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# Australian residential housing and mortgages



# CBA mortgage book secure



**Commonwealth**Bank



9 September 2010

Commonwealth Bank of Australia ACN 123 123 124

# Overview

- ❑ Concerns of a potential residential housing price bubble in Australia are often based on a superficial/incomplete analysis of the Australian market.
- ❑ Taking into account geographic differences, the ratio of house prices to income in Australia is not that much different to most other comparable countries.
- ❑ Population growth and excess demand relative to supply has been a key driver of Australian house price appreciation – these factors are unlikely to reverse in the near term.
- ❑ Other factors driving house price appreciation are structural, rather than cyclical, in nature, including the broader accessibility of credit and larger average house sizes.
- ❑ The household debt ratio in Australia is similar to many other developed countries, and debt increases have largely been taken up by customers in the strongest position to service it.
- ❑ The strong fundamentals of the Australian economy provide a firm underpinning to the housing market, reducing the risk of a sudden and dramatic collapse in house prices.
- ❑ Historically, home loan losses have been very low notwithstanding house price movements, reflecting strong portfolio credit quality.
- ❑ Given the high quality of the CBA mortgage book, even under the most highly stressed scenario, potential losses would be modest (~0.2% of total home loan balances).



# Concerns of a housing bubble are often based on a superficial/incomplete analysis of the Australian market

## Commentary

### **Morgan Stanley, August 2010**

“In my view, Australian house prices are expensive on every value metric, they are expensive relative to history and expensive relative to houses in comparable countries”

### **Jeremy Grantham, GMO, June 2010**

He said that ...Australia had an unmistakable housing bubble and that prices would need to come down by 42 per cent to return to the long-term trend. "You cannot possibly miss it," he said. "The price of housing typically trades about 3.5 times of family income and in bubble it goes to 6 or . . . 7.5 (times). "Australia is having one now. You are at near 7.5 times family income . . . which suggests you are twice the size that you should be.”

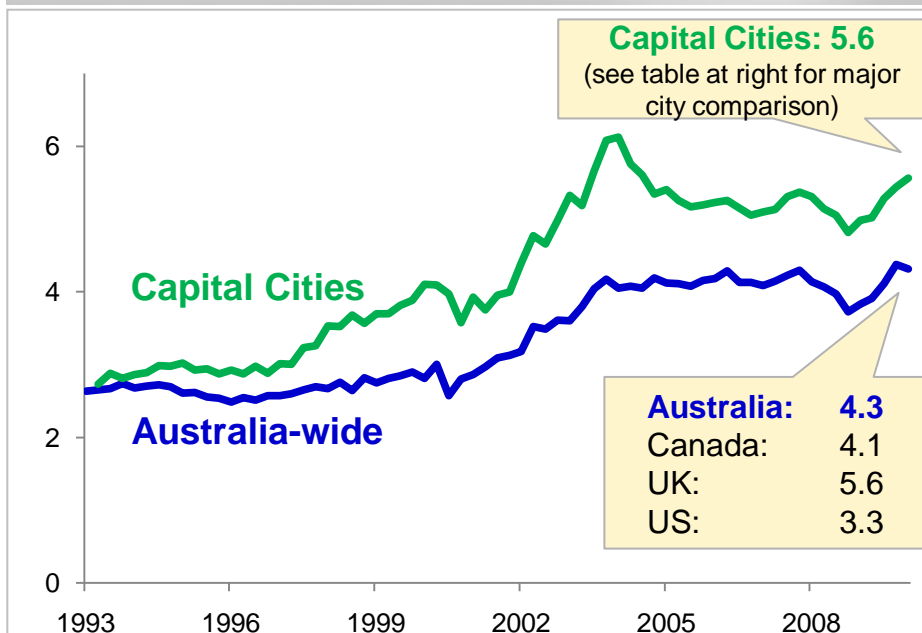
## Our View

- ❑ Australia's house-price-to-income ratio is 4.3, similar to many other countries (slide 4)
- ❑ Australia's capital city house price to income ratio of 5.6 is comparable with coastal city metrics globally (slide 4)
- ❑ Whilst this ratio has trended higher over time, a large component of the uplift is driven by structural factors (slides 5, 6) and is unlikely to reverse



# Taking into account geographic differences, Australian house prices are similar to other countries

## Ratio of house prices to income



Source : RP Data/CBA/ABS; UBS

## Coastal city comparison

		House Price to Income
Australia	Sydney	6.2
Australia	Melbourne	5.7
Australia	Brisbane	4.7
US	San Francisco	7.0
US	Los Angeles	5.7
US	New York	7.0
Canada	Vancouver	9.3
UK	Bristol-Bath	6.1
NZ	Auckland	6.7
NZ	Wellington	5.8

