# 2. Household and Business Finances in Australia

Households and businesses were generally in a strong financial position leading in to the recent spread of the Delta variant of COVID-19 and associated lockdowns. Most had accumulated substantial liquid asset buffers and continued to meet, or remain ahead of, their debt repayment schedules. These large buffers, along with temporary support measures, are supporting those whose incomes have declined during recent lockdowns, enabling continued servicing of debt and assisting affected businesses to retain workers. Over the longer term, the financial resilience of the household and business sectors is tied closely to the outlook for public health and the economy, about which there remains ongoing uncertainty.

Some households and businesses are vulnerable in the near term. Those in pandemic-affected industries or located in regions that have experienced prolonged lockdowns are more likely to be running down their buffers and some could face debt repayment difficulties. Despite the significant policy support, it is likely that not all businesses will recover and insolvencies will rise, although this will be from a low level. Overall, there is only a small share of households and businesses that are both vulnerable to cash flow reductions and are heavily indebted. Lenders' non-performing loan ratios are therefore expected to rise only modestly from currently very low levels.

Housing lending has picked up this year. This reflects the strength in the housing market that began in the latter part of 2020 and has been underpinned by low interest rates, targeted policy measures and the economic recovery. Lenders have maintained sound lending standards to date, although there has been an increase in loans with high debt-to-income (DTI) ratios. While there has been a slight moderation in housing turnover and housing price growth as a result of the lockdowns, recent data on commitments suggest housing credit growth is likely to pick up further over the coming months. A sustained acceleration in housing credit growth would add to risks related to the already-high level of household debt. Unsustainable debt trends could emerge in an environment of rapidly rising property prices and extrapolative expectations, with new borrowers stretching their financial capacity and a greater chance of disorderly future price corrections. To address rising systemic risks, the Australian Prudential Regulation Authority (APRA) has announced a 50 basis point increase to the serviceability assessment rate it expects banks to use to assess prospective buyers (see 'Chapter 5: Mortgage Macroprudential Policies').

### The majority of households have added to their large liquidity buffers …

Households have continued to build their financial buffers, with higher saving rates in the first half of 2021 than for most of the past decade (Graph 2.1). The saving rate declined from its significant peak in 2020 as consumption picked up and income growth slowed. The recovery in consumption over this period occurred amid greater confidence about the health and economic outlook; the slowing in income growth was due to the unwinding of the initial COVID-19-related support measures

that offset the strong recovery in the labour market. Timely survey data suggest that households have maintained high savings buffers into the second half of this year.

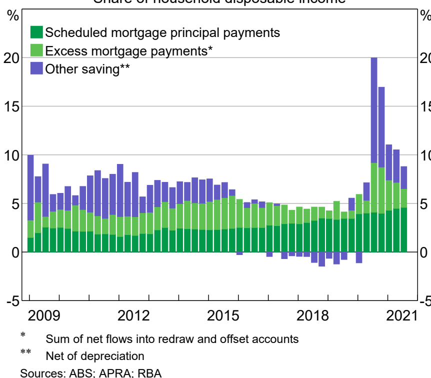
Most indebted households have continued to increase their already significant mortgage prepayment buffers. In aggregate, inflows of mortgage prepayments into offset and redraw facilities accounted for around 4½ per cent of household disposable income in the three months to August. This is similar to the share over the same period last year when prepayments were also elevated due to the effects of the pandemic. The ability of households to build their prepayment buffers continues to be supported by the reduction in mortgage interest rates – interest payments as a share of disposable income have declined by around ¾ of a percentage point since March 2020.

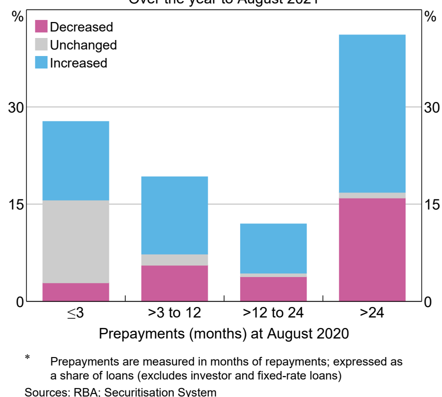
Consistent with this, loan-level data from the Reserve Bank's Securitisation dataset suggest prepayment buffers on the majority of housing loans (excluding loans to investors and fixed-rate loans where there are disincentives, or an inability, to prepay) have increased over the past year (Graph 2.2). Only a small share of loans had low buffers in August 2020 and further decreased their buffers over the following 12 months. Indeed, the majority of loans that had reduced buffers relative to a year prior started with very large buffers of over two years.

