

3. Household and Business Balance Sheets

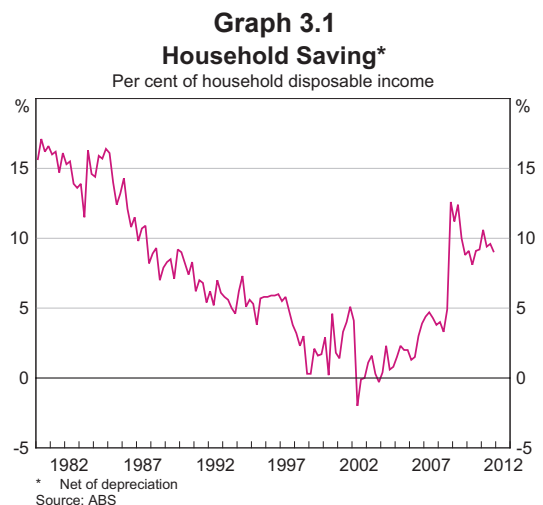
The household sector has continued to consolidate its financial position. The household saving rate remains well above the levels recorded in the 1990s and early to mid 2000s and households have been actively shifting their portfolios towards more conservative assets such as deposits. The aggregate debt-to-income ratio has drifted down over the past year, with demand for new debt remaining low and many households choosing to repay their existing debt more quickly than required. Solid income growth is also helping to support households' debt-servicing capacity. In aggregate, households are managing their debt levels well, though mortgage arrears rates are still a little higher than a few years ago.

The business sector has been experiencing mixed conditions: the mining and related sectors continue to benefit from the resources boom, while the retail, manufacturing, construction and tourism sectors are facing weaker conditions associated with subdued retail spending, the high exchange rate and, in some cases, tighter lending standards than average. Overall, profitability and conditions in the business sector are positive. However, banks' non-performing business loans and failure rates are somewhat higher than average, reflecting the challenges some firms are facing as the Australian economy goes through a period of structural change. The business sector is in a better financial position than it was several years ago, having reduced leverage considerably and improved its liquidity position. Even so, demand for credit remains subdued.

Household Sector

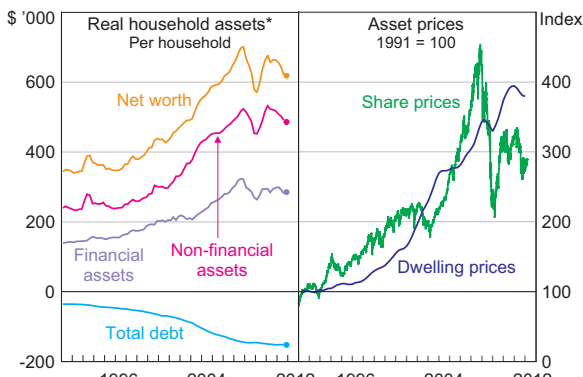
Households' more prudent approach to financing has persisted through the past few quarters. As one indicator of this, the household saving ratio has been around 9½ per cent of disposable income for the past few years, significantly above the levels recorded in the 1990s and early to mid 2000s (Graph 3.1).

Part of the motivation for this higher rate of saving may have been a desire to bolster wealth, given the weakness in some asset markets in recent years. Real net worth per household is estimated to have fallen by 6½ per cent over 2011, to be 11½ per cent below its 2007 peak (Graph 3.2). This contrasts with the rapid trend expansion in this series over the decade to 2007 when average annual growth was 6½ per cent. Recently, the weakness in household wealth has been driven by dwelling prices, which were down about 4 per cent on an average nationwide basis over the year to December 2011; prices declined in



Graph 3.2

Real Household Assets and Asset Prices



* In 2009/10 dollars; deflated using the household final consumption expenditure implicit price deflator; includes unincorporated enterprises; RBA estimates for December quarter 2011
Sources: ABS; Bloomberg; RBA; REIA; RP Data-Rismark

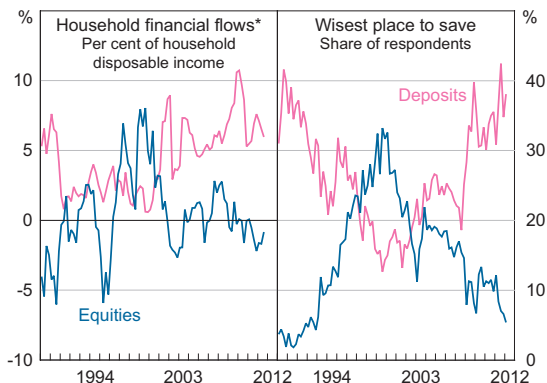
most cities over the year. Housing market conditions remain soft; preliminary data indicate that dwelling prices have fallen a little in early 2012. At the national level, the ratio of dwelling prices to income has fallen over the past year, and is below the average of the past decade, while rental yields have begun to pick up, assisted by stronger rental growth as well as lower prices.

Another sign of the more cautious approach of households is that they have been actively shifting the composition of their financial asset portfolio away from riskier assets like equities and towards deposits. From the beginning of 2008 to September 2011, there were net outflows from households' directly held equities of nearly \$50 billion, while holdings of deposits increased by around \$210 billion (\$94 billion more than in the previous corresponding period) (Graph 3.3, left panel). The net outflows from equities have come on top of – and were probably in reaction to – declines in equity prices over recent years, especially given that the resulting capital losses coincided with more attractive rates of return available on deposits.

The share of (directly held) equities in household financial assets is now almost half its pre-crisis level, at 9 per cent, while cash and deposits account for 27 per cent, up from 19 per cent in December 2007.