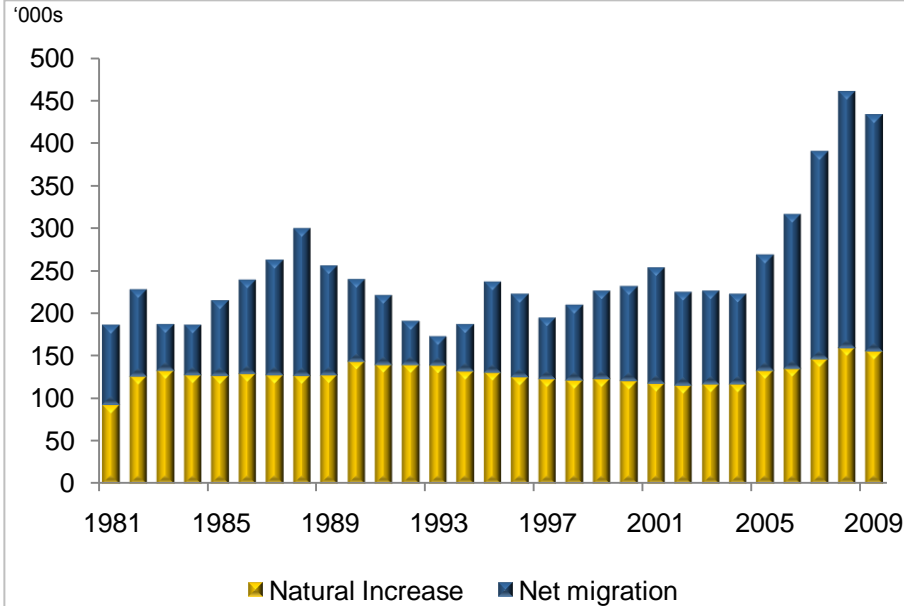
Source : Demographia; UBS

- Australia the 4<sup>th</sup> least densely settled country in the world – 83% live within 50 kms of the coast.
- Coastal locations demand a premium – Australia’s population concentration in capital/coastal cities distorts comparisons to other , more densely settled countries.
- Australia’s capital city house price to income ratio of 5.6 is consistent with coastal city metrics globally
- On a nation-wide basis, Australia’s house price to income ratio of 4.3 is “not that different to most other countries” *RBA Deputy Governor Battellino, June 2010.*



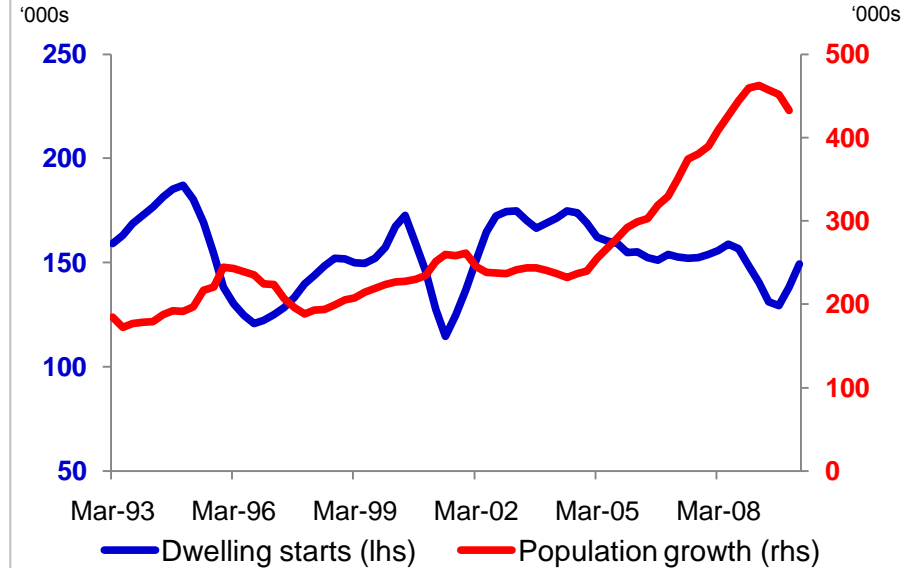
# Population growth has been a key driver of Australian house price appreciation

## Strong net migration



Source : ABS

## Population growth vs dwelling starts

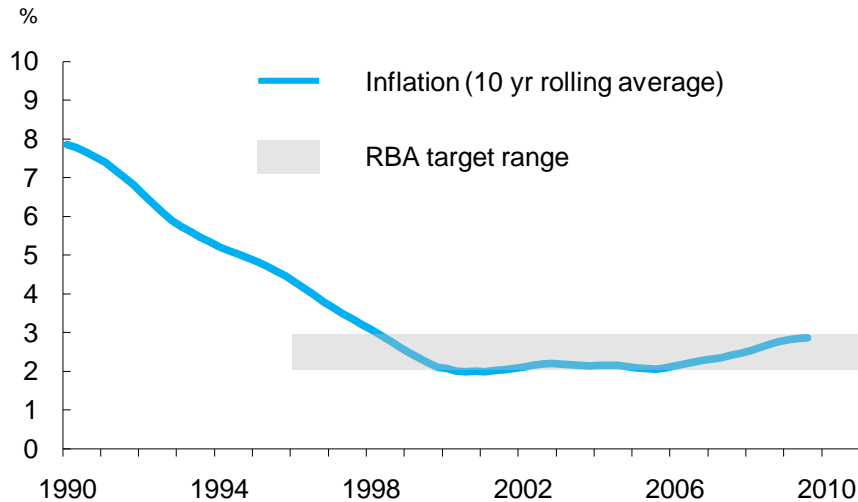


Source : ABS, CBA Economics. Dwelling starts relates to physical construction activity (all new housing)

