Aussie

'Your Next Mortgage Move' Report

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CoreLogic®

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Aussie CoreLogic 'Your Next Mortgage Move' Report 2022

Australia's mortgage market is moving through unprecedented change. With rates rising rapidly, record levels of household debt and the cost of living on the rise, your mortgage decisions could be key to making savings in the new year.

Fixed or variable?

A **fixed** rate home loan is where the cost of your borrowing is held steady, generally between 1 and 5 years. During this time, the interest rate on a mortgage, and the actual value of mortgage repayments, will be the same month to month. After the fixed term, the borrower may be able to secure another fixed term (though probably at a different price), or they may move onto a variable rate.

A **variable** rate home loan is where the interest rate on a mortgage could change from month to month. Each month, banks will review the price of a variable mortgage, based on what the RBA is doing with the cash rate. The RBA influences the cash rate to try to control spending in the economy, and the cash rate also influences the mortgage rates set by lenders.

While the certainty of a fixed rate on your mortgage may sound tempting, Australians have actually preferred variable rates historically. This is because variable rates have often been lower than fixed rates. In return for the discounted variable rate, lenders get the flexibility to change mortgage rates when the cash rate rises.

An unprecedented move in mortgages

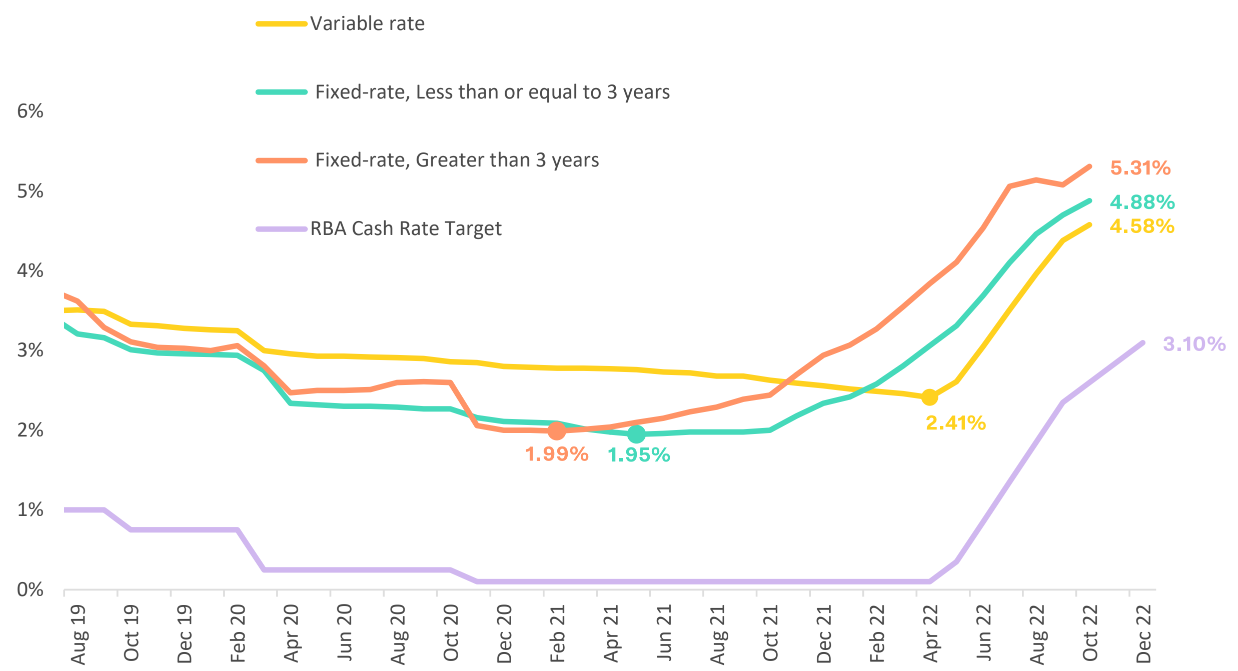
Following the onset of the COVID-19 pandemic in Australia, the RBA set the cash rate at a record low of 0.1% in November 2020 and signalled that it could stay there for a long period of time.

Before the pandemic, the cash rate target had averaged 2.55% for the previous decade. The ultra-low cash rate target was a part of a set of policy measures to get more credit flowing through the economy. By signalling an extended period of rock-bottom rates, lenders were confident in substantially dropping the price of fixed mortgages.