Graph 3.3

Saving Measures



* Four-quarter moving average; excludes income and financial assets of unincorporated enterprises and is after interest, tax and depreciation
Sources: ABS; Melbourne Institute and Westpac

Superannuation continues to account for the largest share of household financial assets, at 58 per cent, and has seen a similar shift in asset allocation away from equities and towards deposits. While fund managers' decisions need not directly reflect household preferences, the shift was more pronounced for self-managed superannuation funds, suggesting that households who directly manage their superannuation have indeed changed their investment preferences.

Consistent with this portfolio shift, surveys show a marked increase in the share of people nominating deposits and paying down debt as the 'wisest place' for their savings and a decline in the share nominating equities and real estate (Graph 3.3, right panel). Disaggregated data from the Household, Income and Labour Dynamics in Australia (HILDA) Survey also indicate that households have become somewhat more risk averse: the share of households who reported having a high tolerance for risk declined from 9½ per cent in the 2008 survey to 8 per cent in the 2010 survey.

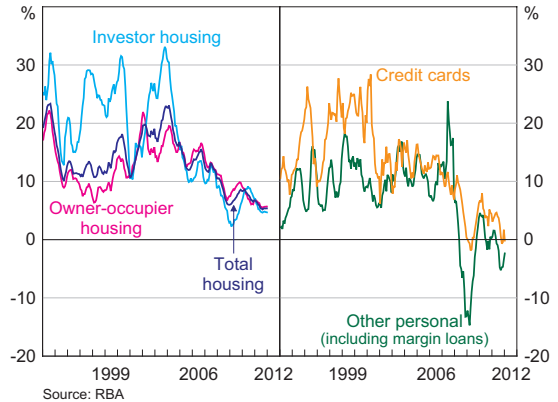
Households have also displayed a less exuberant approach to taking on additional debt in recent years. Growth in household credit has remained at an annual pace of 4½ per cent in the past year, well down on the 14 per cent average growth rate recorded between 2000 and 2010 (Graph 3.4). The reduced

appetite for debt has been more pronounced for borrowing for investment purposes, with investor housing credit growing at a slightly slower pace than owner-occupier housing credit for much of the past few years, and the value of outstanding margin loans continuing to fall; it is now down about two-thirds from its 2007 peak. Households' use of credit cards has also been quite subdued over the past year, with aggregate balances increasing only slightly.

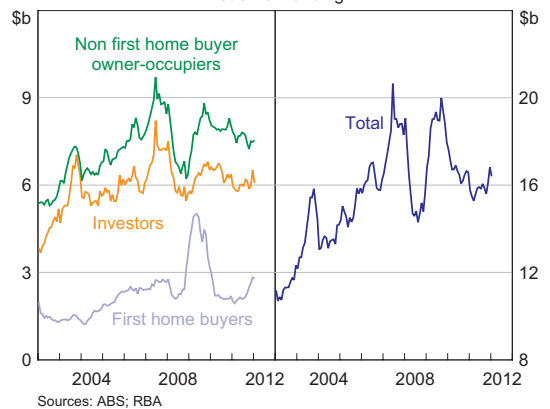
Housing loan approvals data point to continued modest growth in housing credit in the immediate period ahead. Although the value of monthly approvals increased a little over the six months to January, it remained well below the peaks seen in recent years (Graph 3.5). The increase was largely driven by a pick-up in approvals to first home buyers, partly reflecting some pull-forward of their demand ahead of the expiry of stamp duty exemptions in New South Wales on 31 December 2011. Some first home buyers might have also been attracted into the market because lenders resumed offering loans with 95 per cent loan-to-valuation ratios (LVRs) last year. Consistent with this, the share of new owner-occupier housing loans with an LVR above 90 per cent has risen from a trough of 11½ per cent in the June quarter 2010 to 17 per cent in the December quarter 2011 (Graph 3.6). The share of owner-occupier housing loans approved at fixed interest rates has also increased over this period, to about 11½ per cent in December, a little above its long-run average. This increase likely reflects a narrowing in the spread between fixed-rate and variable-rate loans, though it may also be associated with recent uncertainty about lenders' loan pricing related to volatility in their funding costs. The share of interest-only (including 100 per cent offset) loans was broadly steady in 2011, while low-doc and other non-standard loans continued to account for a very small share of the market.

Reinforcing the effect of subdued approvals on credit growth is the continued pattern of many households choosing to repay their mortgages more quickly than required. Data from the latest HILDA Survey

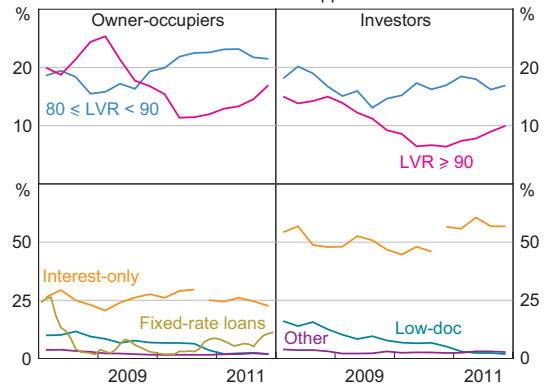
Graph 3.4
Household Debt by Type
Six-month-ended annualised growth



Graph 3.5
Value of Housing Loan Approvals
Net of refinancing



Graph 3.6
Banks' Housing Loan Characteristics*
Share of new loan approvals



* LVR = loan-to-valuation ratio; 'Other' includes loans approved outside normal policies, and other non-standard loans; 'Interest-only' includes mortgages with 100 per cent offset accounts