Aggregate data indicate that the share of all loans (including investor and fixed-rate loans) with very low prepayment buffers of less than or equal to one month has drifted modestly higher since the middle of last year, to be 41 per cent at August 2021. This is partly explained by an increase in the share of fixed-rate mortgages – which typically limit prepayments – as many borrowers have taken advantage of very low interest rates on fixed-rate products. In August, nearly 35 per cent of outstanding housing loans had fixed interest rates, up from 20 per cent at the start of 2020. Fixed-rate borrowers should be well placed to manage possible higher interest payments at the end of their fixed-rate period over coming years, as the interest rate buffers built into loan serviceability assessments account for potentially higher interest rates.

## … and the share of households with both high debt and low liquidity buffers is very small

Borrowers that are both highly indebted and have low liquidity buffers face the highest risk of experiencing repayment difficulties in the event of an adverse shock to their incomes or



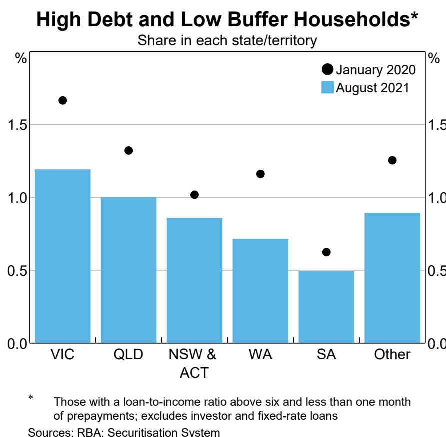
expenses. The Securitisation System data indicate that less than 1 per cent of owner-occupier borrowers have both high debt (measured as a loan-to-income ratio above six) and small prepayment buffers (equivalent to less than one month's worth of repayments) (Graph 2.3). This share of vulnerable borrowers has declined since the beginning of the pandemic, in part reflecting lower interest rates and ensuing debt repayments. Consistent with this, housing loan arrears also remain very low, at around 1 per cent of banks' total housing loans (see 'Chapter 3: The Australian Financial System').

## Households heavily affected by the recent restrictions appear more vulnerable, although household cash flow is being supported by policy measures

Survey data suggest that around one-fifth of indebted households source at least part of their income from the retail, recreation & personal services, transport & storage and construction industries, parts of which have been heavily affected by pandemic-related restrictions. These households tend to have higher debt-servicing and DTI ratios and lower deposit holdings than other households, and have been slightly more likely to seek financial assistance since the pandemic began (Graph 2.4).

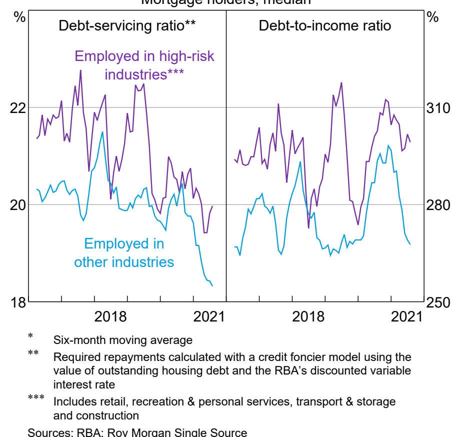
Governments and banks have extended new support measures to households in response to the recent Delta outbreak, including cash payments, loan repayment deferrals and, in some jurisdictions, a moratorium on rental evictions. Support provided to businesses (discussed below) also provides indirect support to households which would otherwise be at greater risk of losing their jobs.

The COVID-19 Disaster Payment, available to workers who have lost hours of work due to lockdowns, has provided direct cash flow support. The maximum payment (of $1,500 per fortnight) is currently equivalent to the initial JobKeeper payment and so will have been supporting many of the most vulnerable households. However, eligibility is confined to regions that are under lockdown and so stimulus payments will contribute less to overall household saving and consumption. Around 2 million people have accessed the Australian Government's Disaster Payment since the start of the program in June. A little over two-thirds of these payments have been made to New South Wales (NSW) residents.