Figure 1 shows average new mortgage rates by type for owner-occupier home loans. As the cash rate hit a record low, the price of fixed mortgages soon followed. In May 2021, average fixed mortgage rates with a set rate of three years or less dipped to a low of 1.95%.

Fixed rates where the set term was greater than three years dipped as low as 1.99% in February 2021. Average variable rates bottomed out at 2.41% in April of 2022, in line with the last month of the record-low cash rate setting.

Figure 1: Average lending rate, new, owner-occupied

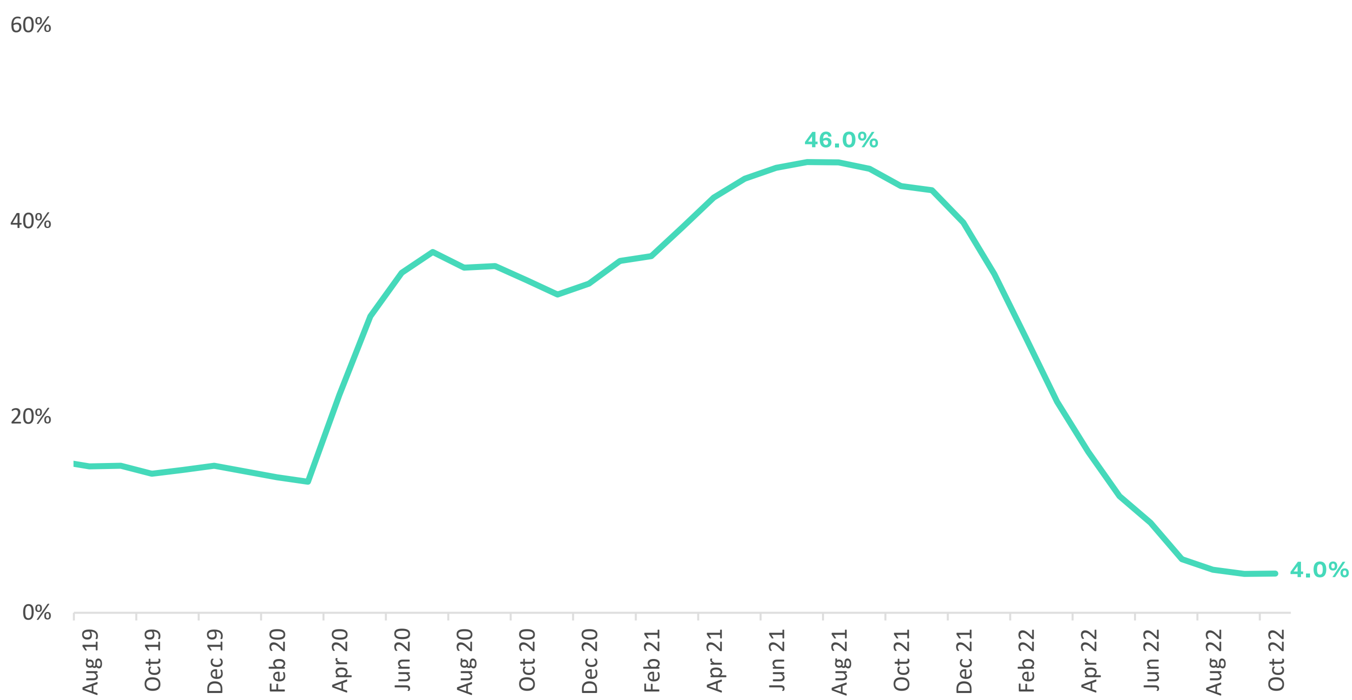


Source: RBA

Interest rate data from the RBA suggests it is unusual for fixed rates to be low relative to variable rates. Around 20% of housing lending has been on fixed rates as a result.

But cheap rates through the pandemic created a rare period in which fixed-rate borrowing ballooned, with total housing lending and refinancing on set interest rates peaking at 46% in July 2021.

Figure 2: Portion of new housing lending on fixed rate terms



Source: ABS

This has led to the total outstanding value of housing credit in Australia sitting at around 35%, up from less than 20% at the onset of the pandemic, according to the RBA.