Sources: ABS; APRA

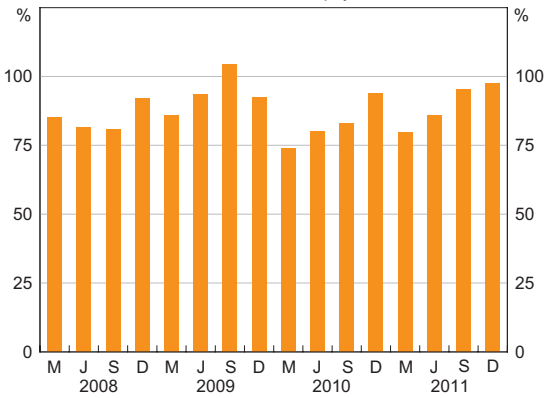
indicate that nearly 50 per cent of owner-occupiers with mortgages were ahead of schedule on their repayments in 2010, a slightly higher share than in the 2007 survey (see 'Box B: Home Mortgage Debt: Recent Insights from the HILDA Survey'). Many borrowers are repaying substantially more than required: data from lenders suggest that the rate at which borrowers were making excess repayments on their mortgages increased over 2011. Total excess repayments were roughly the same as required repayments in the December quarter 2011, up from about 80 per cent in the March quarter (Graph 3.7). These data include regular excess repayments as well as any one-off excess repayments made as a result of salary bonuses and other irregular income. Given that most borrowers do not change their regular repayment amounts when interest rates fall, the reductions in lending rates in late 2011 would be expected to boost excess repayments even further. This would add to the buffers that some of these borrowers are building up, and thus their resilience to potential future setbacks to their income.

Consistent with these mortgage borrowing and repayment trends, the rate of housing equity injection has increased over the past few years; on average, households have injected around 3 per cent of disposable income annually since 2008,

compared with average annual equity withdrawal of 4 per cent of disposable income around the middle of the decade.

Household income growth has been solid, and this is underpinning households' debt-servicing capacity. Real household disposable income increased by 3¼ per cent over the year to the December quarter 2011, largely driven by an increase in compensation of employees. Reflecting the combination of solid income growth, subdued credit growth and lower lending rates, the ratio of household interest payments to disposable income has drifted down since late 2010. At an estimated 11 per cent in the March quarter 2012, this interest-servicing ratio is around 2½ percentage points below its 2008 peak (Graph 3.8, right panel).

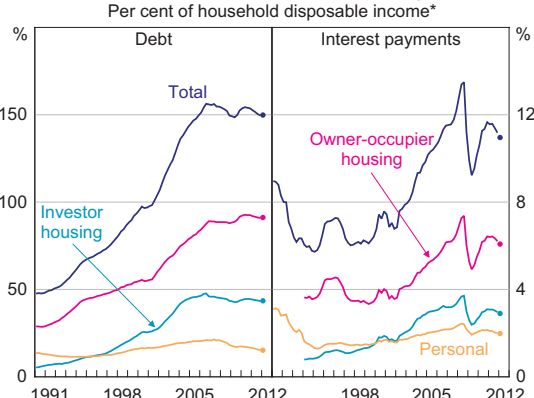
Graph 3.7
Net Excess Mortgage Repayment Flows*
Per cent of scheduled repayments**



* Excludes repayments due to sales and refinancing
** Scheduled repayments include interest and principal
Source: APRA

Graph 3.8

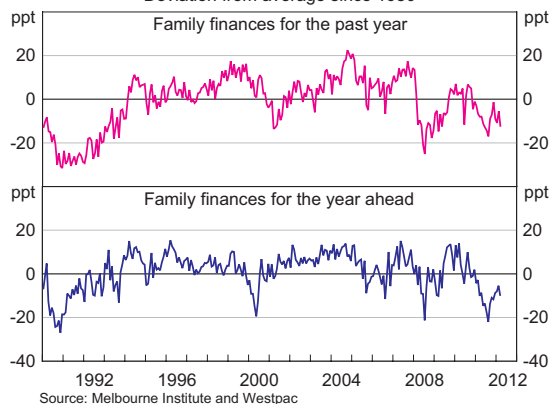
Household Debt and Interest Payments



* Household disposable income excludes unincorporated enterprises and is before interest payments; debt-to-income uses annual income; RBA estimates for March quarter 2012
Sources: ABS; RBA

Despite the strength in incomes, households' sentiment towards their financial position has been relatively weak in recent years. For example, surveys suggest that households' view of their current and future financial positions has dipped below average in the past year or so (Graph 3.9). Household sentiment may have been dampened by the softening in the labour market; employment and hours worked grew very little in the year to February 2012, and the unemployment rate is somewhat

Graph 3.9
Consumer Sentiment
Deviation from average since 1980



higher. Forward-looking indicators, such as surveys of business hiring intentions, point to only modest growth in employment in the period ahead.

With income growing faster than debt, the ratio of household debt to annual disposable income has, like the interest-servicing ratio, drifted down recently, from 154 per cent in mid 2010 to an estimated 150 per cent in March 2012; however, this is still high by historical standards (Graph 3.8, left panel). Aggregate gearing of the household balance sheet – the ratio of debt to assets – has drifted up over the past year as asset prices have weakened. At nearly 20 per cent at the end of 2011, it is close to the previous peak in 2009.

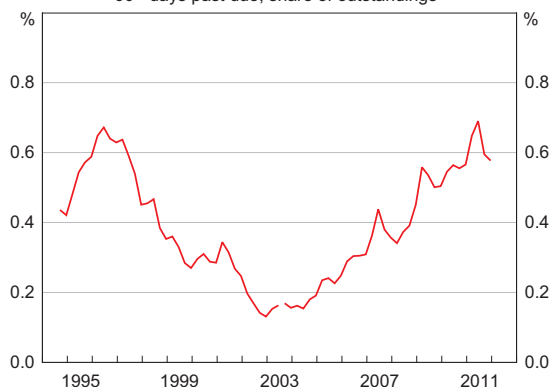
Although the household sector as a whole is still quite indebted, it remains the case that there is only a small share of very highly geared borrowers, and households generally appear well placed to meet their debt obligations. Data from the latest HILDA Survey, for 2010, show that a declining fraction of indebted owner-occupiers met standard criteria for assessing vulnerability. Just under 3 per cent of indebted owner-occupier households (holding around 7 per cent of owner-occupier housing debt) had both high debt-servicing ratios (DSRs) and high LVRs in 2010, compared with 3½ per cent in 2008. As well, less than 5 per cent of indebted owner-occupiers in 2010 were in the lowest 40 per cent of the income distribution and had DSRs above

50 per cent. More than 90 per cent of owner-occupier households with mortgages in the 2010 survey had an LVR below 80 per cent and/or a DSR below 30 per cent of income. These households also account for the bulk of outstanding owner-occupier debt.