* Those with a loan-to-income ratio above six and less than one month of prepayments; excludes investor and fixed-rate loans

Sources: RBA; Securitisation System




* Six-month moving average

** Required repayments calculated with a credit foncier model using the value of outstanding housing debt and the RBA's discounted variable interest rate

*** Includes retail, recreation & personal services, transport & storage and construction

Sources: RBA; Roy Morgan Single Source

Most banks have offered loan repayment deferrals since early July for a period of up to three months. The share of loans on deferral has been very low relative to last year, reflecting less precautionary behaviour by households and that banks are now assessing the needs of each applicant as opposed to automatically granting all applications (as was the case last year). In August, less than 1 per cent of housing loans by value were on deferral, considerably lower than the peak of 11 per cent in May 2020. Liaison with banks indicates that more than half of borrowers currently on deferral also had a loan deferral last year. Loans currently on deferral tend to have riskier characteristics than other loans, including higher loan-to-valuation ratios (LVRs) at origination or low prepayment buffers (Graph 2.5). A high share of borrowers with loan repayment deferrals are continuing to make partial payments compared to last year. Almost all borrowers who took a deferral last year had resumed making payments and were up to date with their loan schedule prior to the mid 2021 lockdowns.

Renters – who typically report higher levels of financial stress than indebted households – have also been afforded some relief from the rental evictions moratorium in some jurisdictions. Loan repayment deferrals have reduced risks that landlords would be unable to make repayments due to temporary declines in rental income as a result of current lockdowns.

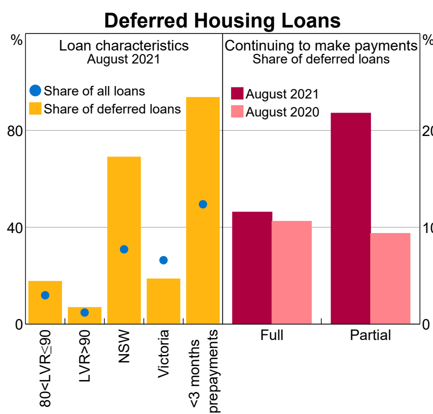
## Housing credit growth has picked up

Housing credit growth increased at an annualised rate of 7½ per cent over the six months to August (Graph 2.6). Higher borrowing has been supported by low interest rates and reflects increased turnover of existing dwellings as well as elevated levels of construction of new houses – the latter boosted by a range of government initiatives. As a share of credit, loan commitments have increased sharply for both owner-occupiers and, more recently, investors. Commitments for owner-occupier loans have moderated a little as lockdown restrictions have contributed to lower auction volumes and property listings in Sydney and Melbourne.

If loan commitments were to be maintained around their recent levels, credit growth could be around 10 per cent in six-month-ended annualised terms by early next year. This would exceed income growth, pushing aggregate household credit-to-income ratios higher (Graph 2.7). A sustained pick-up in housing credit growth well in excess of growth in household incomes would add to risks related to the already high level of household

**Graph 2.5**

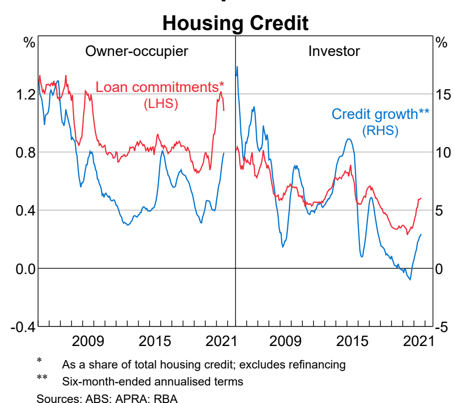
**Deferred Housing Loans**




Sources: APRA; RBA

**Graph 2.6**

**Housing Credit**




* As a share of total housing credit; excludes refinancing

** Six-month-ended annualised terms

Sources: ABS; APRA; RBA

indebtedness (see 'Chapter 5: Mortgage Macroprudential Policies').

