A CLASSIFICATION OF HOME LOAN PRODUCTS IN AUSTRALIA

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Abstract

The paper explores major reasons for recent proliferation in a number of home loan products, and provides a classification and detailed account of various contemporary home loan products and packages offered in Australia. The following series of categories are used to facilitate discussion: type of offering, major functionality, major purpose, distribution segment, interest structure and conformation status.

Among other things, the large number of home loan products, a significant variation in home loan products world wide, recent dynamic changes in the home loan market and the number of different ways in which home loan products can be grouped and viewed, make it difficult to exhaustively categorise home loan products. The home loan classification presented results from the author's attempt to overcome this difficulty. As much as the author is aware, this is the first time that an exhaustive series of classifications of home loan products has been compiled. Finally, it is important to note that many of the findings in this study are derived from a number of different sources, including the author's extensive experience in the industry.

Keywords

Home loans, mmortgage, housing finance, financial products, home loan classification, home loan interest rates, home loan functionality.

1. Introduction

A mortgage loan can be defined as a loan secured by property through the use of a mortgage[1]. Nevertheless, in day to day usage, the word mortgage is by and large used to mean mortgage loan. According to purpose for which the loan is taken, mortgage loans can be divided into: (i) home loans[2], (ii) business loans secured by mortgage[3] and (iii) commercial mortgages[4].

The primary objectives of this paper are to: (i) briefly explore major reasons for recent proliferation in a number of home loan products offered in Australia, (ii) classify and provide a detailed account of various contemporary home loan product classes and groups, and (iii) serve as a background study for further structured research in the field.

The significant variations in home loan products and regulations (home loan products are known to significantly differ from country to country, region to region, and even within the same region), make it very difficult to exhaustively categorise home loan products. Furthermore, recent dynamic changes in the home loan market, a significant increase in a number of home loan products offered, and the number of different ways in which home loan products can be classified and viewed add to the complexities.

1 A mortgage is a legal document that promises the transfer of an interest in property to a lender as a security for payment of a debt.

2 A home loan is a lending product secured by mortgage where borrowed funds are used to purchase residential property.

3 A business loan secured by mortgage, as it name states, is a loan secured by mortgage, where borrowed funds are used for a specific purpose to establish/operate a business.

4 A commercial mortgage is similar to a home loan except that the loan is intended for a purchase of commercial property.

Although there has been a lot of informal research on certain facets of home loans (undertaken by various bodies ranging from the media, financial institutions, financial consulting agencies, marketing agencies, research companies, real estate agencies, welfare associations and various industry associations, to reports provided by regulatory bodies[5]), the research focusing on home loan products in Australia is extremely scant in the formal literature. As much as the author is aware, this is the first time that an exhaustive classification of home loan products has been compiled[6]. Finally, it is important to note that many of the findings in this study are derived from a number of different sources, including the author's extensive experience in the industry.

Although the classifications overlap somewhat, each group covers an important viewpoint:

1. HOME LOANS BY TYPE OF OFFERING (whether they are offered on their own or together with some other products and services): Stand-alone and Packaged Home Loans;

2. HOME LOANS BY MAJOR FUNCTIONALITY (primarily from the lender's point of view, the determining function of a home loan): Standard Variable Rate Home Loans (SVRHL), Basic Home Loans (BHL), Introductory (Honeymoon) Home Loans, Fixed Rate Home Loans (FRHL), Line of Credit (LOC) Home Loans, All- in-one (Offset) Home Loans, Reverse Home Loans and Islamic Home Loans;

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5 Such as the Reserve Bank of Australia (RBA) and Australian Prudential Regulation Authority (APRA).

6 Interesting contributions with respect to examining certain mortgage types and home loan products were made by Fisher (2004, pp 287 - 291) and Waxman (2004, pp 467 - 478) respectively.

3. HOME LOANS BY MAJOR PURPOSE TYPE (what they are used for): Owner Occupier Home Loans, Investment Home Loans, Construction Home Loans, Refinancing Home Loans and Upgrading Home Loans;

4. HOME LOANS BY DISTRIBUTION SEGMENT (how they are distributed): Direct Channel (Branches, Telephone and Internet) Home Loans, and Third Party Channel (Introducers and Brokers) Home Loans;

5. HOME LOANS BY INTEREST STRUCTURE (what kind of interest payments they have): Interest Only (IO) Home Loans and Principal and Interest (P&I) Home Loans; and

6. HOME LOANS BY CONFORMATION STATUS (whether they conform to typical home loan lending standards or not): Conforming (prime) Home Loans and Non-conforming (sub-prime) Home Loans.

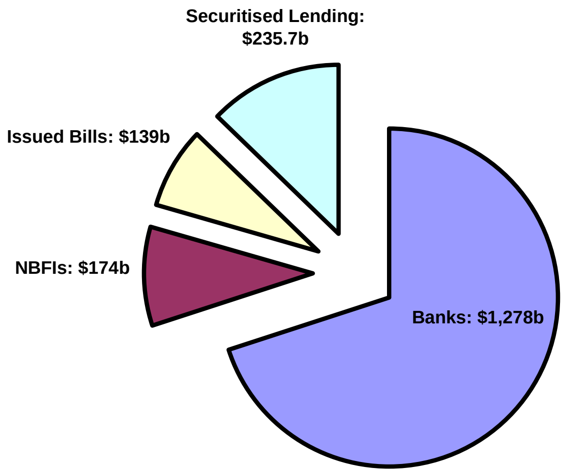
The next section of the paper briefly explores major reasons for recent proliferation in a number of home loan products offered in Australia. Sections 3 to 7 discuss home loan groups according to the six home loan classes, above specified. Finally, in Section 8, the paper concludes.

2. Major Reasons for an Increase in a Number of Home Loan Products at the Australian Home Loan Market

The primary motivation of this section of the paper is to briefly explore major reasons for recent proliferation in a number of home loan products offered in Australia. In doing so, the following factors will be examined: the size, composition and changes in the total and home lending in Australia; consequences of the two most recent rounds of financial system deregulation; trends in home loan interest rate and property prices; and recent changes in a typical borrower behaviour.

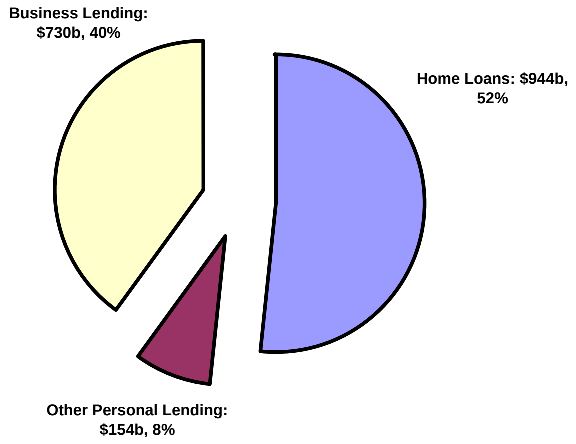
According to the Reserve Bank of Australia (2008a), as of April 2008, the total lending in Australia amounted to $1,827b. As shown in Figure 1, 79.5 per cent of the total lending came from Australian Financial Institutions (AFIs), namely Banks and Non-banking Financial Institutions (NBFIs), 13 per cent was securitised lending and the 8 per cent were issued bills. The majority of the $1,827b was absorbed by home loans (52%), followed by business lending (40%) and other personal lending (8%).

Figure 1: Total Lending in Australia, April 2008



Source: Extracted from the RBA (2008a).

Figure 2: Composition of the Total Lending in Australia, April 2008



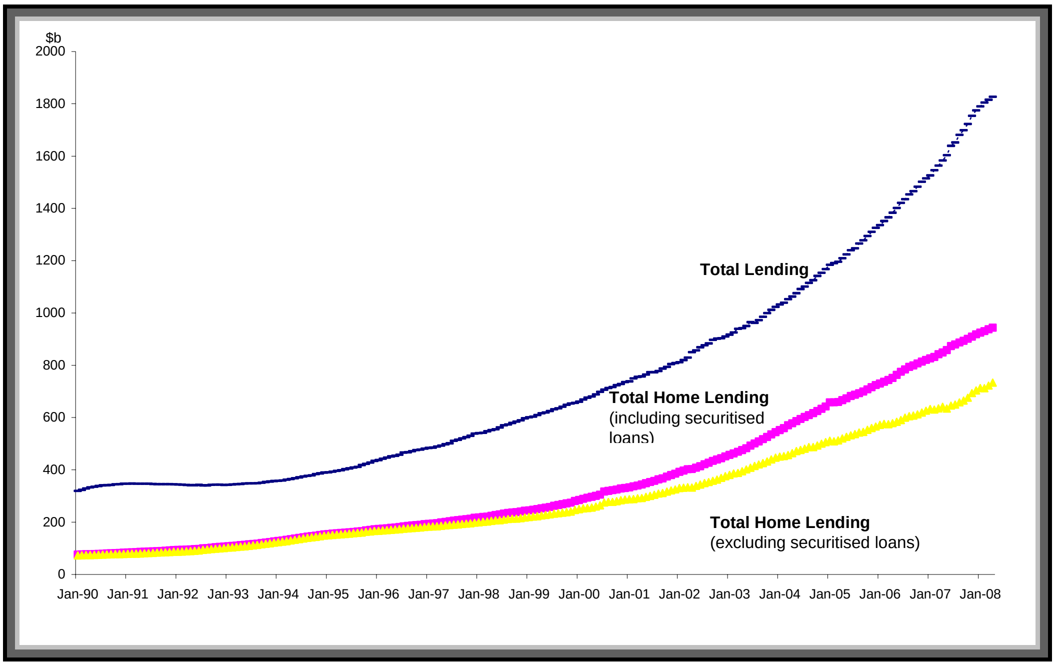
Source: Extracted from the RBA (2008a).

As shown in Figure 3, the total lending has experienced an astonishing growth, increasing almost six folds during the observed period (from $319b in January 1990 to $1,827b in April 2008). During the same time, the total home lending (excluding securitised loans[7]), increased by more than ten folds.

The increase was even higher, almost 13 times, for the total home lending that included securitised loans. Accordingly, the total home lending contribution to the total lending almost doubled. The total home lending contributed only 24 per cent to the total lending in January 1990, the contribution increased to 52 per cent in April 2008.

Figure 3: Total Lending versus Total Home Loan Lending

7 Home loan securitisation is a financing technique that involves conversion of individual home loans into pools of marketable securities.



Source: Extracted from the RBA (2008a).