Consistent with these survey results, aggregate indicators of financial stress show that the household sector has been coping reasonably well with its debt level. While arrears rates on mortgages are still above average, they have eased a little recently, and remain low by international standards. The arrears rate for housing loans (on banks' domestic books plus securitised housing loans) declined to 0.6 per cent in December, from 0.7 per cent in mid 2011 (Graph 3.10). The non-performing rate for credit cards has also improved, falling from 1.4 per cent in June 2011 to 1.2 per cent in December, while the rate for other personal loans has been broadly unchanged since mid 2011 at around 2 per cent (Graph 3.11).

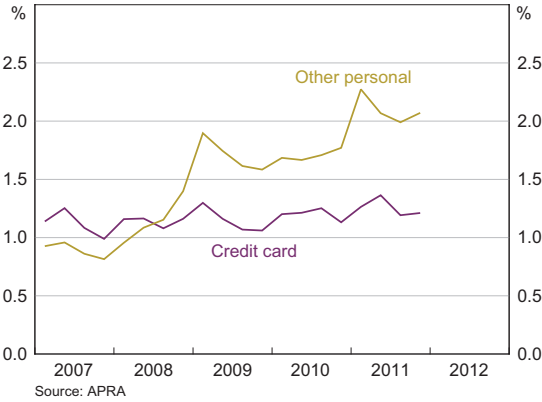
While the aggregate mortgage arrears rate has come down recently, state-level rates have diverged somewhat. Securitisation data suggest that arrears rates on housing loans in Queensland and Western Australia have increased the most over the past few years (Graph 3.12). Many of the loans in arrears were originated between 2006 and 2008, towards the end of the period of rapid housing price growth in

Graph 3.10
Housing Loan Arrears
90+ days past due, share of outstandings*

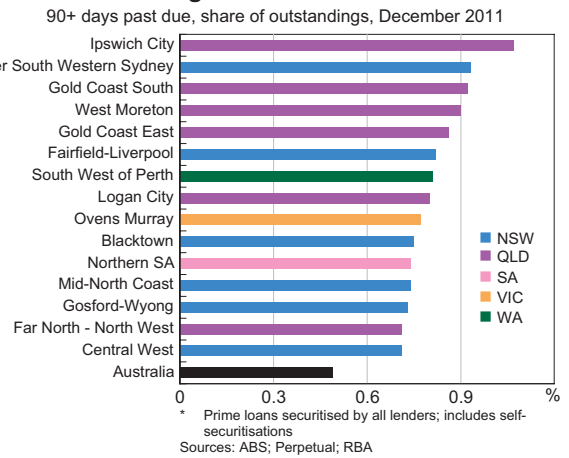


* Includes banks' on-balance sheet loans and securitised loans from October 1997 onwards; securitised loans include only prime loans prior to April 2003 and loans securitised by all lenders afterwards; on-balance sheet loans are 90+ days past due but otherwise well secured by collateral
Sources: APRA; Perpetual; RBA

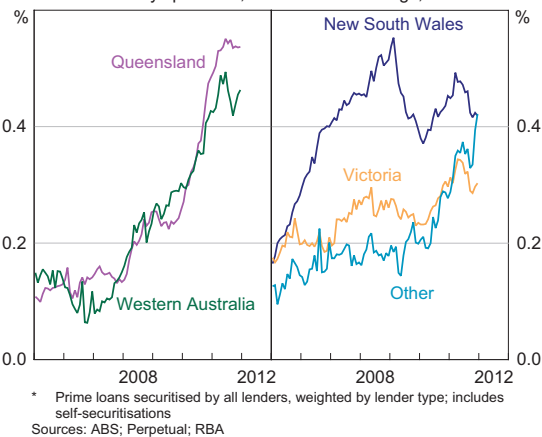
Graph 3.11
Banks' Non-performing Assets
 Domestic books, share of loans by type



Graph 3.13
Regions with the Highest Housing Loan Arrears Rates*
 90+ days past due, share of outstandings, December 2011

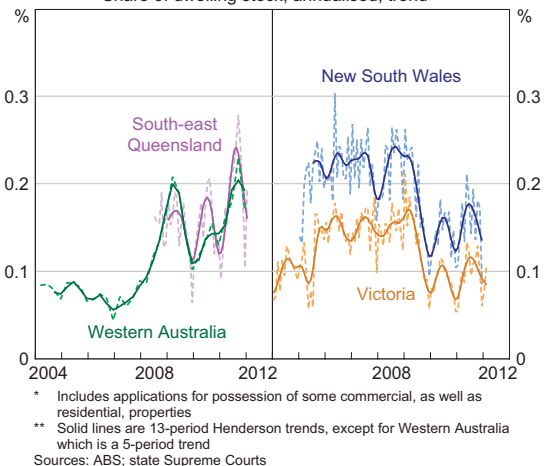


Graph 3.12
Securitised Housing Loan Arrears by State*
 90+ days past due, share of outstandings, sa



for lender property possession in South-east Queensland and Western Australia in the past year, although these have eased in recent months (Graph 3.14). In contrast, possession rates have generally either stabilised or improved in most other states. Bankruptcy rates have broadly fallen across states since 2009, although less so in Queensland and Western Australia. Overall, though, the number of households whose financial difficulties have deteriorated to the extremes of bankruptcy or lender property possession is very low in absolute terms.