- ❑ Australian population growth is running at ~2% pa, providing a firm underpinning to housing demand.
- ❑ Over recent years, net migration has trended in a range of between 150,000 and 300,000 pa.
- ❑ Structural under-supply of housing is reflected in gap between new dwelling starts and population growth.

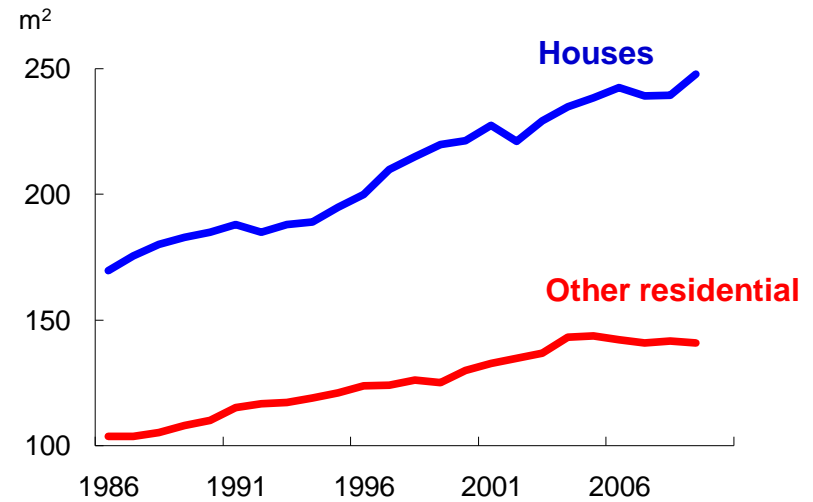
# Other drivers of house price appreciation are structural, rather than cyclical in nature