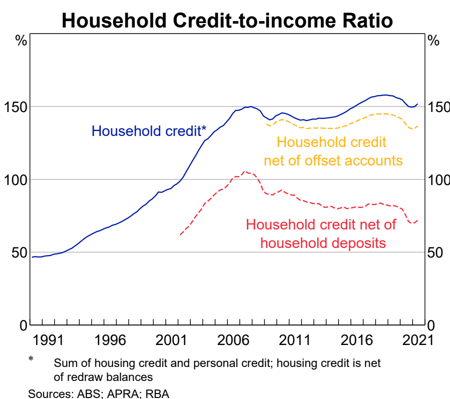
## Lending standards remain sound, although high DTI lending has increased

Lending standards remain sound overall, and the quality of outstanding credit is high. While aggregate lending standards tightened slightly in the early stages of the pandemic, this had mostly been reversed prior to the most recent lockdowns so that lending standards were broadly in line with those in early 2020. However, the quality of new lending depends not only on banks' lending standards but also on the riskiness of households that seek to borrow. Overall, there have been some increases in particular forms of mortgage lending that are typically considered to be more risky – in particular, lending at high DTI ratios and, for a period, at high LVRs.

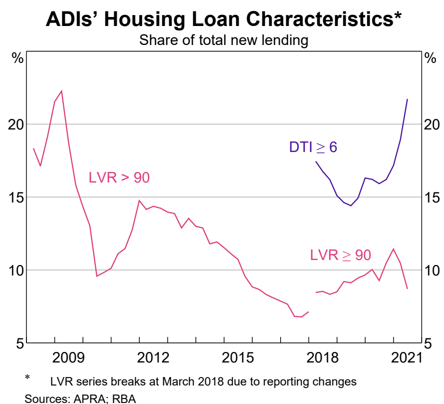
Most notably, the share of new loans originated with a DTI greater than or equal to six, increased by around 6 percentage points to 22 per cent over the year to the June quarter 2021 (Graph 2.8). This share could rise further given the share of high-DTI lending remains below internal risk limits at most banks. Some high-DTI loans are more risky as repayments account for a significant share of income. However, the composition of lending also matters for the riskiness of debt as a whole. For example, some high-DTI loans are taken out by high-income borrowers who can comfortably service a large loan. Further, the increase in the share of high-DTI lending partly reflects the fact that lending to investors (who tend to have higher DTIs, but also larger liquidity buffers) has increased. According to bank liaison, some of the increase in high-DTI lending also reflects higher demand for bridging loans – this is due to increased housing turnover and rising house prices, which encourage repeat purchasers to buy new properties before selling their existing properties. High-DTI borrowers (particularly investors) tend to have larger liquidity buffers than borrowers with lower DTIs (see 'Chapter 5: Mortgage Macroprudential Policies').

The share of new lending at high LVRs (at or above 90 per cent) peaked at 11 per cent in the December quarter of 2020, but has since declined sharply following the end of the 2020/21 First Home Loan Deposit Scheme and as lending to investors (who tend to have lower LVRs) has started to pick up. Around one-third of lending at high LVRs in the first half of 2021 was to first home buyers (FHBs), who are more likely than other borrowers to be deposit-constrained. Survey data indicate that, relative to other owner-occupiers, FHBs tend to start with higher

**Graph 2.7**




**Graph 2.8**



DTI ratios and lower net income surpluses (the amount of income a borrower has left over after meeting their mortgage repayments and basic living expenses). These riskier characteristics are persistent, as FHBs do not repay their debt nor accumulate prepayment buffers at a faster pace than other owner-occupier borrowers in the first five years of their loans (Graph 2.9). While this might suggest FHB loans face a higher probability of default, in practice FHBs are no more likely to report financial stress, difficulty repaying their mortgages or losing their job than other indebted households.

Information from liaison suggests that a couple of banks have tightened lending practices a little recently. Actions taken include requiring applicants to provide more recent income statements, additional discounting of variable income sources and increasing the minimum floor rate used in loan serviceability assessments.

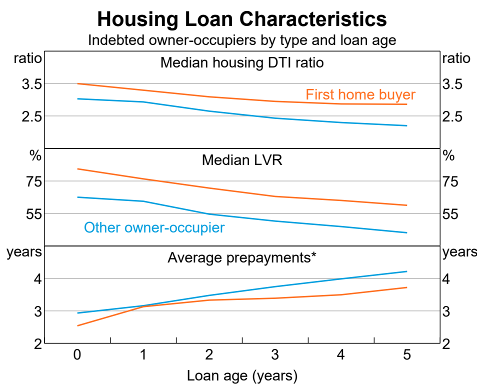
## Broad-based growth in housing prices has reduced the incidence of negative equity

The pick-up in housing borrowing has been accompanied by an acceleration in national housing prices, which were 20 per cent higher over the year to September 2021. This growth has been supported by low interest rates and the economic recovery that had been underway prior to the recent COVID-19 restrictions. Price growth has been broad-based across capital cities and in regional areas, but more pronounced for detached houses than apartments. Despite ongoing lockdowns and slightly slower price growth in the past few months, conditions in established housing markets appear relatively robust overall.

