The Smart Mortgage Broker's Guide to Household Living Expense Assessments

connective

Creating better customer outcomes

Even a borrower who enjoys a high income can experience financial stress.

As a broker, a key component of the service and advice you provide is ensuring that your customer can afford to repay their loan without substantial hardship. That's why making an accurate household living expenses (HLE) assessment is so important.

More than 53% of all home loans in Australia are written by brokers

This Household Expenses Assessment eBook is focused on helping you achieve a best practice outcome for your customers, every time.

Your obligations under NCCP

Responsible Lending is a provision of the National Consumer Credit Protection Act of 2009 (NCCP).

NCCP and Responsible Lending requires that all lenders and credit assistance providers (including brokers) ensure that consumers don't enter into credit contracts or leases that are 'unsuitable'. This is also an important part of the service you provide to your customers!

What are your Responsible Lending obligations?

1. Make **reasonable enquiries** about the consumer's financial situation, requirements and objectives.
2. Take **reasonable steps** to verify the consumer's financial situation.
3. Make a preliminary assessment to determine that the proposed credit contract or lease is '**not unsuitable**'.

What are "reasonable steps to verify"?

- Asking your customer to tell you what they spend every month.
- Obtaining documentation to evidence what they have told you.
- Checking carefully to verify the contents of the documents are correct.
- Checking the documentation to ensure it has not been altered or fraudulently created.

What does "not unsuitable" mean?

A credit contract will be unsuitable if it is:

- Unlikely the consumer will be able to comply with the terms and conditions.
- Likely to cause the consumer substantial financial hardship.
- Not likely to meet the consumer's requirements, needs and objectives.

Caution!

- Using industry benchmarks (i.e. Household Expenditure Measure/HEM) instead of making an actual living expenses assessment is not acceptable.
- If you habitually submit loan applications where the assessed Household Living Expenses (HLE) are less than HEM, be advised that lenders are collating this data and it may affect your accreditations.

What is a household living expense?

A household living expense could be just about anything a customer spends their money on (excluding fixed debt commitments).

They cover everything from their morning coffee to children's school fees. At Connective, we provide a Needs Analysis Questionnaire in Mercury with 13 comprehensive expense categories to ensure you don't miss anything. These categories are aligned to the standard 'LIXI' categories.

86% of Australians don't know how much money they spend every month.

Child care
Everything from formal day care costs for each child, to nannies and occasional babysitters.

Personal care
All clothing, footwear, cosmetics and personal hygiene products, hair dressing, manicures and massages etc.

Education
Educational costs/fees for themselves and any children, including books, uniforms, equipment and excursions.

Groceries
This includes meat, fruit, vegetables and anything else you might buy at a supermarket, like toilet paper and cleaning products.

Insurance
This includes all personal insurance like health, home and contents, life, income protection and pet insurance.

Medical
This section is specifically for health care costs like doctors, dental care, optical and pharmaceutical prescriptions.

Utilities/home expenses
Gas, water, electricity, rates, taxes and levies, and any other costs for running your own home.

Entertainment
Recreational expenditure like take-away food, dining out, movies, gifts, club memberships, pet care, holidays and hobbies.

Connections
Include expenses like mobile phone plans, pay or cable TV, internet, house phone, personal magazine subscriptions etc.

Transport
This section is for public transport costs, petrol, car registration, car insurance, car parking, car servicing and maintenance.

Rent
This is for rent on a property where you live, board (if you are living at your parent's home or renting a room), or similar housing costs.

Other
Any regular living expense which is not covered by the above categories.

Investment property expenses
Costs you are responsible for paying—council rates, property management fees, taxes and levies, body corporate/strata fees, maintenance etc.

Living Expenses Verification Webinar

Watch this short video from the Connective Compliance Team for guidance on how to identify and verify living expenses.

Bonus for Connective brokers!

The Mercury Compliance Wizard provides full compliance documentation at a click! You can also find out everything you need to know about NCCP, Responsible Lending and Lender/ Connective documentation requirements on Connective Wiki 24/7. Simply click the Wiki icon when you log in to Mercury.

Working with the customer

Understanding your customer's financial situation is vitally important. Depending on the customer, it may take a lot of work.

This process is just good customer service. Discovery is an essential part of building your relationship with your customer—as well as meeting your responsible lending obligations.

82% percent of Australian home owners don't know their mortgage interest rate.

Best-practice discovery process in four easy steps

1. **Send** the Needs Analysis Questionnaire to your customer and ask them to complete and return it with three months of bank transaction account statements and credit card statements, where applicable.
2. **Check** the amounts declared by the customer on the Needs Analysis against the amounts on the bank statements and credit card statements.
3. **Locate** any discrepancies, or expenditure on the statements which are not accounted for by the customer's Needs Analysis.
4. **Discuss** the Needs Analysis and any queries face-to-face with your customer.

How to conduct the interview

The Connective Best Practice Interview Guide aligns with the questions in the Needs Analysis. Follow this fully comprehensive guide to make a full discovery of your customer's:

- Living expenses.
- Reasons for applying for credit.
- Credit History.
- Risk profile.
- Lender selection.
- Loan feature requirements.
- Product selection.
- Anticipated changes to circumstances.
- Insurance requirements.

Caution!

Household living expense assessments need to cover both current and future expenses. Ensure your assessment covers how the expenses are likely to change over the next few years and consider expenses for the new home or car purchase.

Remember, a face-to-face discussion about the customer's needs and goals is essential to meeting your responsible lending obligations and determining that a loan product is 'not unsuitable'.

Tips

1. Discretionary expenses

Convince your customers to give up discretionary spending to increase their borrowing power, then flag the discretionary items in your living expenses assessment. Expenses like holidays, or one-off luxury items can be considered discretionary.