Graph 3.14
Applications for Property Possession*
 Share of dwelling stock, annualised, trend**



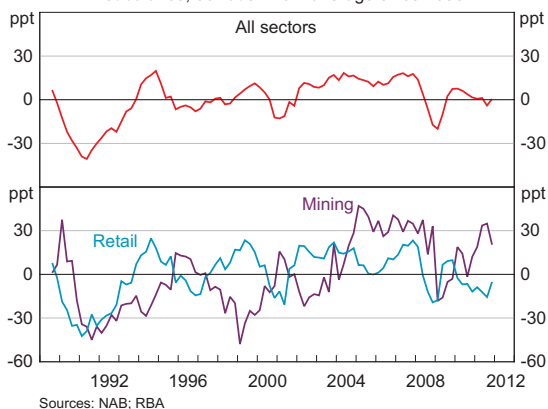
those states, which was followed by falls in prices. By contrast, arrears rates have declined from the recent peaks in New South Wales and Victoria. As a result, Queensland – particularly the areas in the south-eastern part of the state that rely on tourism, such as the Gold Coast and Sunshine Coast, and where unemployment is higher than the state average – is now more heavily represented among the regions in Australia with the highest mortgage arrears rates; a few years ago, New South Wales was more heavily represented (Graph 3.13).

The developments in state arrears rates have also been reflected in higher rates of applications

Business Sector

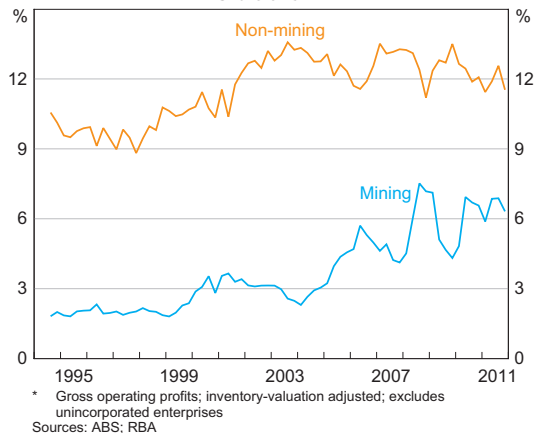
The divergence in conditions between the mining and non-mining sectors continues (Graph 3.15). In particular, the retail, manufacturing, construction and tourism sectors are facing weaker conditions because of relatively subdued retail spending, the high exchange rate, and in some cases, tighter lending standards than average. Thus although conditions in the business sector overall are quite positive, there may be a larger than usual segment of poorly performing firms; it is the connections of these firms to the financial sector that are most relevant for financial stability.

Graph 3.15
Business Conditions Surveys
Net balance, deviation from average since 1990



According to the national accounts, business profits fell by 1½ per cent in the December quarter 2011 but were 3 per cent higher over the year. Both mining and non-mining profits increased over the year, though growth in mining profits was a little stronger. Mining profits remain well above their average share of GDP while the GDP share of non-mining profits is a little below its decade average (Graph 3.16). This sectoral divergence was also evident in the latest profit reporting season for listed companies. Market analysts forecast profits to increase faster next financial year than in the current one and profit growth is expected to be stronger for listed resources companies than for other non-financial companies.

Graph 3.16
Business Profits*
Share of GDP



Profitability remains somewhat softer for smaller businesses than for larger businesses. Survey measures of small business profitability are still below average. The national accounts measure of profits of unincorporated enterprises fell by 2 per cent over the year to the December quarter 2011; the corresponding growth rate for (typically larger) incorporated businesses was around 5 per cent. Partial credit bureau data suggest that profitability in the unlisted (generally smaller) sector was broadly unchanged in 2011 across most industries; the median after-tax return on assets remains at about 4 per cent, which is a little below its long-run average. The share of unlisted businesses reporting losses was also broadly unchanged in 2011, at around 20 per cent, which is slightly above its pre-crisis average, though still down from a peak of 28 per cent in 2009. The share of loss-making firms is higher among the smallest unlisted firms – as has been the case historically – and for firms in the agriculture, property services and utilities sectors.

Robust total profits, together with lower disbursements, have generated strong internal funding of businesses in recent years. Internal funding of non-financial corporates increased to 11 per cent of GDP over the nine months to September 2011, the highest level in over 20 years

(Graph 3.17). The share of profits retained internally has been unusually high: buybacks and dividend payout ratios have fallen since the crisis, and interest payments have fallen relative to profits in line with lower interest rates and past reductions in leverage. Internal funding is estimated to have accounted for 80 per cent of total business funds raised in 2011, compared with an average of about 40 per cent in the years leading up to the crisis. This shift is consistent with the usual tendency of mining firms to fund a high proportion of their investment internally.