These broad-based increases in housing prices have strengthened the balance sheet positions of property owners (around two-thirds of all households), including those with existing mortgages. Almost all borrowers have positive equity in their properties (i.e. the current value of their property exceeds that of their outstanding loan), and so (at current prices) could resolve serious debt repayment difficulties by selling their properties. The share of loans in negative equity is estimated to be exceptionally low, at just over a ¼ of a per cent, having fallen throughout the past year alongside the increase in housing prices (Graph 2.10).

Strong price growth and extrapolative price expectations can lead to over-exuberance in housing markets. In practice, however, it is difficult to determine if housing prices are over-valued in real time, and current signals from timely data are mixed. User-cost models, which

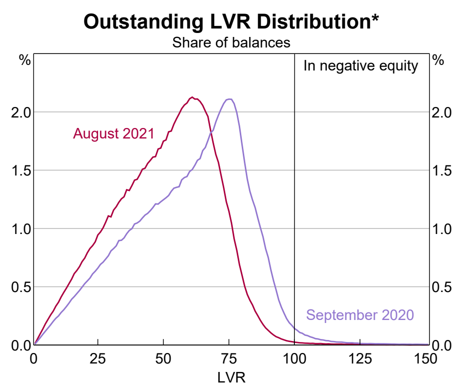
**Graph 2.9**




* Sum of offset and redraw balances measured in years of repayments; excludes fixed-rate loans

Sources: HILDA Survey Release 19.0; RBA; Securitisation System

**Graph 2.10**




* Loan balances adjusted for redraw and offset account balances; property prices estimated using SA3 price indices

Sources: ABS; CoreLogic; RBA; Securitisation System

compare the relative costs of owning versus renting a property (and so take into account a range of factors including the decline in interest rates), suggest housing prices remain broadly in line with fundamentals. However, cruder metrics of over-valuation such as price-to-rent and price-to-income ratios have increased markedly (Graph 2.11).

## The economic recovery supported overall business profitability in the first half of the year, but outcomes have been mixed

In aggregate, business profits increased in the first half of 2021. As a result of improved trading conditions, many businesses were well placed to absorb higher labour expenses when the JobKeeper subsidy ended in March. Aggregate cash holdings remained considerably higher than before the pandemic, with low interest rates providing support to indebted firms (Graph 2.12).

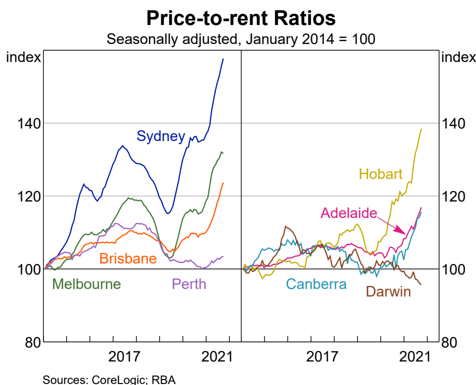
Across nearly all industries, aggregate revenue had recovered to be around or above its pre-COVID-19 level in the first half of this year. However, outcomes have been mixed across firms, reflecting the uneven impact of the pandemic. In particular, firm-level data show that one-fifth of all businesses reported March quarter revenues this year that were less than 60 per cent of their averages between 2014 and 2018 (Graph 2.13). Although only around half of firms reported revenues that met or exceeded their 2014–18 averages in the March quarter of 2021, this share had increased from around 40 per cent since the middle of last year, reflecting improved trading conditions and the broader economic recovery.