## Low inflationary environment



Source : ABS

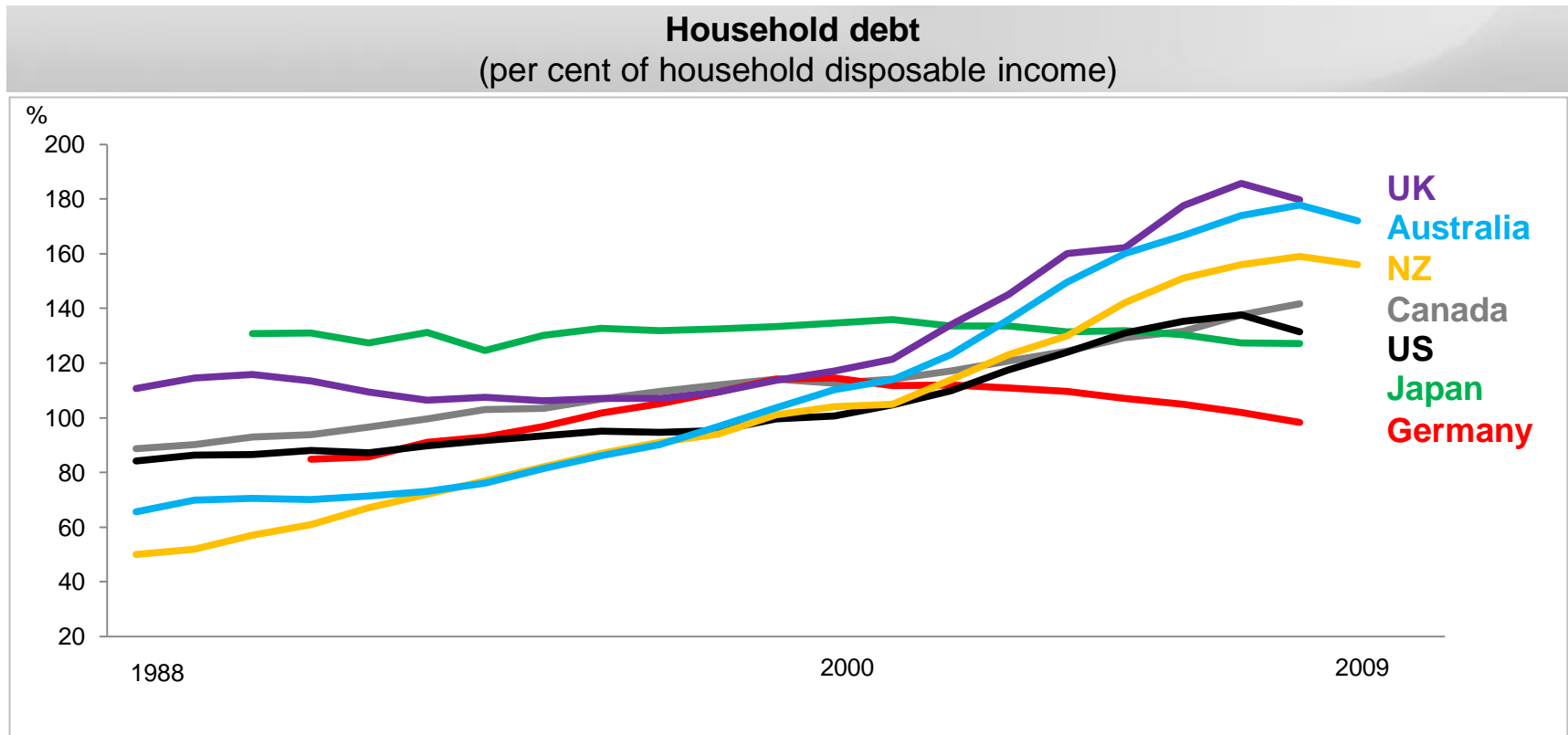
## Average dwelling size



Source : ABS

- ❑ Australia's low inflation/low interest rate environment has dramatically increased the demand for, and accessibility of credit.
- ❑ On RBA estimates, the reduction in mortgage rates during the 1990's expanded the potential housing market by 600,000 households. Absent a dramatic response from the supply side, a large part of the lift in valuation ratios is a permanent structural shift.
- ❑ Australia's propensity for larger sized homes has also contributed to valuation growth, with the average floor area for a new home now ~50% larger than in 1986.

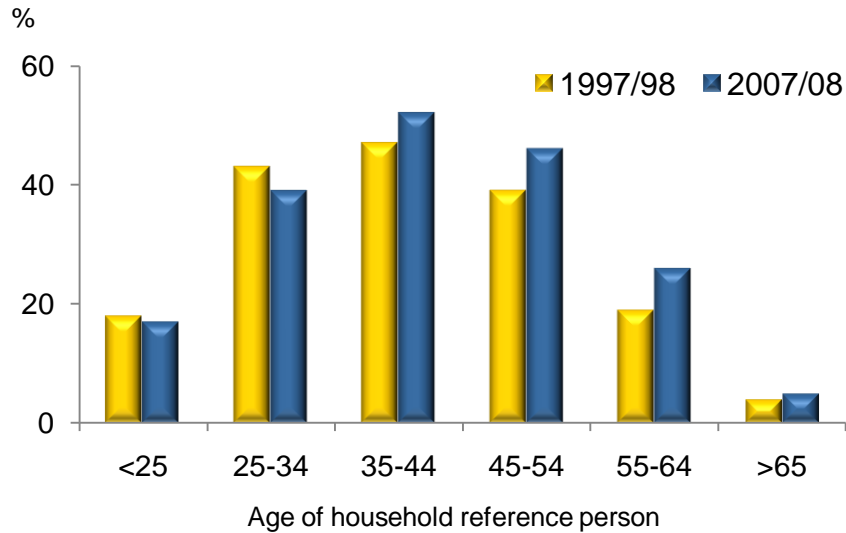
# The household debt ratio in Australia is similar to many other developed countries



❑ Australian household debt as a percentage of income similar to many other developed countries.

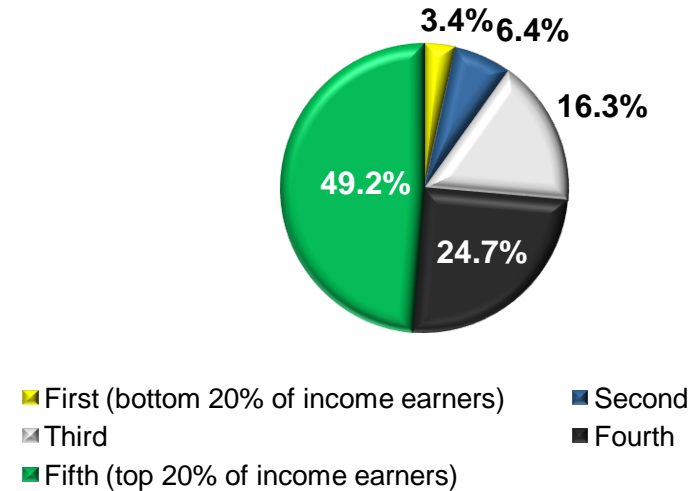
# Much of the increase in household debt has been taken up by segments in the strongest position to service it