This astonishing increase in both the total lending and home lending was made possible by a set of financial system deregulations. The initial wave of deregulation, conducted in the early 1980s, has changed the state of Australia's financial system. The call for deregulation was an attempt to allow banks greater freedom in response to competitive market signals and borrower demands, and to ensure institutions met minimum prudential standards designed to protect depositors and maintain the stability of the financial system. As a result, within a relatively short period, the deregulation freed banks and capital markets from the majority of previous regulatory constraints. This initial wave of deregulation resulted in changes such as removing the ceiling on bank lending and deposit rates, introducing tender systems to sell government securities and floating of the Australian dollar. It is worth noting that with the floating of the exchange rate in December 1983, impacts on the domestic money market from overseas markets were almost completely removed.

In addition to the deregulation conducted in the early 1980s, another round was conducted as a result of the 1997 Wallis Report. This report stemmed from the government-initiated Financial System Inquiry. The Wallis reforms aimed at facilitating greater choice and competition in financial services, encouraging more rapid innovation and better service, as well as enabling AFIs to be more globally competitive. In July 1998 the new round of changes was introduced. Under this reform, financial institutions became regulated and supervised on the basis of the functions performed. An important effect of the latest round of deregulation was that it, in addition to traditional banks, allowed a number of other institutions (generically called NBFIs[8]) to offer traditional banking services. Consequently, traditional banks increasingly faced higher competition, at least for a portion of the services they were offering.

Most Australian banks agree that NBFIs do not have an advantage in offering products such as credit cards, overdrafts and transaction products. These are the products that are generally characterised by a high number of transactions that require larger accessibility i.e. the existence of larger retail networks (both branch and electronic banking networks). However, banks do generally concur that NBFIs may, under certain conditions, have some advantages in offering home loans.

The comparative advantages of NBFIs in offering home loans are typically referenced to the fact that many NBFIs specialise in home lending. For this reason, they are perceived to be timelier, have lower operating costs and able to provide more personalised service. On the other hand, with respect to funding costs, banks generally have comparative advantage, if for no other reason but due to its size (bargaining power) and on average higher credit rating. Funding costs disadvantage for NBFIs is even more evident as market interest rates move up. Unlike NBFIs, banks typically

8 Primarily credit unions and building societies.

have access to a larger base of retail deposits whose interest rates are relatively insensitive to changes in the cash rate. When market interest rates are low, the benefit of the retail deposit base is small, as the bulk of funding for both banks and NBFIs is sourced from financial markets[9]. However, as financial markets' interest rates rise, the benefit gained from the retail deposits increases. This allows banks to acquire relatively cheaper funds and, in doing so, somewhat mitigate competitive pressure coming from the NBFIs. Nevertheless, the potential comparative advantages of NBFIs with regards to superior customer service and lower operating costs, if fully realised, may result in a further increase in competition and consequent downward pressure on home loan interest rates.

According to Ellis (2006), one of the major results of increased competition was that NBFIs's initial aggressive pricing forced banking sector to reduce their home lending margins. Consequently, lower home loan interest rates improved borrowers' capacity to pay at any stage of interest rate cycle (shifting the whole housing demand curve to the right), making home lending within reach of a wider range of borrowers.

The period since the introduction of the latest round of financial system reforms has been largely characterised by low interest rate environment. The most commonly used proxy for illustrating the level and changes in the entire term structure of interest rates is the cash rate. The major reason for this is that changes in the cash rate, to varying degrees, affect the entire term structure of interest rates in the economy. Lowe (1995), using monthly Australian data for the period January 1986 to October 1994, showed that the coefficient of changes between the cash rate and the shorter-term interest rates was quite close to one, in both an economic and statistical sense, but that the longer-

9 This primarily occurs for the reason that during the low interest rate environment the difference between the deposit rates and the financial markets rates is relatively small.

term maturities were much less impacted by changes in the cash rate[10]. In other words, Lowe showed that the pass-through of cash rate changes to short-term money market interest rates is quick and almost complete, while the pass-through of cash rate changes to longer-term maturities is much less responsive and much more complex. According to the RBA (2008b), between July 1998 and July 2007, the cash rate stayed between 4.23 and 6.25 per cent.

In addition to low interest rate environment, the period since the introduction of the latest round of financial system reforms has also, for the most part, been characterised by rising property prices. Australian house prices, between 1997 and 2004, experienced sustained growth. According to the RBA (2004), house prices increased at an astonishing rate of over 9 per cent per annum between 1997 and 2001, and by 17 per cent in 2002. Although impressive, it is not a unique occurrence. In nominal terms, these rates of increase are lower than those recorded during the second half of the 1980s. A slightly different picture emerges when we compare the two periods in real terms[11]. The real term measurement shows that, broadly speaking, the rise in house prices in those two periods is comparable. House price growth finally started to ease in the first half of 2004, falling to 10.9 per cent after another strong increase of 17.9 per cent, in 2003. Rising property prices over an extended period of time are believed to have encouraged an additional demand for home loans that otherwise would not have had eventuated. This is further emphasised by a sluggish stock market during the same period, diverting investors from the stock market to, at the time, the highly lucrative housing market.

10 Lowe’s sample period was constrained by the fact that prior to April 1985 most lending rates were subject to stringent regulation.

11 Nominal house price increases adjusted by the general rate of inflation measured by the Consumer Price Index (CPI).

Yet another interesting development, which contributes to the increasing complexity of the home loan market, is that borrowers are becoming increasingly sophisticated in their product knowledge, particularly with improved access to the Internet and ease of gaining information. This knowledge, combined with increased media coverage on interest rate variations, enables borrowers to shop around for the most competitively-priced product that meets their needs.

Overall, the implementation of the latest round of deregulation was largely successful[12]. The lasting impact of the reform is a more efficient and effective financial system characterised by increased competition, convenience, diversity of choice, and enhanced stability and integrity of the financial system. In particular, a significant increase in number of competitors, increasing borrower sophistication, low interest rate environment and, up to recent times, comparable funding cost structure for both NBFIs and banks, made it unsound for lenders to compete on price alone[13]. Within this type of environment, any attempt to differentiate on price alone could not be sustained and would only result in driving the whole market down i.e. falling margins. Not surprisingly, lenders (in particular bigger banks) redirected their attention to developing new, typically more functional, home loan products as more efficient and effective approach for differentiating at the market place. Consequently, the contemporary Australian home loan market has approximately 350 institutions offering some 3,000 home loan products[14].

12 Not surprisingly, the deregulation also produced several unexpected outcomes. For details on those reefer to Stanford (2004).

13 Recent credit crisis has changed this and currently all credit is much harder to obtain. Especially NBFI, having lower rating, are finding it much harder to source funds on financial market. Consequently, although the total market has shrank , the banks are improving their market share.

14 Source: www.smithbarney.com.

To enable further structured research in such an interesting and dynamic field, the rest of the paper focuses on providing a classification and detailed account of various contemporary home loan product groups and packages.

3. Home Loan Products by Type of Offering

From the point of view of the type of offering, home loans are offered as either stand-alone products or through various packages, i.e. home loan borrowers can satisfy their home loan needs either by acquiring a financial package, and a home loan as a part of that package, or by obtaining a stand-alone home loan.

3.1 Financial Packages

A peculiarity of financial packages is that they attempt to satisfy borrowers' broader financial needs, including a home financing need. These packages offer a wider range of products and services and purport to be a full financial service solution. In an increasingly competitive environment, such as the home loan market in Australia, it is not surprising that financial institutions are going out of their way to offer borrowers special deals on a range of products and services, from discounted lending interest rates to reduced insurance premiums, discounted share trading or fee-free accounts. Most of

Table 1: Financial Packages Offered in Australia by Selected Financial Institutions

Institution	Personal Package	Business Package	Agri-business Package
Adelaide Bank	Home Loan Package		Rural Power
ANZ	Premier Select	Franchising Package	Tailored Agribusiness Products (supported by business products)
	Business Links Package		
	Professional Mortgage		
BankWest	Gold Club Package		AgriOne
	BankWise Package		
	Reward Package		

Bendigo Bank	Home Loan Package	Business Solutions	Selection of Agri-focussed Products
	Bendigo Plus 2		
CBA	Gold Privilege 1		Tailored Agribusiness Products (supported by business products)
	Gold Privilege 2		
	Wealth Package		
Elders Rural			Specialist Agribusiness Products
Heritage Building Society	Variable Options Package		
HSBC	Power Vantage		
NAB	Tailored Home Loan Package	New Business Package	Farmers Choice
NAB	National Homeowners Package		
NAB	National Choice Package		
NAB	Shareholders Package		
St George Bank	Workplace Banking Package		
Suncorp Metway	Professional Package		Small Selection of Agri-focussed Products
Westpac	Wealth Advantage		Tailored Agribusiness Products (supported by business products)

Source: Extracted from CANNEX database, June 2007.

these packages have been available for only few years[15]. In Australia, the major banks were the first to come to the market with this kind of offering and the response so far seems to be very positive, with the major banks, in particular, experiencing a large take-up by an increasing number of borrowers.

At first glance, financial packages seem extremely appealing to a wide range of potential users. But there is a catch; to be eligible you have to be the sort of borrower who is valued by the financial institution. That means being financially better-off and being willing to consolidate the bulk of your banking activities with the one institution. The proliferation in package offerings has intensified the battle between banks for the

15 Generally the last five to ten years.

financially more astute borrowers with most of the major banks enhancing their product offerings and increasing their distribution network across the country.

Professional banking packages come under a variety of labels, however the fundamentals are essentially the same i.e. borrowers who satisfy certain financial criteria can, for an annual fee, enjoy a range of discounted financial products and have access to other financial services not available to other home loan borrowers.

From the lender's point of view, all financial packages can be segmented by purpose into personal[16], business[17] and agri-business[18] packages. This is illustrated in Table 1. Because business and agri-business packages are significantly less sophisticated than the personal packages, in the rest of the section the focus will be on personal packages. Moreover, all financial personal packages can be further classified into property investors' packages and general packages. Property investors' packages, as their name indicates, focus on the financial needs of property investors, while general packages target all others borrowers who have enough business with the financial institution and satisfy other eligibility conditions.

From the complexity of offerings point of view, all packages can be viewed as branded or tailored packages. In this study we will focus on branded packages i.e. packages that potential borrowers can select "off-the-shelf" from most Australian lenders. Tailored packages, on the other hand, are very hard to group as they cover a wide range of

16 Targeting the borrower's individual personal needs.

17 Targeting the borrower's business needs (such as purchase of commercial property).

18 Targeting the borrower's agri-business needs (such as purchase of farm).

packages and are very often completely individualised to satisfy the most varied of borrower needs[19].