Around 10 per cent of businesses were receiving JobKeeper payments when the program ended in March 2021. Many were located in Sydney and Melbourne and, based on the most recent available data (for end of June 2019), in areas with relatively lower median liquidity ratios (the ratio of current assets to current liabilities)

**Graph 2.11**

**Price-to-rent Ratios**

Seasonally adjusted, January 2014 = 100




Sources: CoreLogic; RBA

**Graph 2.12**

**Cash Holdings of Corporations***

Aggregate ratio to monthly expenses

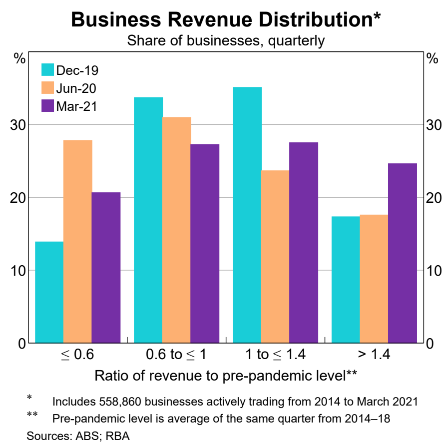
* Private non-financial corporations

Sources: ABS; RBA

**Graph 2.13**

**Business Revenue Distribution***

Share of businesses, quarterly




* Includes 558,860 businesses actively trading from 2014 to March 2021

** Pre-pandemic level is average of the same quarter from 2014–18

Sources: ABS; RBA

(Graph 2.14). Although more timely liquidity ratio data are not available, the prolonged lockdowns in these cities in recent months mean that some vulnerable businesses will be depleting their cash buffers. Some may find it difficult to service their debts, particularly if their trading conditions do not improve when restrictions are eased and targeted policy support measures are withdrawn. Vulnerable firms may also find it difficult to maintain their current levels of employment given cash flow challenges. In turn, this could diminish the ability of affected households to service their own debts.

## Targeted policy support has been helping cash flows for businesses in locked down areas and affected industries …

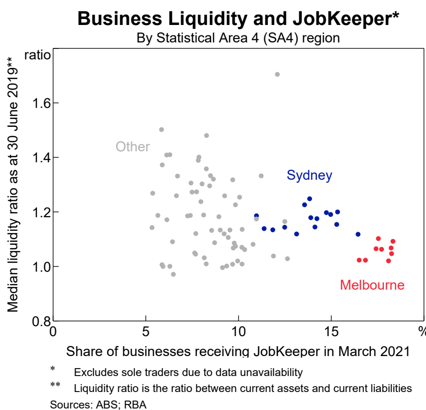
A number of policy measures are supporting the cash flows and liquidity of vulnerable businesses through the 2021 lockdowns. In NSW, small and medium-sized enterprises (SMEs) with a decline in turnover of at least 30 per cent have received over $7 billion since the start of the lockdown in late June – this includes the ongoing JobSaver payment, which has been accessed by a little over one-fifth of businesses in the state. Likewise, one-fifth of Victorian businesses have received similar payments through the Business Costs Assistance Program. Some states have also introduced tax deferrals or waivers (e.g. for payroll and land tax) and rent relief for some commercial tenants to further assist affected businesses.

Since early July, banks have offered loan repayment deferral arrangements of up to three months for small business customers (with loans in good standing of up to $3 million and business turnover of less than $5 million). As has been the case for housing loans, take-up to date has been negligible, at less than ½ per cent of SME loans by value in August 2021. Prior to this, arrears rates on business loans were very low.

## … but insolvencies are likely to rise from low levels

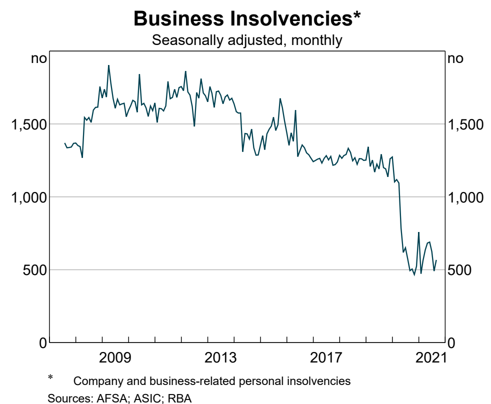
Temporary insolvency relief measures and income support policies had kept insolvencies at very low levels in the second half of 2020, both by providing liquidity and giving distressed businesses time to restructure or wind down without insolvency. As this support was unwound in early 2021, insolvencies rose modestly; however, into the second half of 2021, numbers have remained much lower than before the pandemic (Graph 2.15).