The ‘refinancing cliff’ and your next mortgage move

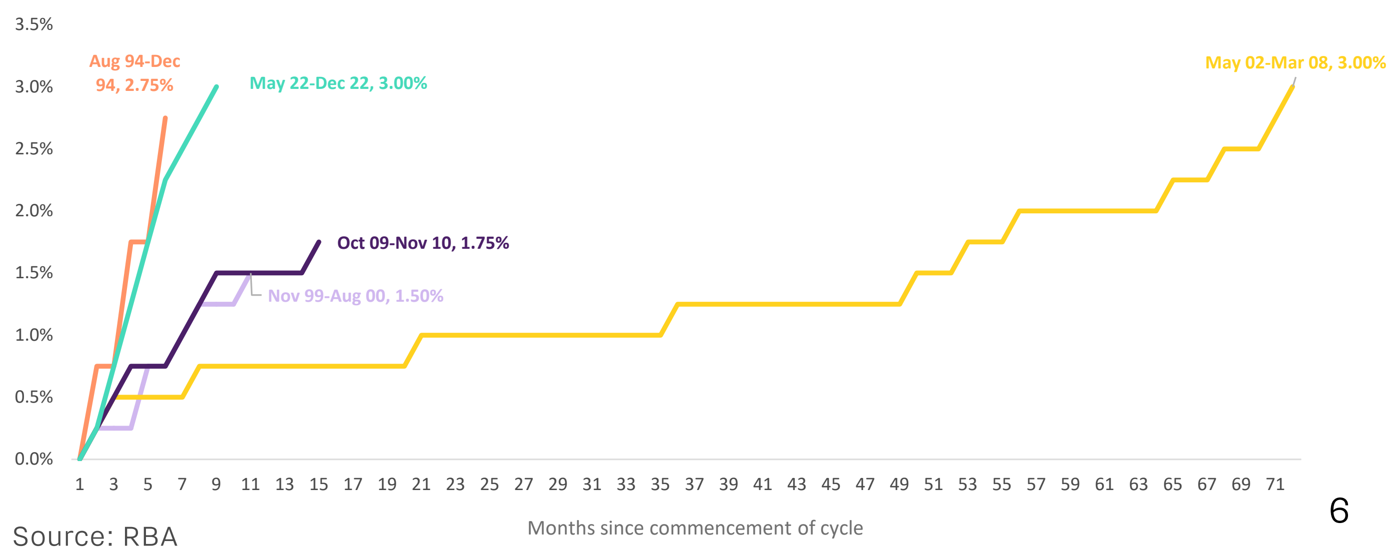
While low interest rates supported a high volume of borrowing to buy housing, fixed terms won’t last forever, and now is arguably a crucial time to be thinking about your next mortgage move.

Borrowers who took out fixed-rate loans during the pandemic are likely to face much higher mortgage rates when their fixed terms end. According to the latest Financial Stability Review from the RBA, around two-thirds of fixed-rate mortgages are set to expire through 2023.

On December 6th, the RBA increased the cash rate by another 25 basis points (to 3.1%), taking the cash rate 300 basis points higher in eight months, which is highly unusual. In fact, it marks the steepest increase in the cost of debt since the 1990s, when the RBA first started setting the cash rate **(Figure 3).**

Assuming full cash rate rises are being passed on to mortgage rates, this would put the average new variable mortgage rate for owner occupiers at around 5.08% through December. The RBA has also estimated that fixed-rate borrowers with expiring terms in 2023 will see rate increases of around 3-4 percentage points.