## Households with owner-occupied debt



Source : CBA Economics

## Share of household debt by income



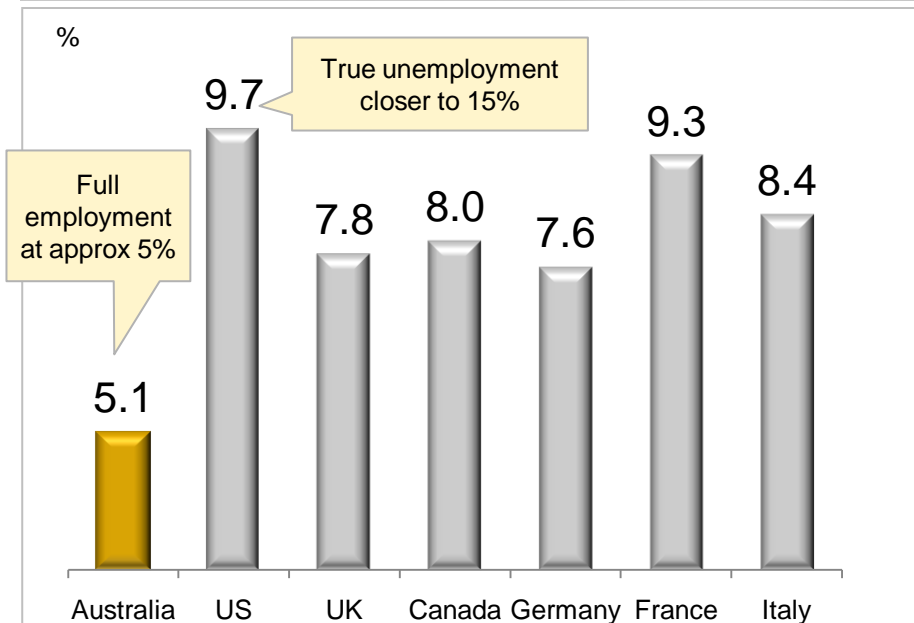
Source : HLDA Release 6.0; RBA

- Home ownership has been steady at ~70% for decades
- Owner-occupied debt increasingly in older age brackets
- Home ownership amongst <35 years trending lower (now <40%)
- 50% of household debt held by top 20% of income earners
- 75% of household debt held by top 40% of income earners



# Strong economic fundamentals minimise the downside risk to Australian house prices

## Unemployment



## GDP growth (pa)

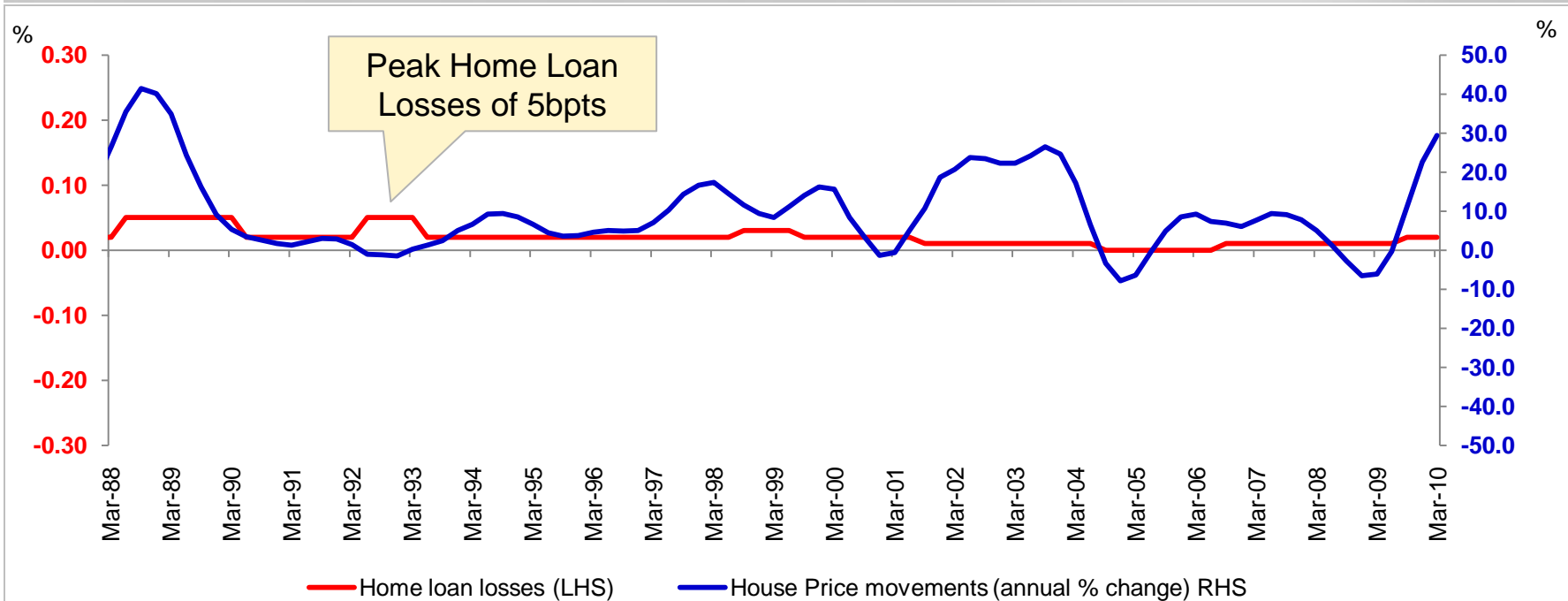
	10 Yr Avg	Forecast 2010-11
Asia	8.0	7.8
<b>Australia</b>	<b>3.1</b>	<b>3.4</b>
US	1.9	2.8
Japan	0.7	1.9
UK	1.7	1.7
Euro Zone	1.4	1.3

Source : ABS, IMF, Consensus Economics.