**Graph 2.14**




* Excludes sole traders due to data unavailability
** Liquidity ratio is the ratio between current assets and current liabilities
Sources: ABS; RBA

**Graph 2.15**




* Company and business-related personal insolvencies
Sources: AFSA; ASIC; RBA

In the near term, government support measures for businesses in areas affected by recent lockdowns will help keep insolvencies low. However, increases are likely over a longer period as vulnerable businesses exhaust their cash buffers. One potential mitigating factor from a financial stability perspective is that around 30 per cent of bank lending for SMEs (those with an annual turnover of less than $50 million) is secured by residential property, meaning that the recent increases in housing prices will likely help some businesses avoid insolvency. For those that do become insolvent, insolvency policies for incorporated small businesses introduced at the beginning of the year are helping to improve outcomes for businesses and their creditors. These include a new debt-restructuring process and simplified liquidation procedures.

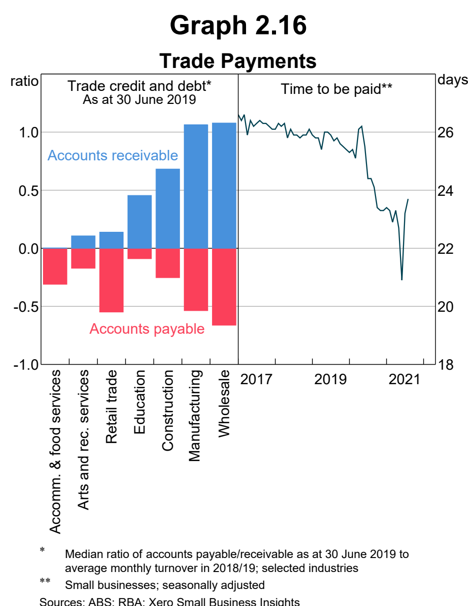
The risks of spillover effects from insolvencies to other businesses through trade credit links appear to have declined since the start of the pandemic, in part because businesses' cash buffers have generally risen. While firm-level analysis suggests businesses in vulnerable industries such as retail, accommodation & food services and construction typically owed significant amounts to other businesses prior to the pandemic, evidence suggests that invoicing practices have since tightened. Data for a sample of small businesses show that the average time to be paid is roughly 5 per cent lower than in early 2020 (Graph 2.16).

## Risks to retail and office property landlords remain elevated …

Prior to the pandemic, retail commercial property was already facing challenges, partly reflecting a longer-run structural shift towards online retailing.[1] Restrictions on face-to-face retailing for non-essential items during the pandemic have accelerated this process. This has placed further pressure on many bricks-and-mortar retailers, and is contributing to greater uncertainty about the longer-term outlook for tenant demand.

Retail vacancy rates, which had been drifting higher over a number of years, have increased sharply since early 2020 (Graph 2.17). The largest increases have occurred in central business districts (CBDs) of major capital cities, where rents have declined by nearly 15 per cent since the start of 2020. Conditions have been relatively more favourable in neighbourhood shopping centres because they are mainly focused on essential food retailing, with supermarkets as anchor tenants. While speciality store vacancy rates in neighbourhood centres have increased, rents have remained fairly stable.

In some states and territories, governments have reintroduced rules requiring negotiation of temporary rent relief for commercial tenants that are experiencing financial stress due to COVID-19 trading restrictions. Under these arrangements, some landlords are eligible for support through grants or tax relief, and this is providing some support to cash flows in light of temporarily declining rent receipts. Large listed real estate investment trusts (which own around




* Median ratio of accounts payable/receivable as at 30 June 2019 to average monthly turnover in 2018/19; selected industries

** Small businesses; seasonally adjusted

Sources: ABS; RBA; Xero Small Business Insights

three-quarters of regional and sub-regional shopping centres) are in good financial health and appear well placed to absorb temporary reductions to income resulting from the 2021 lockdowns.

Office tenant demand has declined considerably since the start of the pandemic. The increase in vacancy rates has been most pronounced in Sydney and Melbourne, and evident in both prime and secondary-grade markets (Graph 2.18). More than one-quarter of the rise reflects an increase in subleasing vacancies, suggesting landlords are still receiving at least some rent for those properties. However, there is a risk that landlord rental income will decrease further if head leases are not renewed on subleased space. Overall, prime CBD effective rents fell by 13 per cent in Sydney and 5 per cent in Melbourne over the year to June 2021, as incentives provided by landlords increased. Conditions in secondary-grade markets could weaken further as demand tends to shift to discounted higher-grade properties.