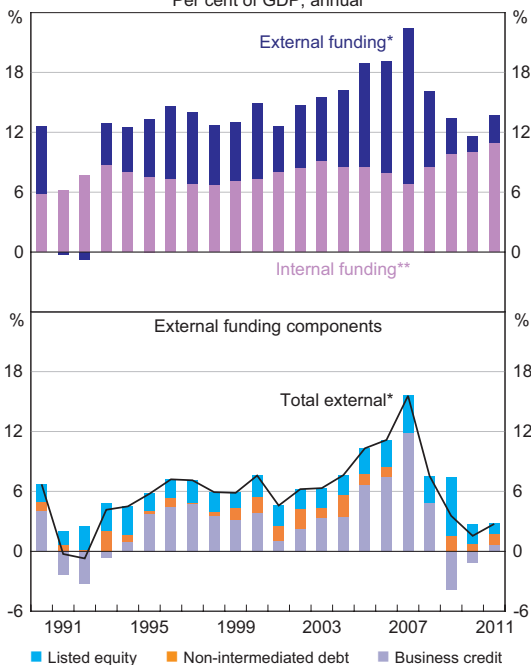
In contrast to internal funding, businesses' external funding has been subdued in recent years, averaging around 3 per cent of GDP since 2009 compared with a long-run average of 6 per cent. Equity raisings have been a more modest source of funds in the past couple of years than during the period of strong raisings in 2008 and 2009. In fact, companies bought back around \$10 billion of shares in 2011, the highest

annual volume since 2007. While the buyback activity was dominated by BHP Billiton, there was also a pick-up in buybacks by other companies and several have announced buybacks for 2012. There have been few initial public offerings in recent years, reflecting the soft share market conditions.

Like the household sector, businesses' demand for credit has been quite muted recently, partly because much of the business investment activity has been undertaken by mining companies that have been able to fund themselves internally. After contracting over much of the period since 2009, business credit increased modestly over the six months to January, but remains around 8 per cent below its 2008 peak (Graph 3.18). The increase in business credit was broad-based across sectors, other than the construction sector where conditions remain quite weak.

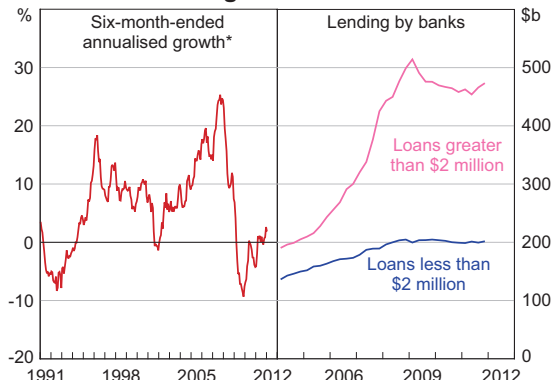
The weakness in business credit over 2009 and 2010 and the subsequent small rise is almost entirely explained by larger loans (above \$2 million); the outstanding value of loans smaller than \$2 million each has been broadly stable since 2008. A broadly similar pattern is evident in the split of credit between incorporated (typically larger) businesses and smaller, unincorporated businesses. Much of the weakness in incorporated business lending over recent years seems to have been driven by

Graph 3.17
Business Funding
Per cent of GDP, annual



* Does not capture loans by institutions domiciled outside Australia
** 2011 observation is for the nine months to September
Sources: ABS; APRA; ASX; Austraclear; RBA

Graph 3.18
Lending to Businesses



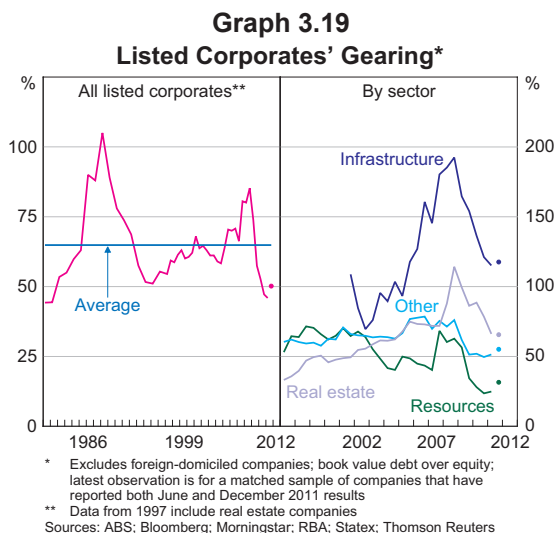
* Seasonally adjusted and break adjusted; includes lending by non-bank financial institutions and securitised loans, but excludes lending to non-residents
Sources: APRA; RBA

listed companies; while some tapped bond markets instead, many of them have chosen to pay down debt to strengthen their balance sheets.

The overall weakness in business credit seems to be mainly due to weak demand rather than supply constraints; liaison suggests that appetite for new debt remains subdued, and some businesses reported paying down existing debt. That said, supply factors have also contributed. Although liaison indicates that the availability of bank finance has improved over the past year for many firms, credit conditions remain tighter than prior to the crisis, particularly for loans to property developers.

While the use of intermediated debt has been relatively weak, corporate bond issuance has been solid in recent quarters. Much of this issuance was undertaken by resources companies as partial funding for acquisitions. Spreads between corporate bond yields and Commonwealth Government securities increased in the second half of 2011, in line with the increased volatility in global markets. However, they did not widen to the same extent as for US and European issuers and they remain well below the peaks in early 2009. In some recent cases, non-financial firms have issued at spreads lower than those on debt of the higher-rated Australian banks.

Corporate leverage has decreased significantly over recent years, to levels last seen in the early 1980s; the previously mentioned equity raisings, lower debt levels and increased retained earnings have served to strengthen companies' financial positions (Graph 3.19). However, the restructuring of balance sheets appears to be drawing to a close for most companies. Preliminary (matched sample) data suggest that average book value gearing of listed non-financial companies increased a little to 50 per cent over the December half 2011, largely driven by debt-funded acquisitions and buybacks by BHP Billiton and Rio Tinto. The decline in gearing over recent years has been broad based across sectors, and has been especially pronounced among highly leveraged companies in the infrastructure and real estate sectors. Gearing in the resources sector is

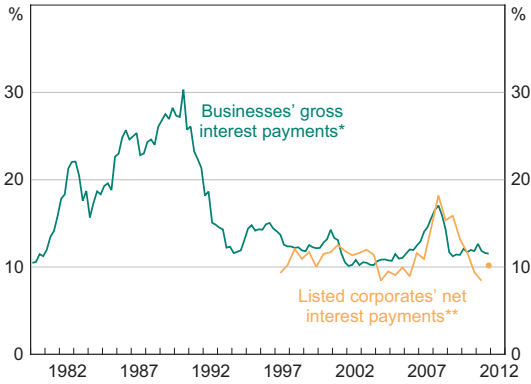


lower than in most other sectors but has picked up recently. Credit bureau data suggest that gearing in the unlisted business sector rose in 2011, after decreasing over the previous few years. Median gearing was 54 per cent based on the 2011 sample of firms, up from 47 per cent in the 2010 sample, but still below the pre-crisis average of 59 per cent.