- Low inflationary, low interest rate environment
- Supportive labour market – low unemployment
- Strong GDP growth + favourable growth outlook (including strong links to Asia)
- Strong banking sector + sound regulatory regime

# Historically, home loan losses have been very low, notwithstanding cyclical house price movements

House prices movements vs Home loans losses (CBA)



Source : CBA Economics.

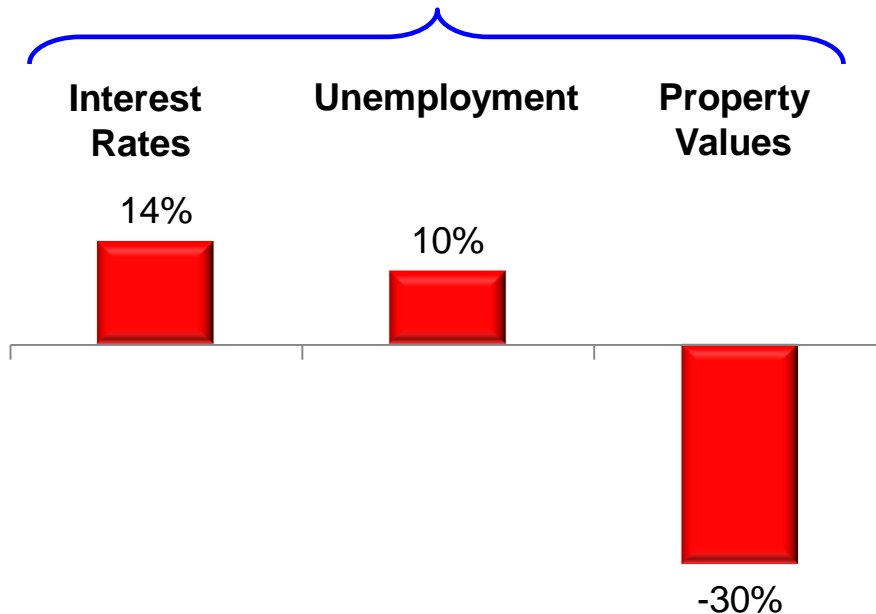
- ❑ Historical home loan losses have been very low, despite cyclical house price movements
- ❑ Strong portfolio credit quality a key driver of low loss rates
- ❑ Effective interest rate settings provide a natural dampening effect to cyclical changes



# Even under a high stress scenario, potential CBA home loan losses would be modest (\$740m or 0.2% of book)

High stress loss = \$740m  
(0.2% of book)\*

Based on 6x probability of default eg:



## Factors Mitigating Against Potential Losses

- ❑ Portfolio average LVR 43%
- ❑ Loans >80% LVR mortgage insured\*
- ❑ 70% of customers paying in advance (avg 9 payments)
- ❑ Rate buffer of 150 bpts built into serviceability tests
- ❑ Full recourse to borrower



\* Additional insured losses under high stress scenario of \$1.5bn (~0.5% of book)

# Appendix: Typical drivers of a housing bubble

Typical Drivers	Current Position
Increased housing stock leading to excess supply	Strong population growth; Demand > Supply
An influx of speculators/investors	Investment lending steady at ~30%
Strong volume growth driven by Relaxed lending standards	Already stringent standards tightened through GFC
Housing affordability issues	Ratio of house prices to income comparable to other countries, once geographic issues taken into account
Domestic economic shock – trigger for price correction	Australian economy well placed Close to full employment



# Appendix: Australia vs US

	CBA/Australia	United States
Unemployment	~5%	~10%
No-Recourse Lending	No	Yes
Variable vs Fixed	85%/15%	15%/85%
Adjustable Rate Loans	Nil/minimal	Widespread
Sub-Prime % (Mkt)	0%	~36% <sup>1</sup>
Securitisation %	~2%	~55%
Account Ownership	Retained by bank	Extensively on-sold