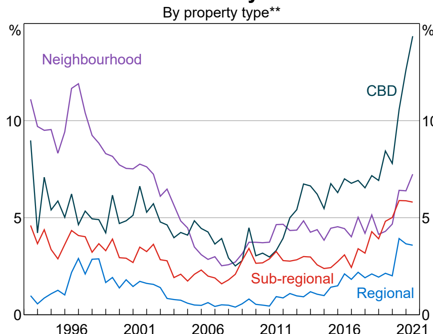
A large volume of office supply is due to be completed in Sydney and Melbourne in the near term (Graph 2.19). In Melbourne, office completions in the second half of 2021 alone are expected to be almost double their decade annual average. Given weak demand, further increases in vacancies and declines in rents are likely. Around half of the additional supply under construction has pre-committed tenants, reducing the risk to income for owners of newly developed buildings.

There is considerable uncertainty about the demand for office space over the longer term. While remote working reduces the need for office space, changes in office configurations to accommodate social distancing will likely increase the floor space required per worker. Despite the uncertainty around leasing demand, valuations have been little changed over the past year, as weaker expectations about future

## Graph 2.17

**Retail Vacancy Rates***

By property type**



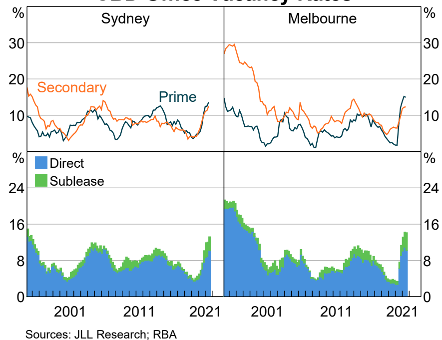

* Vacancy rates for specialty stores

** Regional centres are anchored by department stores, sub-regional by discount department stores, and neighbourhood by supermarkets; CBD includes a variety of retail formats

Sources: JLL Research; RBA

## Graph 2.18

**CBD Office Vacancy Rates**

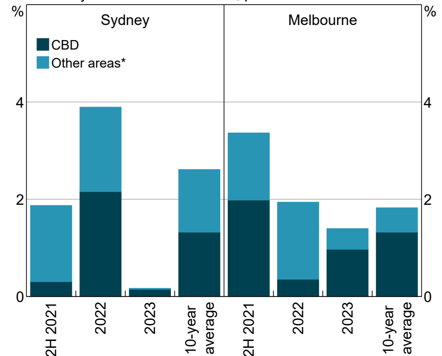



Sources: JLL Research; RBA

## Graph 2.19

**Future Office Supply**

Projects under construction, per cent of 2020 stock



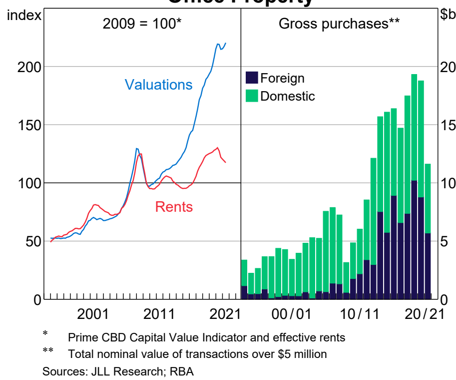

* In Sydney, other areas include North Sydney, Parramatta, Chatswood, St Leonards, Sydney South, Norwest, Sydney fringe, Sydney Olympic Park/Rhodes and Macquarie Park. In Melbourne, other areas are those in Melbourne fringe and south-east suburbs

Sources: JLL Research; RBA

rental income growth have been offset by low interest rates and ongoing strong foreign demand (Graph 2.20).

Graph 2.20

Office Property




* Prime CBD Capital Value Indicator and effective rents
** Total nominal value of transactions over $5 million
Sources: JLL Research; RBA

## … but risks to banks remain low

Despite these challenges, risks to banks remain low. Banks' commercial property exposures are less than 6 per cent of total assets, and impairment rates on these exposures remain negligible. Strong lending standards have been maintained in recent years, and widespread use of watchlists and loan covenants provide lenders with early warning signals for borrowers experiencing financial difficulties. Liaison with banks suggest these instances remain rare. Non-bank lenders continue to account for only a small share of commercial property lending, though there are some signs that they have been growing their loan books over the past year, typically with less stringent lending criteria relative to banks.

## Endnotes

[1] For further details, see RBA (2021), 'Box B: Risks in Retail Commercial Property', *Financial Stability Review*, April, pp 32–36.