Branded or "off-the-shelf" packages can be further grouped into full packages and partial packages. Full packages are those that offer a financial solution that addresses at least four functions. In other words, the borrower, by accepting a full package accesses a complete financial solution through the one branded package. Full packages generally provide the borrower with a home loan and credit card, in addition to other financial products such as insurance and margin lending[20]. Table 2 shows some of the more well-known full packages currently available in Australia. For example, the HSBC's Power Vantage package is targeting the professional or higher net worth individuals through more sophisticated products combined with increased convenience and financial coordination[21].

On the other hand, partial packages are financial packages designed to encourage borrowers to purchase, typically, two products. Table 3 shows some of the more well-known partial package offers in Australia. As can be seen in Tables 2 and 3, all of the major banks offer at least one personal banking package, with NAB, CBA and ANZ each providing three packages.

Table 2: Full Financial Packages

Institution	Package
Adelaide Bank	Home Loan Package
ANZ	Premier Select
	Business Links Package
BankWest	Reward Package
	BankWise Package
	Reward Package

19 Such as the purchase of luxury products or investing overseas.

20 A margin lending facility is a line of credit secured by cash, approved shares or units in managed funds, and provided solely for the purpose of purchasing additional shares or units in managed funds.

21 This is achieved by offering a single statement for all accounts.

CBA	Wealth Package
Heritage Building Society	Variable Options Package
HSBC	Power Vantage
National	Professional Choice Package
	Shareholders Package
	Employees Package
St George Bank	Workplace Banking Package
Westpac	Wealth Advantage

Source: Extracted from CANNEX database, July 2007.

As already stated, all financial packages are subject to minimum relationship criteria and aim to reward borrowers through means of discounted fees, favourable interest rates or superior service delivery. For example, the ANZ's Business Links package and St George's Workplace Banking package both have an interesting twist, targeting the employees of their major business clients. The business relationship then constitutes an additional criterion for accessing this package. It is generally acknowledged that the cornerstone of partial packages is a home loan product. The underlying logic of financial institutions is to use these packages as a means of harnessing the borrower's entire banking relationship.

Although all personal packages currently offered are generally very similar, there are some significant differences between them. These differences primarily relate to: eligibility criteria, products offered and benefits provided. For example, the Westpac's

Table 3: Partial Financial Packages

Institution	**Package**
ANZ	Professional Mortgage
BankWest	Gold Club Package
	BankWise Package
	Reward Package
Bendigo Bank	Home Loan Package
	Bendigo Plus 2
CBA	Gold Privilege 1
	Gold Privilege 2
Heritage Building Society	Variable Options Package
National	Tailored Home Loan
	National Homeowners Package
Suncorp Metway	Professional Package

Source: Extracted from CANNEX database, July 2007.

Wealth Advantage package is available to borrowers with an annual income of at least $60,000, combined home or investment property borrowings of at least $125,000, combined lending and deposit of at least $150,000 and no minimum number of accounts held. By contrast, the CBA's Wealth package focuses on the borrower's overall relationship with the bank. It is simply available to anyone with more than $250,000 in total business with the bank. The Professional Choice package is available to anyone with at least three NAB accounts, at least $150,000 in personal borrowing and who is either a member of a NAB-recognised profession or a payee employee with a gross income of at least $75,000.

In the past, lenders' package offerings were primarily focused on the traditional professionals such as accountants, lawyers, however we now see a broader occupational focus. Such distinct borrower segregation is increasingly seen as unnecessary and counterproductive, and thus the practice is gradually diminishing, although most of the banks still have some kind of occupation-based rules in their policies. In addition to the various criteria outlined thus far, there are annual fees payable to be eligible for the more functional packages[22].

So, having cleared the eligibility hurdles and agreeing to pay the fee applicable, the logical question is what are the major benefits for the prospective borrower? Probably the biggest drawcard for a prospective home buyer or re-financer is a discount on home loan interest rates, typically ranging from 0.5 per cent to 0.7 per cent. As a general rule of thumb, the larger the relationship with the lender, the higher the discount the lender will be happy to provide. Westpac, for example, offers a 0.4 per cent discount on

22 As of 2007, ANZ charged $295 a year, Westpac and CBA each asked for $300 and NAB charged $375.

combined borrowing above $150,000 to $250,000, rising to 0.6 per cent as loans increase above $250,000 to $500,000 and 0.7 per cent for borrowers looking to borrow more than $500,000.

Beyond lending, discounted rates are usually offered on a range of other banking products. In many cases, transaction and credit card fees are dropped or heavily discounted, insurance premiums are reduced and higher interest rates offered on savings accounts. More than twenty different transaction account/package combinations are currently available, of which the majority waive the account-keeping fee as a benefit of the package. Only a few packages offer unlimited transactions to borrowers, while most lenders offer discounts on transaction fees. For example, the NAB's Professional Choice Package targets higher-end premium borrowers[23], guaranteeing one annual fee, which covers all fees and charges.

Probably one of the biggest drawcards of financial packages is improved services. Bigger banks, in particular, offer the services of financial planners and personal bankers. For example, NAB has more than 400 personal bankers countrywide and claims to have the best personal banker service in the country. Financial planners are also often made available for free when a borrower first takes a package, and thereafter usually for a discounted fee. Typically, borrowers are introduced to professional packages when they apply for a home loan. Banks have devised sophisticated ways to explaining to a prospective borrower how these value-added arrangements can benefit and fulfil most, if not all, of their financial needs. Banks, for their part, receive a greater share of borrower's business, improved retention and increased profitability. In

23 The premium market segment typically consist of mid to higher wealth borrowers.

summary, it can be said that professional packages provide a happy arrangement between the lender and its higher value borrowers[24].

3.2 Stand–Alone Home Loans

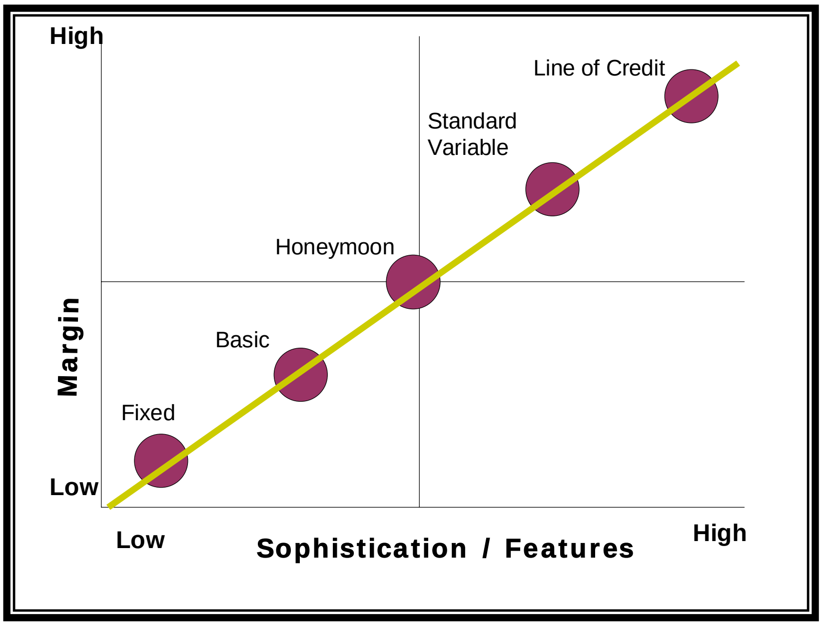
Stand-alone home loan products are home loans offered outside financial packages i.e. offered without ancillary financial products.

4. Home Loans by Major Functionality

The classification of home loan products by major functionality is based on the key characteristic determining the product's utility and functionality. Of the relevant stand-alone home loan products that will be considered in this paper, Figure 4 illustrates that fixed-rate home loans (FRHLs) have the lowest sophistication and number of features associated with them, while revolving line of credit (LOC) home loans have the highest level of sophistication and number of features.

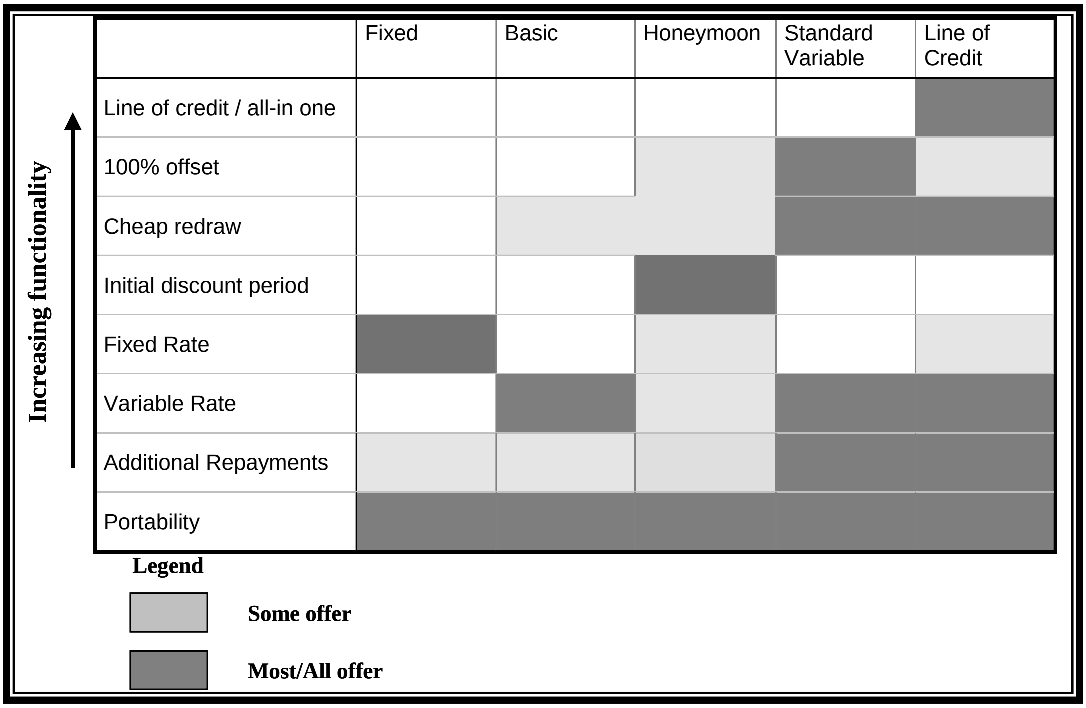
Figure 4 - Home Loan Margins versus Sophistication

24 It is generally accepted that up to 25 per cent of all borrowers are higher value borrowers.



The figure also indicates that, on average, the higher the sophistication, the higher the gross margin realised by the lender. Also important to note is that, normally, with the increase in gross margin and the level of sophistication, comes an increase in costs associated with the product. Nevertheless, the increase in costs is generally of a lesser magnitude than the increase in the lender's margin. This obviously stimulates lenders to

Figure 5 - Functionality of Major Home Loans Groups in Australia



sell more of their more sophisticated products and increases the fight for market share of the higher value borrowers.