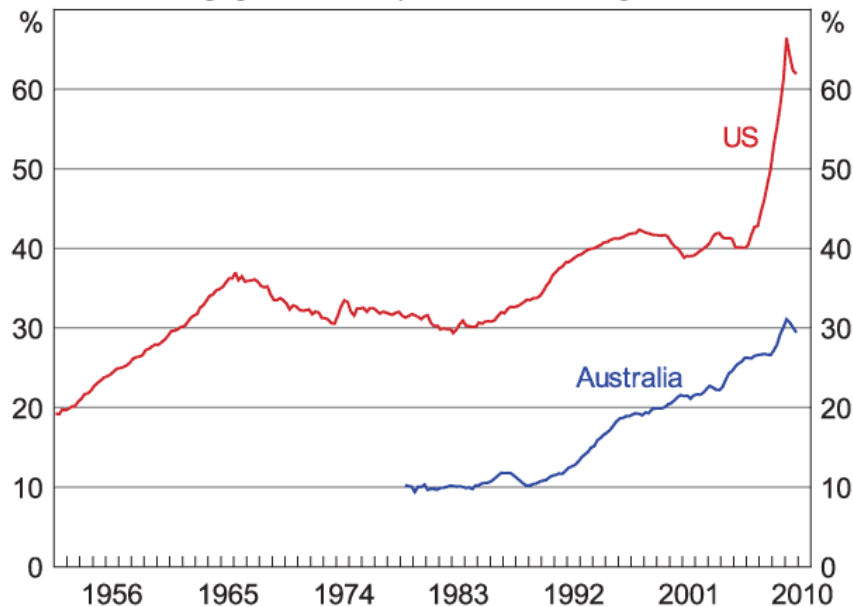
1. At peak in 2006. Source UBS

# Appendix: Household Wealth & Leverage

## Leverage to Housing Stock

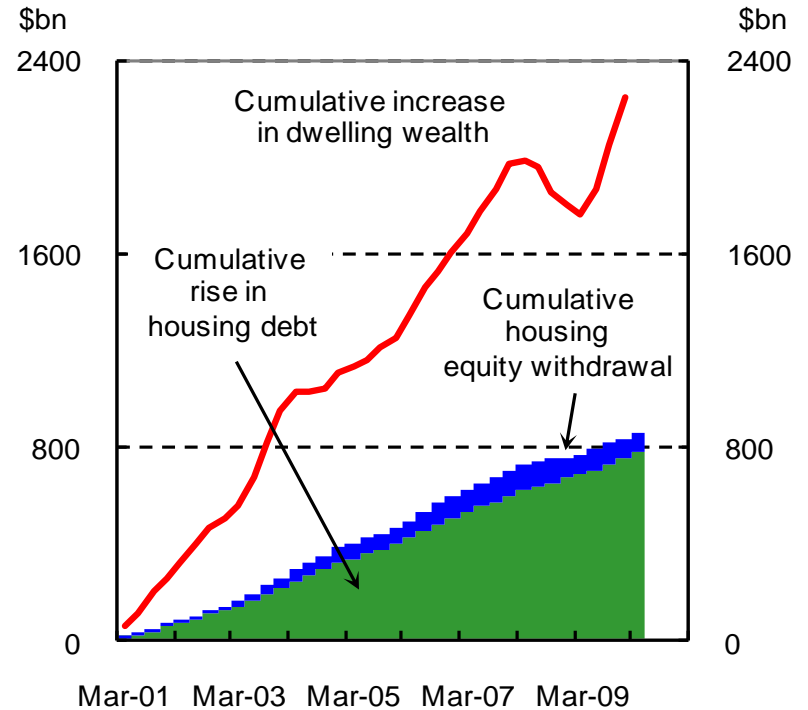
### Leverage on the Housing Stock

Mortgage debt as a per cent of housing assets



Sources: Board of Governors of the Federal Reserve System; RBA; Thomson Reuters

## Household Wealth

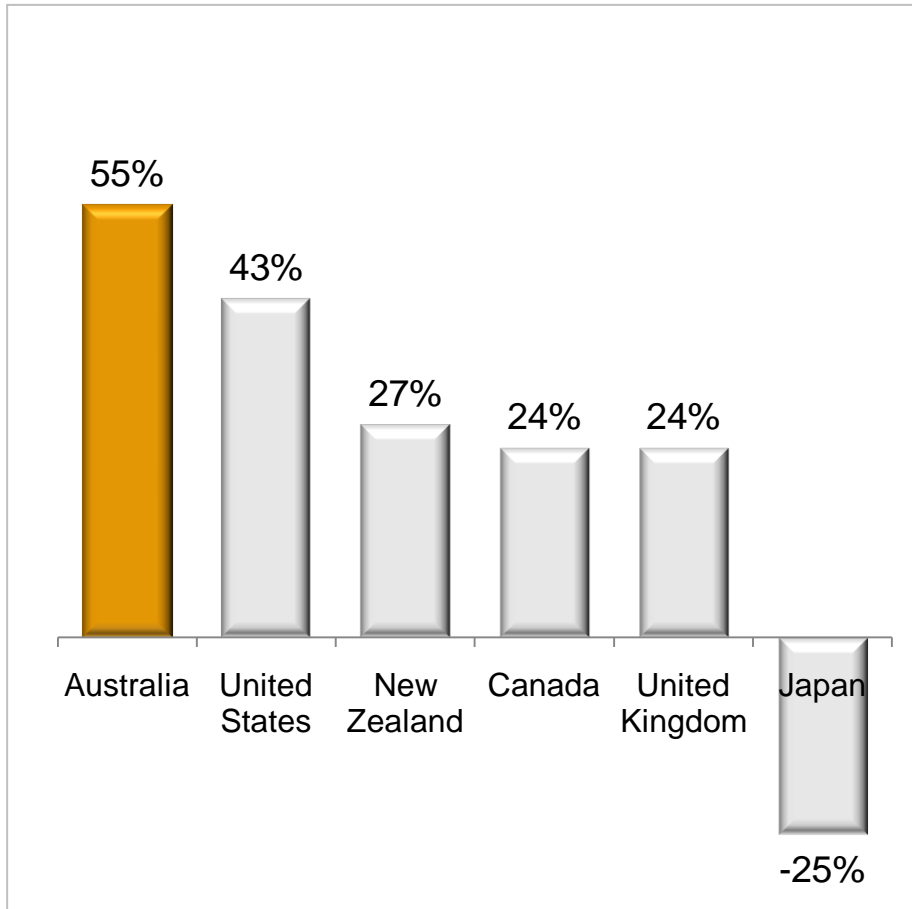


Source : CBA Economics.

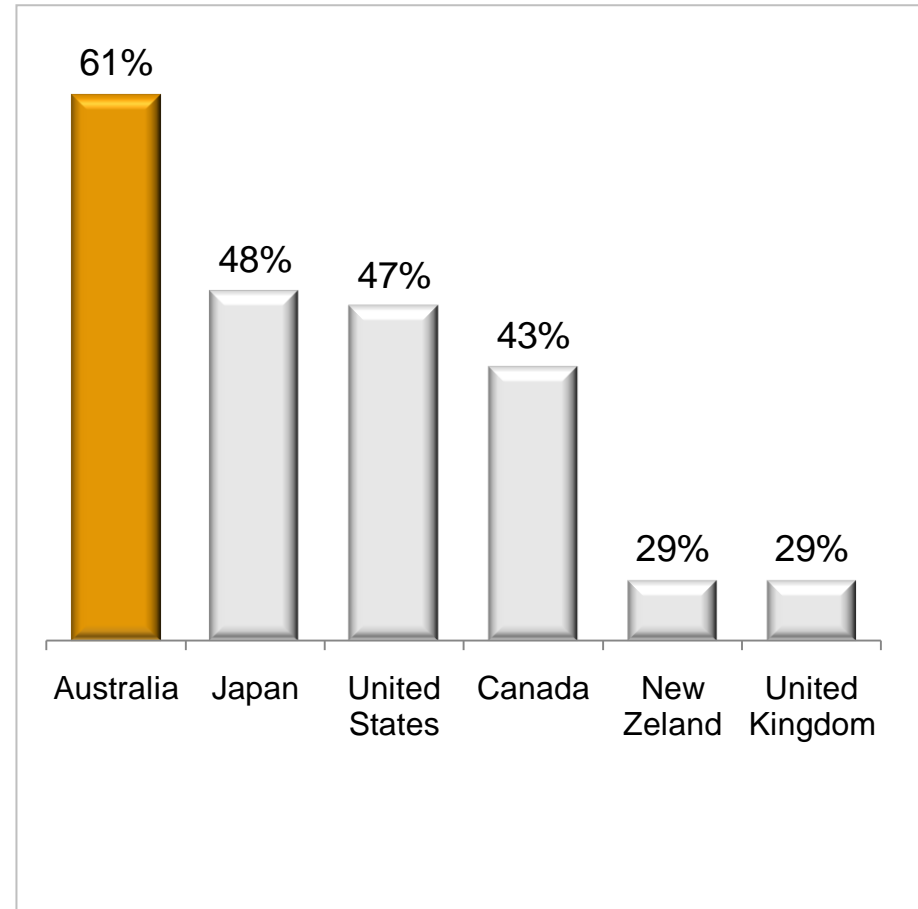


# Appendix: Population/Demographics

Projected population change  
2009-2050



Population living in Urban areas of  
greater than 750,000 persons



Source : PRB, Rismark

# Appendix: Genworth Financial

- ❑ APRA regulated
- ❑ AA- Credit Rating (S&P)
- ❑ Strong capital position:
  - APRA require domestic insurers to hold twice as much capital as offshore regulators
  - requirements met under even the most “extreme” stress scenarios (over-and-above CBA stress tests)
  - high quality liquid investments
- ❑ “Ring-fenced” from US parent
- ❑ Regular CBA review





# Disclaimer

The material that follows is a presentation of general background information about the Group's activities current at the date of the presentation, 9 September 2010. It is information given in summary form and does not purport to be complete. It is not intended to be relied upon as advice to investors or potential investors and does not take into account the investment objectives, financial situation or needs of any particular investor. These should be considered, with or without professional advice when deciding if an investment is appropriate.



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