Box D

The Distribution of Variable Housing Interest Rates

This box discusses the considerable variation in mortgage rates paid across different borrowers and how this distribution has changed over the past two years.

Very few borrowers actually pay mortgage rates as high as the standard variable rate (SVR). Rather, borrowers are generally offered, or negotiate, a discount relative to this reference rate. These discounts can be significant, with the lowest advertised rates being materially below the SVR, and a small share of borrowers paying even lower rates still. The average discount to the SVR for existing owner-occupier loans with variable mortgage rates is currently around 120 basis points. On average, new borrowers receive a further discount of around 30 basis points on owner-occupier variable-rate mortgages. That is, they tend to pay an interest rate that is around 150 basis points below the SVR. These discounts vary, in part, according to the creditworthiness of individual borrowers or the riskiness of the loan.

The interest rates paid by most borrowers fall between the lowest advertised rate and the SVR. This was the case two years ago and remains true currently. In 2017, it was common for borrowers to have paid a rate that was close to the so-called 'package rate'.[1] By contrast, in 2019, a larger share of borrowers are paying rates below package rates.

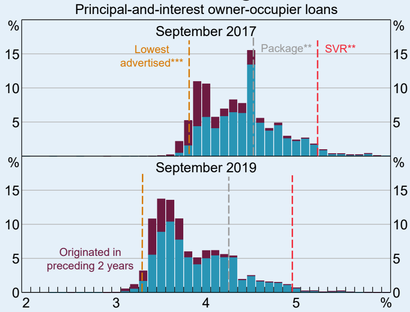
Graph D.1 shows the distribution of variable interest rates for owner-occupier loans with principal-and-interest repayments extended by banks.[2],[3] This is the most common mortgage type in Australia, accounting for about 55 per cent of all home loans. The distribution of interest rates paid for other types of variable-rate loans has evolved similarly over the past two years.

Most households are paying lower mortgage rates now than borrowers were paying two years ago. In other words, there has been a downward shift in the distribution of interest rates over the past two years. This reflects three factors. First, there is the pass-through of the reductions in the cash rate this year to SVRs, and so to all variable-rate mortgages. On average, the banks have passed through 60 basis points of the 75 basis point reduction in the cash rate to their SVRs. (The data in graph D.1 do not include the October 2019 cash rate cut.) Second, new variable-rate loans are typically offered at lower interest rates than outstanding variable-rate

Graph D.1

Variable Housing Rates*

Principal-and-interest owner-occupier loans



* Securitised loans, weighted by institution credit outstanding

** Simple average of major banks

*** Simple average of major banks, including discount brands

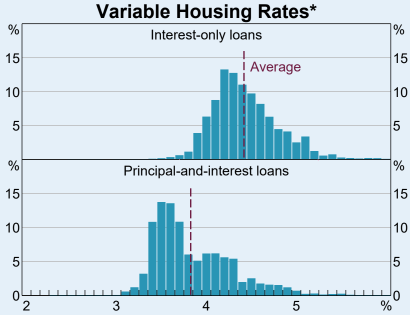
Sources: Banks' websites; CANSTAR; RBA; Securitisation System loans, even for borrowers with similar characteristics. (This can be seen for owner-occupier principal-and-interest loans by the maroon-shaded bars in both panels of Graph D.1.) On average, for owner-occupiers with variable-rate loans, interest rates on new loans are currently around 30 basis points below those of existing loans. Similar discounts for new loans are evident for other loan types, such as investor and interest-only loans. Indeed, households obtaining new loans, refinancing existing loans, or negotiating a better deal with their existing lender, tend to receive lower rates than existing borrowers that do not alter their original loan arrangements. This reflects strong competition among lenders for high-quality borrowers. Liaison with banks, mortgage brokers and non-ADIs confirms that well-informed households with existing loans are approaching their current lenders to request a reduction in their interest rate.

Third, borrowers are continuing to switch from interest-only loans to principal-and-interest loans, which have a lower interest rate (Graph D.2). This is true of both borrowers with owner-occupier and investor loans. Over the past two years, the interest-only share of the stock of loans outstanding has declined from around 40 per cent to 20 per cent.

In combination, the second and the third factors have lowered the average mortgage rate on variable-rate loans by a further 5 basis points (over and above the changes in SVRs) over the past six months or so. Both factors could lead to further small reductions of average mortgage rates in the period ahead. ✠

Graph D.2

Variable Housing Rates*



* Weighted by lender credit outstanding

Sources: RBA; Securitisation System

Endnotes

[1] A typical package mortgage product has additional features beyond the 'basic' mortgage (such as an offset account) and may be bundled with other products (such as a credit card).

[2] The distribution of interest rates is sourced from the Securitisation Dataset, which provides a monthly update on the interest rate paid on around one-quarter of mortgages in Australia. See Fernandes K and D Jones (2018), 'The Reserve Bank's Securitisation Dataset', RBA Bulletin, December. Available at <https://www.rba.gov.au/publications/bulletin/2018/dec/the-reserve-banks-securitisation-dataset.html>.

[3] There is a wider range of interest rates offered by non-banks, as these lenders are more likely to lend to borrowers with higher-risk characteristics and as a result charge a higher interest rate. See Kohler M (2017), 'Mortgage Insights from Securitisation Data', Speech to the Australian Securitisation Forum, 20 November. Available at <https://www.rba.gov.au/speeches/2017/sp-so-dm-2017-11-20.html>.