Figure 3: RBA rate tightening cycles since 1990



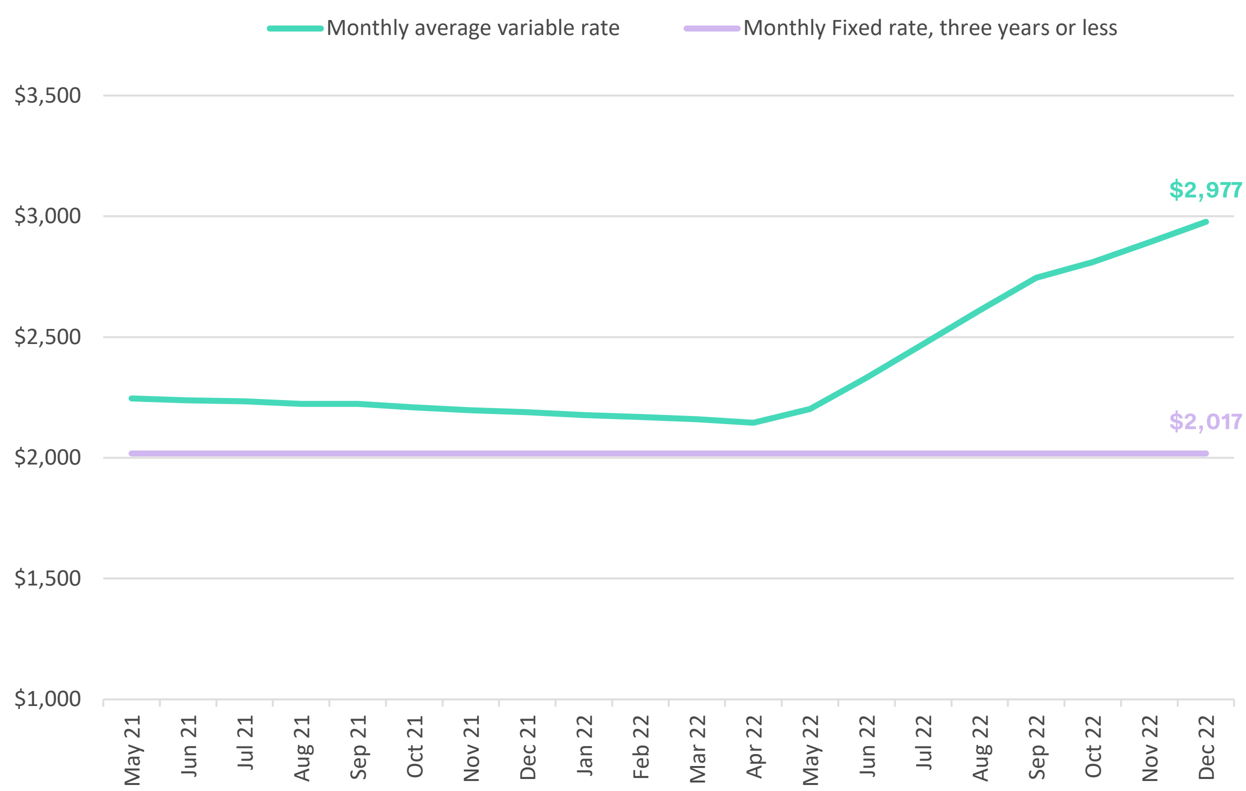
Source: RBA

The reason for the rapid rise comes back to high inflation. The price of goods and services increased by 7.3% in the year to September 2022, the highest level of inflation in over 30 years. Tackling inflation early using high, successive rate rises means avoiding a 'wage-price-spiral' and potentially preventing further pain in the economy down the track.

While the RBA is increasing the cash rate to reduce the potential for long-term high unemployment and inflation, it does mean some short-term pain for mortgage holders. Namely, those coming up to the end of their fixed-rate terms may see a big sticker shock in their mortgage repayments.

Figure 4 shows what monthly repayments look like for fixed-term borrowers versus variable-rate borrowers since May, assuming the national average home loan size over that month (which was $549,498 according to the ABS).

Figure 4: Monthly mortgage repayments since May 2021



Source: ABS, RBA. Assumes a new mortgage is taken out at May 2021, with the average principal loan of $549,498 as reported by the ABS. The fixed interest rate is based on the average new fixed rate as at May 2021 as reported by the RBA (1.95%). The monthly variable repayments are based on the average new variable mortgage rate reported by the RBA. Both series are based on owner occupier home loan rates.

For those who purchased in 2021, being exposed to variable home loan rates has likely meant a big increase in repayments. In the example above, monthly home loan repayments on variable rates are estimated to be around $960 higher than at the fixed rate level.

If the cash rate were to rise a further 40 basis points (to 3.5%), the RBA estimates that around 60% of fixed-rate borrowers with terms expiring in 2023 would have increases in their minimum repayments of at least 40%.

The table below shows a breakdown of how mortgage repayments could rise over time by region. For those who purchased at the lowest point of average fixed rates where the fixed term was 3 years or less (May 2021), we take the median dwelling value and assume a purchase with a 20% deposit.The table shows the difference between a low fixed rate repayment of 1.95%, versus the payment on an average new variable home loan rate (which we assume may reach 5.71% by mid-2023).

Figure 5: What could repayments look like if the RBA were to lift the cash rate a further 40 basis points (to 3.5%).