Figure 5 presents major functionalities associated with each product group analysed and, moreover, suggests the rationale for the naming of each product group, e.g. FRHLs offer fixed rate term lending; the basic home loan (BHL) is a reference to the most basic functionality; Honeymoon (or Introductory) home loans normally provide a 6 to 12 months' honeymoon period during which the interest rates payable are significantly discounted.

As implied above, the classification by major functionality covers the range of home loan product groups. The classification is based on the following determining functions: fixed rate, basic, introductory, variable rate, offset, line of credit, reverse and Islamic.

4.1 Standard Variable Rate Home Loans (SVRHLs)

SVRHL is one of the oldest and best-known home lending products. It is a flexible, variable interest rate-based home loan that can suit the individual needs of a wide spectrum of borrowers, such as first home buyers[25], up-graders[26], re-financers[27], investors[28], and home buyers purchasing a block of land to build on. A SVRHL contains a full set of features available to variable rate home loans. The most common features of a SVRHL in Australia are[29]:

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25 Borrowers who are in the home loan market for the first time.

26 Borrowers who are conducting major renovations/extensions or moving into a new home.

27 Borrowers who are transferring a home loan product from another institution.

28 Borrowers who are investing in residential property.

29 Cannex (specialist supplier of research and analysis for banks, building societies, credit unions, life and general insurance and other financial services providers, as well as the media, which provides Australia's only fully interactive online service in retail and business finance) databases, web sites and product manuals of the top ten Australian banks.

- $2000-$5000 minimum redraw[30], with no fee applicable,
- Partial offset via loan trimmer[31],
- Loan term of one to thirty years,
- Minimum loan amount of $20,000,
- Available as either a low-documentation or full-documentation option[32],
- Lending limit of 80 per cent of loan to value ratio (LVR) without loan mortgage insurance (LMI) and up to 100 per cent LVR with LMI,
- Unlimited additional repayments without penalty,
- Repayment holiday available for borrowers in advance of contracted scheduled repayments,
- Application fee of generally between $300 and $600 that includes up to two home loan applications, provided they are applied for at the same time and are over the same security,
- Monthly service fee of between $5 and $15,
- Insurance premiums can be incorporated into loan repayments,
- Portability[33], and
- Can be taken as a construction loan.

Furthermore, a SVRHL comes as both principal and interest (P&I) and interest only (IO) facility (for more details on interest rate structure refer to Section 7). The features outlined above are fully applicable to the P&I facility, while IO repayment monthly in arrears is available for terms of one, two, three, four and five years only. At the end of

30 Minimum amount of redraw allowed for payments made above minimum scheduled payments.

31 Loan trimmer enables borrowers with loan and deposit accounts to offset interest normally earned on deposits held in designated deposit accounts against the interest payable on part of a designated loan account.

32 Compared to the full-documentation credit application and assessment process, which requires full-documentation disclosure, low-documentation is a credit application and assessment process which principally applies to self-employed borrowers who cannot provide the financial information normally required at the time of application.

33 Allows a transfer of the loan with the borrower, if moving house.

the IO period the loan automatically converts to P&I, for the remainder of the loan term.

4.2 Basic Home Loans (BHLs)

The name of this product group strongly implies that the product has only basic functionalities assigned to it. In summary, a BHL generally comes with the following functionalities[29] [34]:

- Lower interest rate than SVRHL[35],
- No frills or extras attached to it as compared to SVRHL,
- Flexible repayment options[36],
- Standard application fee and generally no monthly service fee,
- Re-draw functionality with a fee applicable,
- Ability to switch to and from SVRHL, and
- Monthly serviceability calculated at prevailing home loan interest rates[37].

The two repayment modes applicable to the facility, namely P&I and IO, make the home loan attractive to both investors and owner-occupiers. Investors are attracted to IO for the obvious reason that repayment amounts are lower as they cover interest payments only. At the expiration of the term of the loan the whole amount borrowed is repayable. This provides investors with an increased cash flow during the term of the loan and the option to sell the investment before they are expected to repay the whole amount borrowed.

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34 As with other considered product groups, different providers use different names (e.g. NAB's equivalent is called National Base Variable Rate Home Loan, while CBA's equivalent is called Economiser.

35 Generally at a discount of 0.50 per cent from the SVRHL.

36 Either weekly, fortnightly or monthly.

37 As of June 2008, between 8 per cent and 12 per cent.

4.3. Introductory (Honeymoon) Home Loans

Introductory home loans are being used as a key promotional product within the home loan market, where the discounted introductory interest rate is a key driver for these facilities. A standard Honeymoon home loan product typically comes with the following functionalities[29]:

- Allows borrowers to defer the first three months of repayment (payments due during the deferment period are distributed over the remaining term of the home loan),
- Ideal for borrowers who have sufficient funds for deposit and/or property related costs but need help with their monthly cash flow,
- During the introductory period, these loans are structured either as a discount off the SVRHL or as a discounted fixed rate loan, and
- Some lenders charge a deferred establishment fee[38].

Currently, CBA, St George, BankWest, NAB and Suncorp Metway offer both fixed and variable rate introductory loans, while HomeSide, Westpac and Rams only offer fixed rate introductory loans. ANZ is the only institution offering variable rate introductory rate home loan.

The NAB's National Tailored Home Loan Package (NTHLP) offers a choice of either a six months or a one year fixed discounted initial period[39]. The HomeSide Introductory Reducible home loan offers borrowers a choice of either a one year or two years fixed discounted initial period. Neither the NAB nor HomeSide Introductory home loan products charge deferred establishment fees, however borrowers are prevented from

38 Also known as an early repayment fee, i.e. if the borrower repays the loan before the prescribed period, the fee will be charged by the lender.

39 Although NTHLP is called a package the products comprising this package are offered on an individual basis.

taking more than one Introductory loan, unless it is for new lending. The NAB's NTHLP, in addition to offering a choice of either a six months or a one year fixed discounted initial period, also offers longer fixed term rates[40], which are set at NAB's standard fixed interest rate. However, unlike the standard fixed rate products, no economic cost[41] or prepayment fees are charged for partial prepayments. The package also offers a free standard credit card and a free Flexi Account[42].

4.4. Offset Home Loans

In Australia, the first offset home loan product was developed by NAB and now most home loan providers in Australia offer offset home loans. The product is comprised of a transaction account, which is linked to a home loan account in such a way that the home loan balance is offset by the deposit account balance on an ongoing basis. For example, NAB's offset home loan is called 100% Offset and is an optional feature of the NAB's SVRHL[43]. Other lending institutions are known to link the functionality with other products, such as BHL and FRHLs.

The arrangement is structured in such a way that the actual home loan is comprised of two accounts, namely a normal home loan account and some kind of transaction account, such as a cheque account or a savings account. The rationale is that the borrower arranges for all income to be deposited in the transaction account and that home loan payments are paid from the same account. The account is linked with the home loan account in such a way that the credit balance in the deposit account is

40 Two, three, four and five years.

41 An economic cost is the lender's loss on a fixed term loan due to movements in the costs of funds (COFs). This may occur, if before the end of the fixed rate term of the loan: the loan is fully repaid, a partial prepayment is made to the loan, the loan changes from fixed to variable or to another fixed term, or the fixed rate period ends early due to the loan being terminated when a borrower is in default.

42 A type of plain transaction account.

43 Source: www.nab.com.au.

deducted daily from the debit balance in the home loan account. This, in fact, reduces the home loan balance by the credit amount in the deposit account, reducing the home loan interest payable. This feature, therefore, very effectively reduces home loan interest payments and also allows borrowers to avoid tax normally levied on deposit interest, as this type of deposit account pays no or minimal interest. This is the case because owner-occupier home loan payments are not tax deductible in Australia. Residential investment home loan payments, however, are tax deductible. Borrowers with such home loans, which are usually IO loans, have no incentive to use home loan offset accounts in the same way as owner-occupier P&I borrowers.

Furthermore, an important characteristic of the offset home loan is that it significantly increases flexibility for borrowers capable of repaying extra, allowing easier access to extra paid amounts when compared to most other home loans that mostly offer only plain redraw facilities. For example, a borrower with $200,000 in home loan debt and $40,000 in an offset account would only pay interest on $160,000 of debt. Interest on the home loan offset account is not subject to taxation. By reducing interest due on loans, the home loan term also reduces. This is very often used by various banks as a dominant point of the advertising campaign with a message such as “Save $80,000 and 8 Years”. The wide spectrum of assumptions available allows virtually any claim to be substantiated.

As can be seen from Table 4, most banks in Australia allow borrowers to link offset accounts to a variable rate home loan, but only some allow borrowers to offset fixed rate home loans. The practice recognises two kinds of principal offset accounts, namely full offset and partial offset. A full offset, or 100 per cent offset, eliminates interest on the home loan debt equivalent to the deposit balance, while a partial offset only offsets a portion of interest due on the equivalent home loan debt.

Offset accounts differ in liquidity as well. Depending upon the institution, borrowers may be required to meet deposit account balance requirements, follow deposit and withdrawal restrictions or pay transaction fees. This time the general rule that the more flexibility, the better the borrower, doesn't necessarily apply. In general, the more accessible the deposits, the fewer benefits are offered. In other words, borrowers pay for increased liquidity with decreased offsets and in most cases an increase in liquidity results in a decrease in the offset amount.

Table 4 - Home Loans Eligible for Offset, the Top Five Banks in Australia

NAB	SVRHL, with Full Offset
Westpec	BHL and SVRHL, with Full Offset
St George	All variable rate home loans, with Full Offset
ANZ	Any home loan account including fixed rate home loan, with Partial Offset
	BHL, with Full Offset
CBA	All variable rate home loans, with Full Offset

Source: CANNEX.

The offset is a relatively new feature on the market and has come to the market as a direct consequence of the increasing competitiveness and commoditisation[44] of home loan products. In other words, lenders have been forced to embark on this journey. The major reason is that the bank's profitability decreases with any offset. For this reason, home loan offset accounts are, for the most part, restricted to variable interest rate home loans, which generally maintain larger profit margins than fixed rate home loans[45]. Currently an exception is ANZ, which provides offset accounts for its fixed rate home loan as well, but only offers a partial offset.

44 When a product becomes indistinguishable from others like it and borrowers buy on price alone, it is said to have become a commodity.

45 Primarily because fixed rate home loans are typically less functional than variable rate home loans.

A good example of a comprehensive offset home loan can be found in Westpac's offset home loan product, which offers the following functionalities: 100 per cent offset[46], portability, redraw[47], progress draws[48], repayment holidays[49], parental leave[50] and smart pay[51].