Businesses' balance sheets have also become more liquid in recent years compared with prior to the financial crisis. Business deposits at banks increased by 12 per cent over 2011, after rising 8 per cent in 2010. Cash balances, including deposits, of listed companies remain at high levels across most sectors, but particularly so in the resources sector. Mining sector cash balances have recently declined a little, however, as BHP Billiton and Rio Tinto used part of their large cash reserves for acquisitions.

Reflecting businesses' low leverage, solid profitability and interest rates being around average, the ratio of businesses' interest payments on intermediated debt to profits is below its long-run average level (Graph 3.20). The ratio declined slightly in the September and December quarters 2011, as profits increased and business interest rates fell, to be around 11½ per cent, well below the peak of 17 per cent in 2008. For listed corporates, net interest payments (on all debt) as a share of profits are also

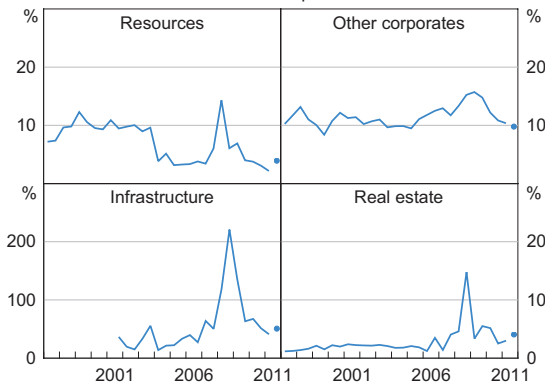
Graph 3.20
Business Interest Payments
Per cent of profits



* Interest on intermediated debt from Australian-domiciled financial institutions
** Interest on all debt; final observation is for a matched sample of companies that have reported both June and December 2011 results; excludes foreign-domiciled companies
Sources: ABS; APRA; Morningstar; RBA

at low levels. This is particularly the case for mining companies, reflecting their low leverage and high profitability, despite a slight increase in the second half of 2011 (Graph 3.21). Servicing ratios vary widely across sectors, in line with their different business models; for example, the average ratio is higher for infrastructure and real estate companies, though well below the peaks seen in 2008 when profits fell sharply, as well as for agriculture and hospitality companies.

Graph 3.21
Listed Corporates' Net Interest Payments*
Per cent of profits

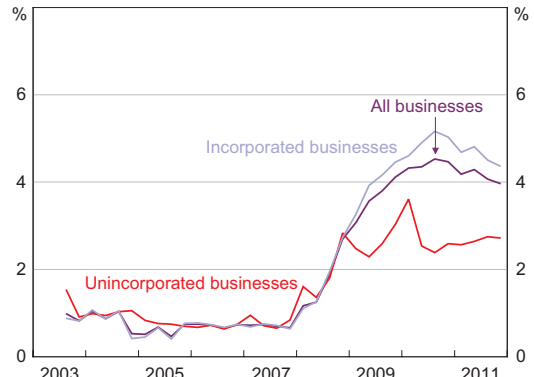


* Final observation is for a matched sample of companies that have reported both June and December 2011 results; excludes foreign-domiciled companies
Sources: Bloomberg; Morningstar; RBA

As discussed in the chapter on 'The Australian Financial System', the share of banks' business loans that is non-performing has declined over the past year, though it remains above average (Graph 3.22). The non-performance rate is still higher for loans to incorporated businesses than for loans to unincorporated businesses.

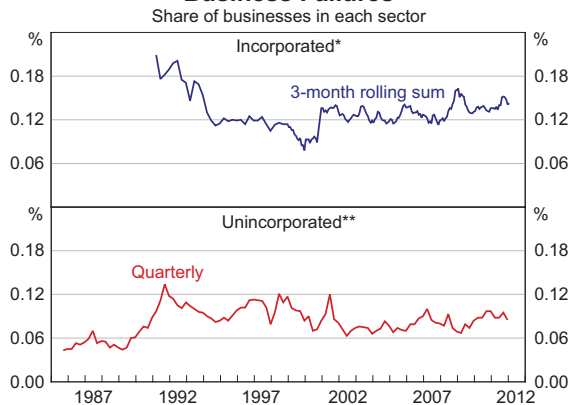
Business failure rates, a lagging indicator of business financial health, have been a little above average recently, though still below earlier peaks (Graph 3.23). The rate at which incorporated businesses were entering external administration has been elevated over the six months to January 2012, but has eased a little recently. Estimates based

Graph 3.22
Banks' Non-performing Business Assets*
Domestic books, share of outstandings by type



* Excludes lending to financial businesses and includes bills and debt securities
Sources: APRA; RBA

Graph 3.23
Business Failures
Share of businesses in each sector



* Companies entering external administration; pre-1999 data are quarterly
** Business bankruptcies
Sources: ABS; ASIC; ITSA; RBA

on projections of the number of tax-reporting (and thus economically active) firms suggest that the corporate insolvency rate may be closer to its 2009 peak, though still low in absolute terms. The failure rate among unincorporated businesses has eased a little recently after increasing over 2009 and 2010. In recent years, a larger share of business failures has been attributed to economic conditions, which may reflect the lagged effects of the financial crisis or pressures on those sectors not benefiting from the resources boom. Disaggregated data on corporate failures by industry show the recent increase was concentrated in the business and personal services sectors, while the share of failures in the hospitality and retail trade sectors has also increased a little.