Region	Median dwelling value - May 2021	Home Loan Principal	Monthly home loan repayment - 1.95%	Monthly home loan repayment - 5.71%
Greater Sydney	$1,120,836	$896,669	$3,292	$5,210
Greater Melbourne	$806,196	$644,956	$2,368	$3,747
Greater Brisbane	$779,895	$623,916	$2,291	$3,625
Greater Adelaide	$628,744	$502,995	$1,847	$2,923
Greater Perth	$555,538	$444,430	$1,632	$2,582
Greater Hobart	$738,399	$590,719	$2,169	$3,432
Greater Darwin	$504,306	$403,445	$1,481	$2,344
Australian Capital Territory	$940,026	$752,021	$2,761	$4,369
Rest of NSW	$746,839	$597,471	$2,193	$3,472
Rest of VIC	$594,056	$475,245	$1,745	$2,761
Rest of QLD	$557,479	$445,983	$1,637	$2,591
Rest of SA	$330,229	$264,183	$970	$1,535
Rest of WA	$407,519	$326,015	$1,197	$1,894
Rest of TAS	$534,778	$427,823	$1,571	$2,486
Rest of NT	$416,761	$333,409	$1,224	$1,937
8 Capital Cities Combined	$829,390	$663,512	$2,436	$3,855
Combined Rest of State Regions	$597,074	$477,660	$1,754	$2,775
Australia	$752,507	$602,006	$2,210	$3,498

Source: CoreLogic

Assumes a home loan rate based on the RBA series average for new and variable home loan rates. The 5.71% figure is derived using the average new variable rate for owner occupiers at September 2022, and adding the median forecast of the cash rate peak across the major banks, which was 3.73% at October 2022. The mortgage is assumed to be a 30-year loan, with no fees or transaction costs taken into account.

These extremes of lows and highs in mortgage rates show how dramatically home loan repayments could be subject to change in the next 6 months. The scenario in table 5 shows a 58.3% uplift in mortgage repayments across the capital cities and regions of Australia, ranging from a monthly repayment lift of $565 in regional South Australia to an increase in monthly repayments of around $1,918 in Sydney.

However, this is certainly the more extreme scenario for changes in mortgage repayments for the end of fixed rate terms. For example, not all borrowers would have made purchases this large at a low rate of 1.95%. Furthermore, the RBA may not need to hike rates to the high 3's if the economy can be slowed down by a smaller rate rise.

How can refinancing help?

Another way borrowers can help to mitigate a jump in housing payments is to consider refinancing. Refinancing occurs when new mortgages are used to pay off an existing mortgage. This can enable the borrower to change the terms of their borrowing, including the structure and interest rate. Borrowers may be able to find a more competitive interest rate by looking for finance elsewhere.

A lot of Aussies have refinanced through the low interest rate environment. According to data from the ABS, a record $18.9 billion in housing loans was 'externally' refinanced through the month of August (refinanced with a different bank). The volume of refinancing could grow even further as borrowers look for more competitive rates over 2023.

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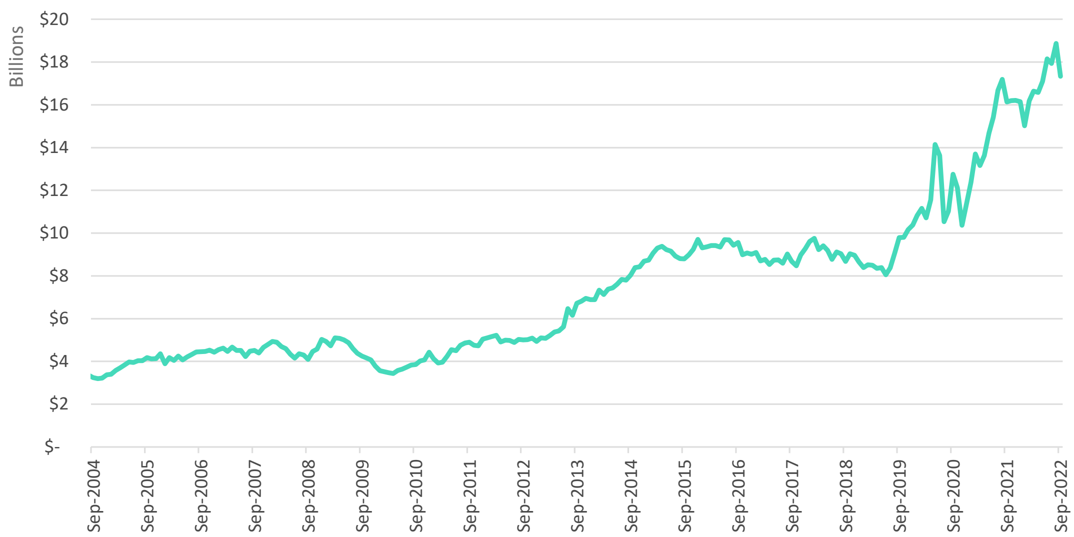
Figure 6: Monthly value of external refinancing - Australia



Source: ABS

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