Home loan offset accounts do not exist in the United States or Canada. In the United States, home loan payments are tax deductible so there is no need to use offset accounts to avoid tax. However, in Canada, where home loan payments are not tax deductible and borrowers would benefit from home loan offset accounts, such loans are not offered because the Canadian Government does not allow lenders to shelter borrowers from taxation.

4.5 Line Of Credit (LOC) Home Loans

LOC home loans are even more flexible than offset home loans as they allow the borrower unrestricted access to the equity in the property, up to an approved limit. These products routinely come with features such as cheque books, telephone and internet banking. For this reason, traditionally these products were offered only by banks, which were equipped to provide the combination of home loan and associated facilities at a reasonable price.

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46 Borrowers can fully offset the balance of their transaction accounts against their home loan to save interest on their loan. In addition, the bank encourages borrowers to utilise the interest free period on their credit card to maintain extra funds within their offset account.

47 Enables borrowers to gain immediate access to any payments made above their scheduled repayments.

48 Enables borrowers to draw funds to make payments during construction. The lender generally stipulates that drawing must be completed in 12 months.

49 Provided that substantial additional repayments into the loan account have been made, borrowers may take leave from their regular repayments, for as long as the excess funds cover standard repayments.

50 Typically if a home loan has been in operation for over 18 months, borrowers are eligible to reduce their regular loan repayments by up to 50 per cent, for up to six months, to ease financial pressure after an event such as the birth of a baby.

51 Enable borrowers to use their income to save on loan interest, by depositing all of their income into their loan account until there is an alternative need for the funding. Automatic transfers can be set up for bill payments and regular cash deposits.

The original LOC home loan in Australia was established as a wealth creation product targeted at the professional and investment home loan market. Due to the changes in the market towards all-in-one[52] banking, the product is increasingly being taken up by less financially astute borrowers as an all-in-one home loan product.

Due to the functionality of the product, borrowers also increasingly began using home equity LOC as a mean to, among other things, finance car loans and consolidate other forms of debt. Favourable interest rates (as a result of increased competition and being secured by a property) relative to other forms of credit (such as unsecured personal loans and credit cards) also increase borrower appeal.

In summary, a LOC home loan product typically comes with the following functionalities[29]:

- A flexible overdraft facility where any amount of the approved credit is readily accessible[53],
- A LOC can be secured by a home or residential investment property,
- If acquired as a stand-alone product generally an application fee is charged,
- It allows for personal and investment finance consolidation,
- It allows for split facility, i.e. splitting personal and investment facilities for no additional fee,
- It has flexible repayment, i.e. no principal reduction is required and payments can be made at any time,
- Borrowers are allowed to draw on the entire credit limit approved and are charged interest only on the portion used,

52 Concentrates all the borrower's needs into a single facility.

53 As long it is under the approved limit.

- Easy access to accounts - over the counter, cheque, telephone, Automatic Teller Machine (ATM) and Electronic Funds Transfer at Point of Sale (EFTPOS), and
- Borrowers typically have the benefit of unlimited free transactions.

A very recent development is the introduction of amortising or P&I LOC. The reducing limit facility is very similar to offset home loans. This facility provides borrowers with the flexibility of the LOC but with the added assurance that they will pay their loan off eventually. The reducing limit option can also be viewed as an additional feature of the LOC home loan[54]. Not surprisingly, the product is usually available under the same guidelines as the standard LOC home loan. It is offered as a stand-alone product or as part of a financial package. The key features to the reducing limit functionality are as follows:

- A limit reduction schedule[55],
- To maintain flexibility, the product allows borrowers to turn the limit reduction schedule on and off as their needs change, and
- One contract typically covers the terms and conditions of both the fixed limit and reducing limit options[56].

4.6 Standard Fixed Rate Home Loans (FRHLs)

In Australia, a FRHL generally offers fixed interest periods of one, two, three, four, five and ten years. Although some exceptions are also known, the above specified terms are the most prevalent. The fixed interest period, being a period for which the loan's interest rate and other conditions are fixed, should be distinguished from the loan term, which is the term of the facility (generally up to thirty years).

54 For example, NAB's FlexiPlus home loan has both functionalities.

55 This schedule reduces the facility limit on the last business day of each month, on a similar schedule to the normal variable rate home loan, and in doing so provides borrowers with the discipline required to reduce their debt.

56 This is intended to improve the borrower's experience by simplifying the contractual procedures.

A major appeal of FRHLs comes from the fact that they offer stability i.e. they are especially appealing to borrowers who want to lock in their interest rate and avoid any ambiguity about future loan payments for the duration of the agreed interest rate term. With most providers of home loans in Australia, at the end of the fixed rate period, FRHLs convert to SVRHL (unless another fixed rate term is negotiated). From the borrower's point of view, FRHLs are generally perceived to be suitable for first and subsequent owner-occupier home buyers or residential investors, who want to lock in an interest rate on their borrowings.

In summary, a standard FRHL product typically comes with the following functionalities[29]:

- Partial offset via loan trimmer[57],
- Loan term of one to thirty years,
- Minimum loan amount of $20,000,
- Allows for a rate lock[58],
- Available as a either low-documentation or full-documentation option,
- Lending limit of 80 per cent of LVR without LMI and up to 100 per cent LVR with LMI,
- Up to $20,000 partial prepayment per fixed rate period without penalty, i.e. prepayment fee generally applies when this amount is exceeded,
- Repayment holiday available for borrowers in advance of contracted scheduled repayments,
- Generally, application and maintenance fees are applicable[59],

57 Loan trimmer enables borrowers with loan and deposit accounts to offset interest normally earned on deposits held in designated deposit accounts against the interest payable on part of a designated loan account.

58 A fee for which FRHL borrowers are guaranteed the fixed rate at the time of approval. Borrowers are inclined to pay the fee if they expect the interest rate for the term they have selected to increase between the time of approval and the time they draw the loan.

- Insurance premiums can be incorporated into loan repayments[60], and
- Portability.

From the repayment point of view, a FRHL is offered as either IO or P&I. IO FRHLs (FRIOHLs) are offered as one, two, three, four and five years fixed rate IO repayments, payable monthly in arrears. They also come as one, two, three, four and five year fixed rate IO repayments, payable in advance, however these are generally only available for investment purposes. It is important to note that the fixed rate term must be less than, or equal to, the IO period. At the end of the IO period, the loan automatically converts to a P&I SVRHL for the remainder of the loan term.

4.7 Reverse Home Loans [61]

A reverse home loan can be defined as a loan that enables senior homeowners to convert a part of the equity in their homes into tax-free income without having to sell the home itself, give up the title or take on new monthly home loan payments[62]. Interest charged on the reverse home loan is accrued. Therefore, instead of being paid by the borrower each month, the interest accumulates and must be repaid at the time when the homeowner no longer occupies the home as the principal residence.

Reverse home loans allow homeowners, usually from the age of 62, to receive cash in exchange for a stake in the equity of their homes. Borrowers can receive the reverse home loan funds as a lump sum, monthly income for life, LOC, or any combination of these. The Council of Financial Competition (2002) found that reverse home loan

59 For example, NAB charges a $600 application fee and a $5 per month maintenance fee.

60 This functionality is generally not available for IO loans.

61 Also known as a conversion loan.

62 For more on reverse home loans reefer to Reed (2004).

products have quickly grown in popularity, in particular in the United States (where reverse home loan sales grew by impressive 112 per cent between 2003 and 2004) and the United Kingdom.

As with any other home loan, the maximum amount a borrower can borrow for a reverse home loan is based on the borrower's age[63], the property's value and the affordability rate[64]. Generally, the rate charged by the lender is variable, i.e. rises or falls with the general trend in interest rates. Borrowers may spend the funds from a reverse home loan in any way that they wish. The repayment amount, as expected, can never exceed the value of the home.

Over the last half decade an increasing number of authors have been considering this new phenomenon, trying to determine the reasons for its increasing popularity. According to Kulkosky (2002), the most commonly cited reasons for reverse home loans' growing popularity are: culture change, demographics, current economic climate and legislation. Seniors are seen to be changing long-held cultural beliefs, by starting to look at the value of their home in terms of a usable asset and no longer just in terms of an inheritance for their families. The fact that reverse home loans have matured as a product and are increasingly gaining acceptance can also be attributed to significant educational and advertising efforts conducted by lenders. Demographics are also quickly changing and the population is getting older.

A strongly contested issue in the contemporary literature on the topic, is the discussion regarding the advantages and disadvantages of this kind of lending. The most

63 For more details and actual illustration of how the borrower's age relate to the amount a borrower can borrow reefer to Cannex (2008).

64 The Affordability Rate is a tool used by lenders to assist in determining customers' ability to service loans. It is intended to approximate an interest rate averaged over a medium to long term.

commonly used argument for the benefit of this kind of lending is that the reverse home loan allows seniors to remain financially independent, who otherwise might not have been able to, by enabling them to free up previously illiquid home equity as cash. The most commonly quoted disadvantage is that if, and when, seniors move to assisted accommodation, they may encounter cash flow difficulties as they would have already spent most of the value they had in their home.

4.8 Islamic Home Loans

The principal need for an Islamic home loan exists as the Islamic economic system is based on religious goals and values such as abolition of interest (riba), economic prosperity within the framework of the moral norms of Islam, universal brotherhood and justice and the desirability of economic enterprise. More precisely, as stated by the Institution of Islamic Banking and Insurance (2006), the concept of Islamic banking is based on the following principles:

- *"Morally and socially harmful means of wealth creation are forbidden,*
- *Individuals must spend their wealth in worthwhile and legitimate ways, and not accumulate wealth for personal gain,*
- *The wider community, particularly the destitute and deprived sections of society, should benefit from excess wealth,*
- *Wealth should not remain in the control of a small number of people, to the detriment of society, and*
- *The Islamic economic system should balance individual entrepreneurship and social justice."*

A basic principle of Islamic banking is the outlawing of *riba*, a term that can be conservatively interpreted to encompass both usury[65] and the charging or payment of any interest on borrowing or lending. Under this interpretation, followers of Islam who take out a conventional home loan are not acting in accordance with Shariah (Islamic) Law[66]. A more liberal interpretation of *riba* is that it entails only usury.

Islamic home loans are currently very modestly represented in Australia. Nevertheless, the product is increasing in relevance in other parts of the world and is definitely an interesting one to be considered[67]. Of the developed countries, Islamic home loans are most common in the United Kingdom.