Please note: Filing your notes about discretionary expenses in the Opportunity in Mercury is compulsory for all Connective Credit Representatives.

2. Predicting the future

Always ask your customer what could happen to change their financial circumstances in the foreseeable future, to help determine if the loan is likely to cause financial hardship, e.g. having a baby.

Please note: It is compulsory for Connective Credit Representatives to file notes about this conversation in the Opportunity in Mercury.

3. Tips for property investor customers

Recent lender policy changes require all investment property expenses to be included in a customer's living expenses assessment when applying for another loan, or a refinance. Read more in this recent article.

4. Keep notes for compliance!

File them in the Opportunity in Mercury (or, if you are not a Connective broker, your own customer file) so that you can produce them to prove you made reasonable enquiries if you should be required to do so later. It is very important that you keep detailed notes about every aspect of your living expenses and income assessment and what the customer tells you.

Please note: This step is compulsory for all Connective Credit Representatives.

Verifying the customer's income and documentation

While it's no longer strictly necessary to sight original documents, it is necessary to verify them.

Your responsible lending obligations require you to take 'reasonable steps' to verify your customer's financial situation. A critical part of this process is obtaining the correct documents to prove the customer's income and checking them carefully.

Most Australian homeowners spend around 37.2% of their income servicing their mortgage.

Document requirements

PAYG Customers must provide:

- personal identification, and
- three months of transaction account statements for all customers (the bank account and/or credit card nominated for salary credits and living expenses).

Self-employed/sole traders must provide the above, along with the following:

- latest personal tax return
- latest ATO notice of assessment
- ASIC ABN search (to be saved in Mercury)
- One of the following:
  - 12 months of statements from tax portal
  - 12 months of BAS Statements
  - Two years' business tax returns and financial statements.

Documents required for verifying other income types

- **Superannuation:** obtain a copy of the latest statements.
- **Government payments:** obtain confirmation from Centrelink.
- **Maintenance/Child support:** copy of Child Support Agency agreement or Court Orders.
- **Rental income:** copy of lease, agent tax invoice, rental estimate from valuation or real estate agent.
- **Overseas income:** payslip and letter from employer, with a translated copy from a certified NAATI translator.

The following services are useful for obtaining original documents and for conducting important background checks:

- ABN Check: abr.business.gov.au
- bankstatements.com.au
- RELIE
- Cashdeck

Best practice income verification process in three easy steps

1. **Check** the Needs Analysis to determine what documents you'll need, then collect them from the customer (or another acceptable source).
2. **Check** to ensure there are no discrepancies—for example, compare the payslip to the deposits on the bank transaction account statement to ensure the amounts are the same and appear in cycle.
3. **Check** to ensure the documents are authentic and have not been doctored—for example, do an ABN search of the employer using the number on the payslip and check it against their PAYG summary. Or ask permission from your customer to phone the HR department to check.

Bonus for Connective brokers!

Mercury automatically pre-populates the Preliminary Assessment with information from the Needs Analysis, saving you data entry time. Both can be quickly located under the "Questionnaires" tab in Mercury.

Note: Completing the Needs Analysis and Preliminary Assessment and filing them in the Opportunity in Mercury is compulsory for all Connective Credit Representatives.

Tips

1. Alt doc lending

You can avoid a higher interest rate for your customer by helping them submit the standard documents the lender requires to evidence income. This is the only difference between a normal loan and an alt doc loan. To find out more, read this article

2. APRA says build in a buffer

Assist your low net income surplus customers by building in a financial buffer so they are not as vulnerable to mortgage stress if interest rates rise.

According to APRA, this is a major concern. Read this article to find out more

Caution!

What seems like a harmless little white lie to a customer, could legally amount to loan fraud or money laundering. This article explains how to identify false or doctored income documents and other things that may indicate a customer is not being completely honest. This is very important to protect your business from risk.

Helpful resources

Five common mistakes to avoid

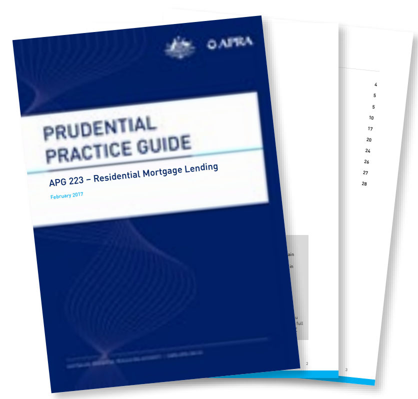
This article explains some common mistakes brokers make with living expense assessments and provides some tips on how to overcome them.

Borrowing power

You must do everything you can to help your customer avoid borrowing more than they can afford. Read this article to find out ways to help your customer increase borrowing power when possible and when you need to help them adjust their expectations.

ASIC RG209 Credit licensing: Responsible lending conduct

This guide sets out ASIC's expectations for meeting the responsible lending obligations in Chapter 3 of the National Consumer Credit Protection Act 2009.



APRA Prudential Practice Guide APG 223: Residential mortgage lending

While this guide is generally directed at Australian Deposit Taking Institutions (ADIs/Lenders), it offers worthwhile guidance by presenting APRA's view of sound practice in mortgage risk management.

Get your household living expense assessments right

As a broker, you have a responsibility to both your customer and the lender to ensure every application is true and correct. But there will be occasions when you need support and advice to get it right. That's why your local Compliance Support Manager is always on hand to assist.

Connective Wiki can also help you access easy 'how to' instructions, videos and articles, 24/7. Simply click on the Wiki icon in Mercury to find out what you need to know. Alternatively, click on the help icon in Mercury to get in touch with the team by email or Live Chat.

If you're not a Connective broker yet, why not have a chat with us today?

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