- Drought Proof Australia to sustain jobs and provide resilience in the face of climate change.

Name Withheld