Currently only Ahli United Bank underwrites Shariah compliant property finance in the United Kingdom. The bank offers two home loan products, Murabaha and Ijara, under the brand Manzil. These home loan products differ from a conventional home loan in that they do not formally include payment of interest rates by borrowers. Ahli United uses a council of advisers on Islamic law to ensure that their products are Shariah-compliant.

Murabaha is also referred to as a cost-plus-finance type of Islamic home loan product and has been offered since 1997. With this product a borrower chooses the property and the bank commissions an independent valuation of the property. Once the bank is satisfied as to the value of the property, it requires a 20 per cent down payment on the

65 Defined by the Webster's Dictionary as illegal interest; a premium or compensation paid or stipulated to be paid for the use of money borrowed or retained, beyond the rate of interest established by law.

66 Islamic law is derived from three sources - the Quran, the Hadith, and the Sunnah. For more information see www.islamic-banking.com.

67 The 'modern era' of Islamic banking began in the 1960s with the foundation of the pioneering 'social bank' in Egypt. Since then, over 150 Islamic banks and institutions have been set up in more than fifty countries. Pakistan, Iran and Sudan have actually taken steps to Islamicise their whole banking industry, with an aim to demolish the forbidden riba (interest) entirely. It is estimated that the Islamic banking industry is currently worth more than US$100 billion.

value of the property i.e. it allows the maximum LVR of 80 per cent. This, of course, does not mean that the bank will automatically lend so much. Instead the bank will investigate the potential borrower's risk profile[68] and financial position, and will lend up to 2.5 times the income for sole applicants, subject to approval from the bank's credit committee. If the bank is happy to borrow the required amount, the bank purchases the property, exchanging contracts with the property owner, and then immediately resells the property to the borrower at a higher purchase price. The bank sells the property to the borrower for a higher price than it paid for it, thereby covering the necessary interest payment and its profit margin. A part of the contract is that the borrower will have to pay fixed monthly payments over a period of up to fifteen years, to pay for the property. Therefore, the final result is that, at face value, these payments attract no interest, and are merely fixed, equal payments of a proportion of the price for which the bank sells the property to the borrower.

In contrast to Murabaha, Ijara is a lease-purchase finance facility. This product has been offered since 1999. As with Murabaha, the product comes with a maximum LVR of 80 per cent. It is termed to be suitable for a broader range of borrowers, such as first home buyers, refinancers and investors. Being a lease-purchase finance arrangement, it consists of a lease with promise to buy. The concept is that throughout the term of the loan, the bank owns the borrower's property, which it sells to the borrower at the end of the term for the same price at which it originally purchased it. Hence, the borrower gains from any increase in the value of their property over the term of the loan. The borrower, on the other hand, is required to make monthly repayments, which contain three elements: lease payment or rent[69], payment towards the cost of purchasing the

68 For more on risk management in murabaha see Kumar (2008).

69 Intended to remunerate the bank for living in a property which it owns. This payment provides the bank's profit.

home, and insurance rent[70]. The bank then collects fixed monthly repayments which are reviewed each April to reflect the amount repaid and the return that the bank receives. The standard term is twenty-five years. Unlike Murabaha, Ijara allows borrowers to make lump-sum payments in order to reduce the monthly outlay.

Being a relatively new practice it is not surprising that Islamic home lending is facing significant barriers. For example, stamp duty of between one and 3.5 per cent was levied twice in the process of purchasing a home using Shariah law-compliant Islamic home finance products in the United Kingdom before 2003. The situation transpired because such products technically require the property to be purchased twice, once by the bank and then again by the borrower. Furthermore, the costs of these home loan products are further increased by the associated tax obligations relating to the two sales. In April 2003 the United Kingdom government, through its budget, announced reforms to free purchasers of Islamic home finance products from the payment of double stamp duty. The changes took effect in December 2003.

Moreover, government agencies are working to remove the remaining barriers in response to lobbying by the home loan industry. For example, lenders that provide this kind of lending are currently required to hold higher capital for Islamic home loans compared to conventional home loans.

Overall, the development and availability of Islamic home loans, in particular in the United Kingdom, has been evident. Nevertheless, according to Wilson (2008), even London as the major western centre for Islamic finance so far has failed to fulfil the demand for those kinds of financial products.

70 Intended to cover the cost of the insurance the bank pays on the property.

5. Home Loan Products by Major Purpose Type

The purposes of acquiring a home loan can be: (i) the purchase of home to live in, (ii) the purchase of a house as a rental investment, (iii) the construction of a home, (iv) refinancing and (v) up-grading. Bearing in mind that home loans have been almost completely commoditised and that, primarily due to enhanced competition, the home loan market can be termed a buyer's market, the intended purpose of the home loan is an exceptionally important consideration for lenders.

Different home loans are generally viewed as being more suitable for particular purposes. This doesn't mean that other home loans cannot be used for the same purpose, but that some home loans may be more suitable compared to others. This is primarily reflected in the home loan interest rate applicable and eligibility criteria that lenders impose. For example, a first home buyer seeking to take out a fully flexible home loan such as a LOC home loan may not be eligible. Even if eligible, the borrower would be paying significantly more for the funds borrowed than if the borrower had opted instead for a low flexibility home loan such as BHL.

5.1 Owner-Occupied Home Loans

Owner-occupier home lending targets borrowers who intend to occupy the premises. It can be subdivided into first time home buyers and subsequent home buyers.

First-time home buyer products, in addition to funding purchase of a property, specifically focus on the cash flow and affordability needs of borrowers. First home buyers are borrowers who are in the market for the first time, probably at the beginning of their careers and with average or below average family income. Consequently, first home loan buyers are typically characterised as being primarily driven by competitive rates and fees, looking for simple “no frills” products, very happy to receive any additional advice and, compared to other types of borrowers, place higher significance on a need to trust the organisation that is providing the service. It is commonly accepted that BHLs and Introductory home loans are the best fit for this category of borrowers.

Subsequent owner-occupier home buyers are much more difficult to categorise and their needs will depend on their stage in the customer life cycle. For example, young professionals who have recently purchased their first home and then sold it to move to another area will be extremely similar to first home buyers. However, more experienced professionals who have paid off their first home and now intend to rent it and are looking for new home to live in, will most probably be more inclined to consider a more flexible home loan such as an Offset or LOC home loan.

5.2 Investment Home Loans

Investment home lending borrowers are home buyers who are purchasing housing property for investment purposes. These are generally better-off borrowers who already have owner-occupied property. That, of course, may not always be the case as they may be people who rent and decide to buy a property for investment purposes.

Generally, in Australia, all home loan products are allowed to be used for both owner-occupation and investment purposes. The major difference between investment and owner-occupier borrowers is that investors are solely focused on expected capital gains and are happy not to repay the home loan in full until the time they sell the property. Therefore, it is generally accepted that the most suitable product for these borrowers are

IO home loan products, in particular IO fixed rate home loans with interest payable annually in advance.

5.3 Construction Home Loans

A Building In Course Of Erection (BICOE) loan is available to borrowers who require funds to build a property on vacant land. BICOE loans are progressively drawn down at each stage of building construction after receipt of the relevant construction invoices by the lender. These loans are generally available for all types of home loans, with the exception of low-documentation loans.

Table 5: Major Features of Construction Home Loans: Top Five Australian Banks

FEATURE/BANKS	ANZ	CBA	National Australia Bank	St George Bank	Westpac
Application Fees	$500	Between $450 and $600	$600	Between $600 and $750	Between $600 and $750
Ongoing Fees	Between $0 and $5 monthly	Between $0 and $12 monthly	Between $0 and $15 monthly Excluding: $250 Annually for Flexiplus (NAB's LOC)	Between $0 and $14 monthly	Between $8 and $10 monthly Excluding: $199 Annually for 100% Offset
Fees for Progress Draws	$250 once off fee payable only on construction loans that are progressively drawn (regardless of number of progress draws). Payable at first draw down. Does not apply to LOC products.	$50 per progress payment	Nil	$250 for contract builders and $350 for owner builders with an additional progress payment fee for owner builders of $50 for every draw down after the first 6 advances.	$300
Fees to Convert to Other Products	$200 for a non credit critical change or $350 for a credit critical change.	$300 Switch Fee	On a case by case basis	$350.00	Between $8 and $10 monthly Excluding: $199 Annually for 100% Offset
Interest Only (IO)	Yes	Yes	No	Yes	Yes
P&I	Yes	Yes	Yes	Yes	Yes
Owner Builder	Up to 80% of land value only.	Not accepted	On a case by case basis	Max LVR on owner builders is 75% based upon land value + costs to complete.Customer must complete cost estimate worksheet inconjunction with normal application.	Max LVR 60%

Source: Extracted from CANNEX database, June 2008.

5.4 Re-finance Home Loans

Re-financers generally represent much more experienced borrowers, looking for competitive functional offerings. They require excellent service and very functional products that can satisfy a wide spectrum of financial needs. Price generally is not the deciding point for these borrowers, however it plays an important role. Therefore, a combination of competitive prices, value-added product offerings and timely communication is the mix that will be successful with these borrowers. In Australia, this borrower segment is almost completely controlled by major banks and its needs primarily fulfilled through various financial packages.

5.5 Up-grader Home Loans

Up-graders are defined as value-adding existing borrowers who are looking for further opportunities and have increasing needs for broader spectrum of financial services. Depending on their stage of the life cycle, borrowers' needs will change and thus different home loans might become more suitable. For example, first home buyers after several years of maintaining a BHL or Introductory home loan and with an increase in their accessible income will most probably look for more functional products such as Offset and LOC home loans via stand-alone offerings or through various financial packages.

These borrowers typically require full flexibility, such as being able to increase the loan amount, make extra repayments and have the funds accessible whenever they want without being excessively charged for it. Being in that mind set, it is not surprising that they generally also require full portability. The Council on Financial Competition (2004c) study indicated that there are several triggers which set borrowers on this path, the more relevant ones being the birth of children, professional promotion, marriage and divorce.

6. Home Loan Products by Distribution Segment

The importance of this classification lies in the fact that choice of the particular home loan distribution channel (i.e. means used to deliver the product to the borrower) significantly influences the costs of providing home loans. As borrowers continue to demand increasing accessibility and better service quality, home loan providers must continue developing, among other things, more convenient and efficient channels of service delivery. The widening distribution network that now serves the home loan market with such a broad base of opportunity is reflected in an encroaching commodity based philosophy of the product. This is expected to continue at an even more rapid pace in the future as electronic means continue to diminish the need for borrower-lender interactions.

Home loan distribution can be done either via a direct channel or indirectly via a third party channel. The direct channel, as its name states, involves direct distribution to borrowers by the providers of credit, while the third party distribution channel implies distribution via intermediaries, such as brokers and introducers.