Commercial Property

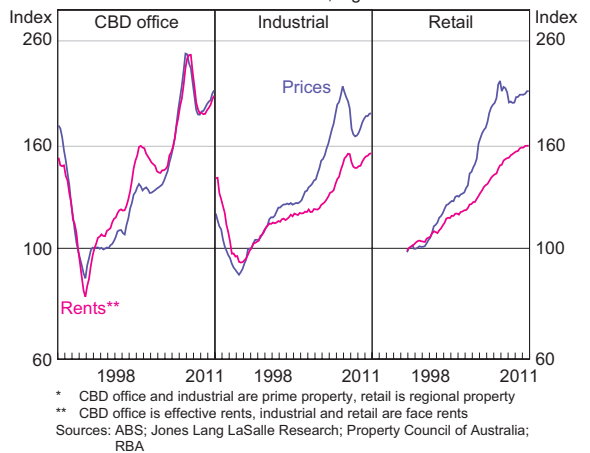
Conditions in the commercial property sector continued to improve in late 2011. Office vacancy rates in most capital cities have stabilised or declined moderately since 2009, with larger falls recorded in Perth and Brisbane (where vacancy rates had previously increased more sharply). Consistent with falling vacancy rates, office property values and rents rose by about 7 per cent over 2011, but remained around 15 per cent below their 2007 peaks on a national basis (Graph 3.24). The pick-up in office property prices was evident across most capital cities. Prices and rents in the industrial property market also strengthened, though conditions in the retail property market have been more subdued.

The adjustment in the commercial property market in recent years was less severe and drawn out than the downturn in the early 1990s: office property values fell by 25 per cent over two years from their late 2007 peak, compared with a 50 per cent peak-to-trough fall over four years in the early 1990s. There was a smaller supply overhang this time, and banks appear to have delayed selling some non-performing commercial property assets until conditions improved rather than selling into a depressed market. There were some market segments, however, where stock additions at the peak of the market subsequently put pressure on vacancy rates and rents, especially

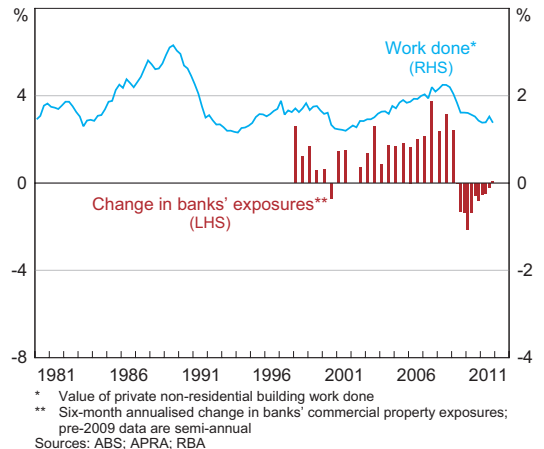
the Perth and Brisbane CBD office property markets. Liaison suggests that the increase in business failures in Western Australia was driven by distressed firms in construction and residential property development.

Despite conditions in the commercial property market improving, construction activity remains below average (Graph 3.25). This partly reflects ongoing tightness in financing conditions. While larger developers reportedly have good access to wholesale finance, industry liaison indicates that smaller developers are facing stricter collateral, covenant and pre-commitment requirements

Graph 3.24
Commercial Property*
March 1995 = 100, log scale



Graph 3.25
Commercial Property
Per cent of GDP



than in earlier years. Lending conditions are said to be particularly tight for residential property developments in Melbourne, given concerns about a possible oversupply of apartments in that city.

After falling about 15 per cent between 2009 and 2010, banks' outstanding commercial property lending was broadly flat in the second half of 2011 (Graph 3.26). This occurred partly because the smaller Australian-owned banks' exposures began to stabilise in the second half of 2011; in contrast, those of the European-owned banks continued to shrink and have now fallen by 60 per cent since the peak in 2009, proportionately more than the decline in their total business lending. This pullback from commercial property financing may partly be explained by the higher impairment rate these banks have experienced on their commercial property portfolios. Some of them have also been under pressure to deleverage given the difficulties their parent groups are facing in Europe. By contrast, Asian banks have increased their exposures to the Australian commercial property market over the past two years, though from a relatively low base. Non-bank sources of finance for commercial property remain constrained, with little issuance of commercial mortgage-backed securities in recent years and mortgage trusts' funds under management continuing to decline. The major banks' lending for commercial property has been

relatively resilient over the past few years; as a result of the declines in debt funding from other sources, they now account for 65 per cent of all commercial property debt financing in Australia, up from 45 per cent in 2006.

As discussed in the chapter on 'The Australian Financial System', the quality of banks' commercial property exposures improved slightly over 2011, but the impairment rate remains above that for banks' total business lending (5 per cent versus 3 per cent). Commercial property impairments are about one-half of banks' total impaired business assets, even though lending to the sector accounts for only about one-third of total business lending.

Australian listed real estate investment trusts (A-REITs) appear to be nearing the end of their balance sheet restructuring, with preliminary data for December 2011 showing average gearing back to 2004 levels at around 60 per cent, and well below the peak of 115 per cent in 2008. Debt levels were lower over the year, while equity raisings of about \$½ billion in the first half of 2011 were almost entirely offset by buybacks in the second half (Graph 3.27). With property prices stabilising, A-REITs' profitability has recovered over recent periods, but remains below the high levels seen prior to the crisis when property price inflation was a significant contributing factor.