Previously, different distribution channels were serviced by exclusive home loan offers. Nevertheless, in the last decade, due to technological advances and increased competition, all channels become capable of handling all home loans on offer. Therefore, instead of focusing on providing different home loan products via different channels, lenders have instituted differential pricing strategies for different channels. According to the Council on Financial Competition (2004b) research younger borrowers tend to be more receptive to alternative distribution means, while mature borrowers tend to be less receptive[71]. Furthermore, there are strong indications that the shift toward an emphasis on alternative delivery means may prove beneficial to both lenders and borrowers. While the increasingly competitive environment is viewed as

71 Alternative distribution means refer to means other than branch distribution, such as telephone, Internet, etc.

the dominant driver behind lenders' development of alternative delivery means, at the same time they provide significant cost benefits to lenders[72].

6.1 The Direct Channel

The direct channel represents a combination of traditional and contemporary distribution means (such as branch network, mobile sales force and, recently, telephone and Internet), where the lenders are directly in charge of the distribution. Lenders have traditionally placed the branch at the centre of their home loan businesses. Historically, other means and channels were developed with the primary aim to support, rather than replace, branches. Even the organisational structure previously adopted by banks, and to some extent in place even today, reflects the underlying assertion that branches were a central driver of product distribution. Whereas in the past the bank branch was the dominant, if not the only, distribution network for selling home loans, currently a number of different networks are increasingly used and continue to erode the branch's dominance. The cost of a branch-staffed network is substantial and the subject of ongoing debate and attempted rationalisation. The response of most banks has been either to cut branch costs by reducing the number of branches or to explore more direct processing costs for home loans.

Research conducted by Mintel (2004) indicated that while branch network personnel cost accounted for nearly two thirds of the total home loan distribution cost, it only contributed to 47 per cent of the new home loan business[73]. This is significantly less than previously thought and reflects low cost efficiency and the real inroads that other distribution options have made. Compared to branch distribution, even with the

72 The cost of processing the average home loan application through a teller is significantly more expensive when compared to processing the same transaction through alternative means.

73 Mintel is an industry-leading market intelligence company, focusing on consumer behaviour, product innovation and competitive marketing strategies.

addition of transportation and other mobile lending costs (such as laptop facilities, mobile phones etc.), the bank's mobile lender distribution represents a significantly cheaper distribution option. Therefore, it is not at all surprising that many lenders have been keen to embrace this distribution option.

As banks move away from a conventional branch-based retail banking framework towards the utilisation of alternative delivery options, the importance of telephone banking becomes increasingly evident. Whereas former telephone banking services offered little more than borrower inquiry services, current tele-banking centres provide round-the-clock account and product access. Banks that provide telephone banking services typically offer a full range of home loan products through their tele-banking centres. Lending over the phone is a way to counter problems such as excessive bureaucracy, extended borrower wait times, long loan approval procedures and inconsistencies in borrower interactions. These days, borrowers can apply for a loan via the telephone and receive a preliminary decision in minutes. Nevertheless, it is important to note that lenders still rely on the mail or a branch visit to complete the loan fulfilment.

6.2 The Third Party Channel

The concept of third party selling has evolved from the more traditional "brokers" to include "introducers", such as accountants and real estate agents. As already mentioned, at the early stage of development of this distribution segment, providers of home loans attempted to develop and use special home loan offers for this channel. These early offers, compared to the direct distribution channel, were generally characterised by lower functionality. This was purposely done by lenders trying to limit their risk exposure, as the segment as whole was viewed as having significantly higher risk associated with it. The perception of higher risk exposure primarily arose because providers of the credit were without full control of the whole lending process. However, attempts to limit the product's availability were unsuccessful, mainly due to ever-increasing competition in the home loan market and the enormous increase in the importance of the third party home loan market. Currently, home loans offered through the third party home loan distribution channel are the same as those offered through the direct distribution channel.

The Council on Financial Competition (2006a) has found that the home loan broker distribution channel in Australia and New Zealand has been the fastest-growing distribution channel, accounting for approximately 30 per cent of loan volumes in both markets in mid-2006. In Australia estate agents, life assurance companies, and financial advisors belong to a group called "introducers", who only perform referral services and for that charge a referral fee[74].

Compared to introducers, brokers additionally offer benefits to borrowers in the form of limited advice and processing of the application. The majority of financial institutions that provide home lending believe the home loan broker market, in Australia, will grow to account for 30 or 50 per cent of new home loan volume in the not-too-distant future. The major reason for this view is that most market participants agree that there is still an upside to the broker market, primarily because there is an increasing need for advice (due to the increasing complexity and multitude of home loan products offered), and because brokers are more readily available to prospective borrowers (typically a broker is contactable twenty-four hours a day, seven days a week, whereas a branch lender is available only during regular bank hours).

74 An example of a successful introducer scheme in Australia is Bank West who externally distribute home loan products through the Count Investment Service, which is an accountant advisory group with 450 firms spanning some 400,000 clients.

The importance of the channel is further confirmed by research conducted by the Council of Financial Competition (2005a), which found that loans originated through the broker channel tend to be slightly larger than home loans originated through the traditional direct channel. The same research also discussed payments to brokers for their services to lenders and specified that most banks in Australia pay between 0.65 and 0.70 per cent in up-front commission[75] and between 0.20 and 0.25 per cent for trail commission[76]. Being such an important segment it is not surprising that almost all lenders have claw-back clauses in their home loan broker agreements, which allow them to call back a portion of up-front commissions paid to brokers for loans, applicable to loans that churn[77] within 12 to 18 months of the origination date.

Yet another important fact relevant to recent development of the broker home loan market is that it is becoming increasingly regulated. Not surprisingly, most providers of home lending welcome regulation as a means of improving the quality of the broker service. Most banks have been actively involved through industry associations in pushing for accreditation and licensing of brokers. Considering, among other things, the current trend of ongoing instability on the financial markets, associated increased difficulty in obtaining credit (both lenders and individual borrowers) and relative increase in lenders' cost of funds, slow down in economic activity, rise in unemployment, falling interest rates and house values, and reduced demand for home financing, most lenders believe that the broker market will become more competitive and regulated. This should have a positive impact on the quality of loans and services provided by this distribution channel.

75 Payable at the time of the home loan settlement as a percentage of the total loan amount.

76 Typically payable monthly as a percentage of the total loan amount owed.

77 Move somewhere else, normally to another lender.

7. Home Loan Products by Interest Rate Repayment Structure

With respect to the interest rate repayment structure, all home loans can be viewed as having either IO or P&I repayment structures. Currently, a large number of Australian home lenders, including the four major banks, offer both IO and P&I products, primarily as a part of their FRHL, LOC, BHL and SVRHL products. Generally, IO periods don’t exceed five years, excluding LOC home loans.

7.1 Interest Only (IO) Home Loans

In general, IO functionality attracts a niche segment as IO borrowers are typically more astute investors. The principal target market for the typical IO product is represented by property investors who wish to maximise their negative gearing with a competitive “no frills” IO loan, either variable or fixed rate. Not surprisingly, some owner-occupiers also demand the product, as it provides a competitive loan option and the ability to preserve principal repayments as extra cash for other purposes.

As of the last few years, and primarily due to increased competition, most home loan providers do not charge a premium for the IO feature. Currently in Australia, the exceptions to this are HomeSide, ING and Westpac whose IO products’ interest rates are priced at the top of the relevant home loan product category.

7.2 Principal and Interest (P&I) Home Loans

The major characteristic of P&I home loans is that their repayment structure is comprised of two elements, namely interest payment and repayment of a portion of the principal debt. Therefore, compared to IO loans, P&I loans are amortised over time and are, eventually, depending on the loan term, expected to be repaid in full.

8. Home Loan Products by Conformation Status

From the point of view of conformation status, all home lending can be divided into conforming (prime) lending, and non-conforming (sub-prime) lending. This classification is primarily based on loan processing and the risk faced by the providers of credit.

8.1 Conforming (Prime) Home Loans

Conforming (prime) lending borrowers are those who exhibit a risk of default that is characteristic for traditional lending borrowers and who can satisfy all standard home lending conditions. These conditions are explicitly discussed in previous sections of this paper.

8.2 Non-Conforming (Sub-Prime) Home Loans

The non-conforming (sub-prime) market is a relatively recent development and as such the market still does not have a standardised definition. The author believes that the most comprehensive definition to date is that provided by the U.S. Federal Deposit Insurance Corporation, FDIC (Council on Financial Competition 2004a), which asserts that there are the following four categories by which a borrower is categorised as a sub-prime loans candidate:

- *"Borrower's credit history i.e. borrower's previous payment experiences, indicate substantial default risk,*
- *Monthly housing expenses of the borrower exceed 28 percent of pre-tax monthly income and housing expenses plus other loan payments exceed 36 percent of pre-tax income for prime borrowers,*
- *Borrower's income level is under stress i.e. prime home loan borrowers do not earn a sufficient amount of income for them to make their home loan payment.*

One portion of the sub-prime home loan market, known as 'low doc' or ‘no doc’ market, involves the extension of credit to those who cannot or do not provide evidence documenting the borrower’s ability with pay stubs, tax records and other financial documents, and

- *Terms of the loan for rated borrowers are not met. For example, lenders typically lend no more than 80 percent of the home’s value unless the homeowner also purchases private home loan insurance. Home loans with loan-to-value ratios higher than 80 percent that do not have home loan insurance or other type of credit enhancement are often rated sub-prime.”*

Non-conforming lending can be subdivided according to the level of non-conformance into the categories of “impaired credit” and “mild non-conforming”. The first category, impaired credit, refers to the term used to describe people with a history of credit problems such as court judgments, arrears and bankruptcy. The other category is the so-called mild non-conforming category, where the term is used to describe borrowers who may not have an adverse credit history but whose financial circumstances make it difficult for them to get credit. The mild non-conforming category will primarily apply to borrowers who are self-employed, experience uneven cash flows, have difficulty in separating their personal and business cash flows, or who don’t have up-to-date financial statements. It is important to note that the literature regarding this topic is still underdeveloped and both terms are frequently used to straddle both categories.

Impaired credit borrowers would generally be offered only a limited number of less functional products at higher interest rates. The interest rate premium charged depends on the level of credit impairment. This is the case because the financial institutions providing the credit would look to compensate themselves for an increased level of risk. On the other hand, mild non-conforming lending generally refers to a credit application procedure targeted at self-employed people or business operators who have income and assets, but do not have available the normal financial documentation required at the time of application[78]. This product group is thus designed to target creditworthy applicants, i.e. although not fully conforming, it is in no way designed to accommodate impaired credit borrowers.

Table 6: HomeSide's Plain & Simple Product Features

Feature	Characteristic
Loan Type	Plain & Simple: P&I and IO
Purpose	Residential & Investment
Application Fee	$600
Interest Rate	90bps above Plain & Simple variable rate Loan reviewed after 2 years – if applicant has met loan terms and criteria, the loan will revert to Standard Variable rate of the day.
LVR	Less than 80 per cent in metropolitan areas Less than 70 per cent in regional areas
Mortgage Insurance	LMI not required.
Valuations	Full valuation required for LVR higher than 65 per cent Kerbside (visiting the property by the accredited valuer) for LVR less than 65 per cent
Documentation Requirements	The following documentation requirements are mandatory: - Signed Customer Certification Form confirming prospective borrowers' income and ability to service the loan, - Confirmation from accountant of borrowers' ability to service loan. Confirmation will be via letter from accountant (on company letterhead) or preformatted form provided by HomeSide, and - Loan statements from current or recent (last 12 months) home loans are required and must demonstrate customers' ability to satisfactorily service an existing or recent home loan.
Type of Security	Loan security must be one or more single residential dwellings, either owner occupied or investment and must be located in a capital city metro or major regional centre as per current policy. Inner city policy is to apply.
Borrower Eligibility	Borrower must be self-employed or employed in job for at least 2 years. Borrower & Mortgagor must be identical – no guarantees or third party loans allowed except where the guarantor is a spouse/partner or de-facto of the applicant. Borrower Certification must be completed. Borrower not to be first home buyer. Borrower must have a clear Credit Enquiry Check.

Source: www.national.com.au.

To be more specific, this functionality is typically available on certain products, as an added functionality, rather than being a product in itself. For example, NAB offers a low-documentation product as an added functionality to the following home loan products: SVRHL, 100 % Offset, FRHLs and FlexiPlus home loan. Eligible applicants must meet all the qualifying criteria, except the normal requirement to provide a full set

78 Also referred to as prescribed verifiable financial statements, such as a group certificate and a payslip.

of documents. For these loans, the total of all aggregate lending facilities typically cannot exceed a LVR of 80 per cent. For example, HomeSide's version of a BHL low-documentation product is their Plain and Simple Home Loan which comes with an optional low-documentation feature, and is only offered through the broker channel. The major characteristics of the product are illustrated in Table 6.

The possibility that borrowers may take an advantage of this product to gain lending while avoiding declaring their true tax/financial position is a significant concern for lenders. To avoid this, almost all lenders insist that at least one of the applicants for the low-documentation loan must be self employed[79] and must hold a current Australian Business Number (ABN).The following factors are most commonly quoted as factors that have contributed to the growth of sub-prime lending in the last decade: increased competition; relaxation of regulations; better risk analysis tools (such as credit scoring[80]), and improved technology, such as online services and telecommunications.

It is important to note that as a result of the current global financial crisis, most of above mentioned factors are currently being re-examined (eg risk analysis techniques used, regulatory regime, funding arrangements, etc). Consequently, at least in the short run, the importance of sub-prime lending will significantly decrease.

79 Self-employed applicants can be a sole proprietor, or partner in a partnership, or shareholder, director and/or company secretary of a private company.

80 Credit scoring is a risk assessment that establishes the probability that an account will remain, or return to, a satisfactory condition.

8. Conclusion

The primary objectives of this paper were to: (i) briefly explore major reasons for recent proliferation in a number of home loan products offered in Australia, (ii) classify and provide a detailed account of various contemporary home loan product classes and groups, and (iii) serve as a background study for further structured research in the field. After reviewing home loan products from a number of different viewpoints, it is seen in this paper that different home loan products have a number of varying functionalities. Moreover, home loan markets and products differ markedly from region to region and country to country. For example, home loan markets in different countries have different home loan products, foreclosure laws and down payment requirements often significantly differ from country to country, and interest rate payments are not always tax deductible. To illustrate, the spectrum of differences in home lending markets in different countries, Tables 6 and 7 summarise the major peculiarities of home lending markets in selected Asian and European countries.

An interesting development, over recent years, is that an increasing trend towards home loan commoditisation and ever-increasing competition has created a home loan market that is increasingly a buyer's market. As a result, home loan lenders are working hard to develop increasingly sophisticated products to meet the needs of increasingly demanding borrowers. These products may include features that reduce/remove so-called "hassle factors", such as shorter approval and closing times, reduced paperwork, easy transfers, price discounts, adjustable-rate schedules, and more convenient forms of delivery. Because each home loan category is having somewhat different functionalities, most home loan product classes and groups are priced from a different COF base, generate diverse lender risk exposures and have different product development and maintenance costs. Typically, with the increase in gross margin and the level of sophistication comes an increase in costs associated with the product. Nevertheless, the increase in costs is generally of a lesser magnitude than the increase in the lender's margin.

Table 7: Major Characteristics of Home Loan Markets in Selected Countries in Asia Pacific

Australia	- Interest on home loans is not tax deductible - Lines of credit and flexible mortgages available
China & Hong Kong	- Interest on home loans is tax deductible. - In 2001, down payments could be as high as 30 per cent. - In 2003, People's Bank of China recommended minimum down payment thresholds of 20 per cent for first home purchase and that the reserve bank increases the down-payment requirements for luxury housing from 20 per cent to fifty per cent, in order to reduce property speculation on the mainland.
Japan	- Home loan interest is not tax deductible, new homebuyers receive a tax credit for six years. - Customary down payment of 10 per cent. - Fixed rate home loans of 3, 5, 7, and 10 years are available; borrowers then have the option to select another fixed rate at current market interest rates or select a floating rate.
Malaysia	- Interest payments are not tax deductible. - A May 2003 promotion, the Meda 48 Incentive Plan, allows buyers to pay a 10 per cent down payment and the remaining 90 per cent in 48 instalments over four years with no interest charges.
Pakistan	- In June 2003, Shaukat Aziz, Federal Minister for Finance, proposed that all profit or interest on home loans be an allowable income tax deduction. - Interest payments up to a set level (Rs. 100,000) are tax deductible. - Down payments for builders are approximately 40 per cent.
Singapore	- Down payments generally 20 per cent; in 2002, the government began allowing down payments of 10 per cent.
Thailand	- Standard tax credit (Bt 50,000) for home loan owners. - Bank of Asia is offering three home loan options for potential homebuyers: first two years at a fixed 2 per cent, the first three years at a fixed 3 per cent, or the first five years at a fixed 4.25 per cent. - Siam City Bank is allowing homebuyers to pay the down payment in instalments for three years. If clients can pay it back, it will offer them a home loan at a special interest rate. - Government Housing Bank offered a down payment period for up to 18 months without charging interest; typically 10 per cent of the total price.

Source: Council on Financial Competition (2003a).

Table 8: Major Characteristics of Home Loan Markets in Selected Countries in Europe

Denmark	- Offers 10-30 year fixed rate home loans. - Only country in the world (other than U.S.) where consumers can fix their home loans at loan origination for the life of the loan and refinance or cancel without any penalties. - All home loan lending is financed through the issuance of home loan backed bonds (MBBs) that are listed on the Copenhagen stock exchange.
France	- Home loan interest is tax deductible. - 30-40 per cent typical down payment. - Fifteen-year, fixed rate loan is most common home loan. - Investors rely more on credit reputation and capacity to pay rather than collateral value of the property. - Prepayment penalties are waived only if a property is sold as the result of the borrower losing a spouse, unemployment or employment related relocation.
Germany	- Home loan interest is not tax deductible. - Down payment is typically 35 to 40 per cent. - Fixed rate terms available for periods from 1-10 years; prepayment prohibited for fixed term home loans. - Common practice for lenders to charge a yield maintenance fee in association with early redemption on fixed rate home loans. - Low overall homeownership rate (40 per cent).
Italy	- Home loan interest is tax deductible for first time home buyers. - Average down payment of 50 per cent. - Typical duration of loan is 10-15 years. Main types are reference and fixed rate home loans.
Netherlands	- Home loan interest is tax deductible. - Home loans usually have a maturity of 30-years with the interest rate fixed for a period of between 5 and 20-years. At the end of each fixed rate period the home loan rate is re-set to the market rate. - Closing costs are approximately 25 per cent of the price. These are composed of a value added tax of 17.5 per cent legal transfer costs of 6 per cent, real estate agent fees of 1.5-2.5 per cent and notary fees of 1.5 per cent. - Prepayment penalties exist, but are not significant.
Ukraine	- Down payments of up to 30 per cent. - Most banks offer 5-10 year home loans. Some banks offer promotional 30 year, inflation adjusted fixed rate home loans.
United Kingdom	- Average down payment for a first time house buyer is 13 per cent. - Reviewable rate home loans are dominant (whenever market rates change, the home loan company reviews the borrower's interest rate and decides whether to impose a new one). - Different types of loans include buy-to-let loans, flexible home loans, and current account home loans price.

Source: Council on Financial Competition (2003a).

Research conducted by the Council of Financial Competition (2004b) showed that instead of the situation of the past, when the banking industry invested heavily in borrower risk management technology to strengthen cross-sales success, these days banks are concentrating on their distribution channels and product packages to improve the borrower experience. Consequently, contemporary lenders are increasingly developing flexible, relationship-based product bundles, which combine current accounts, savings, other loans, and home loan products that grow with their borrowers. It is commonly accepted that the most successful financial institutions are those which meet and exceed borrowers' expectations in terms of accessibility, personalisation and innovation in product and service development, bundling and distribution.

Presently the author sees the following areas as possibilities for the further research in the field: the way contemporary lenders price their home loans; key differences between Basel I[81] and Basel II[82] and impacts of the implementation of Basel II on home loan interest rates; a critical overview of home loan related specific and statistical credit loss provisioning methodologies; the United States sub-prime lending crisis and its impact on home loan funding, funding costs, risk assessment and lending interest rates; an analysis of home loan pricing strategies currently utilised by home loan providers in Australia; and an empirical testing of the presence of seasonality and cyclicality in Australian home loan interest rates.

81 Basel I is the term which refers to an accord defining a set of minimal capital requirements for banks. The accord was issued in 1988 by the Bank for International Settlements (BIS), hence it is also known as the 1988 Basel Accord. The 1988 Basel Accord provided a global methodology and capital ratio, primarily focusing on eligible capital, on-balance sheet credit risk, off-balance sheet credit risk and, in a later version, market risk. For more details on Basel II reefer to www.bis.org.

82 The main purpose of Basel II is to update the original international bank capital accord (Basel I). In doing so Basel II primarily aims to improve the consistency of capital regulations internationally, make regulatory capital more risk sensitive, and promote enhanced risk-management practices among large, internationally active banking organisations. For more details on Basel II reefer to www.bis.org.

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