Box C

Do Borrowers with Older Mortgages Pay Higher Interest Rates?

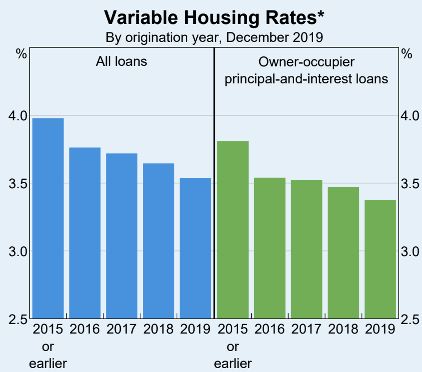
For variable-rate mortgages, older loans typically have higher interest rates than new loans, even for borrowers with similar characteristics. This means that existing borrowers who are able to refinance with another lender or negotiate a better deal with their existing lender can achieve interest savings. This box examines the extent to which borrowers with older mortgages pay higher interest rates and considers the drivers of this.

Interest rates are higher on older loans

The difference in interest rates between new and outstanding variable-rate home loans increases with the age of the loan. Just under half of all variable-rate home loans in the Reserve Bank's Securitisation Dataset were originated four or more years ago. Currently, these loans have an interest rate that is around 40 basis points higher than new loans (Graph C.1). For a loan balance of $250,000, this difference implies an extra $1,000 of interest payments per year.

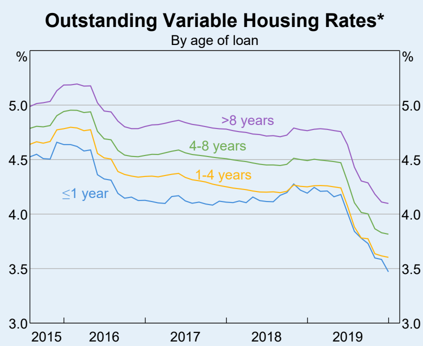
Some of the difference in rates between older and newer mortgages can be explained by a shift in the mix of different types of variable-rate mortgages over time. In particular, the share of interest-only and investor loans in new lending has declined noticeably in recent years and these tend to have higher interest rates than other loans. Nevertheless, even within given types of mortgages, older mortgages still tend to have higher interest rates than new mortgages. The right-hand panel of Graph C.1 shows this for principal-and-interest owner-occupier loans, which account for around 55 per cent of mortgages. Moreover, higher interest rates for older loans has been a feature of variable-rate mortgages for several years (Graph C.2).

Graph C.1



* Securitised housing loans
Sources: RBA; Securitisation System

Graph C.2



* Balance weighted average of securitised principal-and-interest loans, grouped by time elapsed since origination at each time point
Sources: RBA; Securitisation System

There is strong competition for new borrowers

In part, the variation in interest rates paid by different borrowers reflects their creditworthiness or the riskiness and features of loans. In addition, it reflects the different interest rates offered by different lenders. However, the time at which the mortgage was taken out also has an important influence on the interest rate paid. This reflects the tendency for competitive pressures to be strongest for new and other borrowers who are in the process of shopping around for a loan.

The discounts that borrowers receive have increased in recent years

Very few borrowers actually pay interest rates as high as the standard variable rates (SVRs) published by lenders. While SVRs are the reference rates against which variable-rate loans are priced, lenders also advertise a range of interest rates that are materially lower than their SVRs.[1], [2] In addition, most individual borrowers are offered, or may be able to negotiate, further discounts on the interest rate applied to their loan. For instance, the major banks' 'package' mortgage interest rates for owner-occupier loans currently attract a discount of around 50–100 basis points to SVRs.[3] The lowest *advertised* rates are around 100 basis points lower than those package rates, and a few borrowers receive even larger discounts.

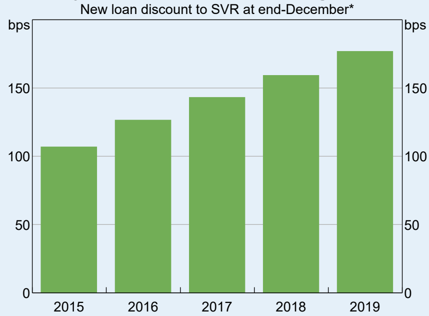
Indeed, in recent years, the average discounts relative to SVRs offered by major banks on new variable-rate mortgages have grown, widening from around 100 basis points in 2015 to more than 150 basis points in 2019 (Graph C.3). By increasing the discounts on rates for new or refinancing borrowers over time, rather than lowering SVRs, banks are able to compete for new borrowers without lowering the interest rates charged to existing borrowers. So the rise in the average differential between SVRs and interest rates charged on outstanding variable-rate loans reflects the increased discounting on more recently originated loans. The discounts borrowers receive on loans are usually fixed over the life of the loan, although they can be renegotiated. Indeed, interest rates charged on outstanding variable-rate loans have declined by more than SVRs in recent times in part because well-informed borrowers have been able to negotiate a larger discount with their existing lender, without the need to refinance their loan.

In January 2020, the Reserve Bank began publishing more detailed monthly data on mortgage interest rates paid by households on new and existing mortgages (see 'Box D: Enhancing the Transparency of Interest Rates'), which may help more households to make better-informed choices about their mortgages.

Graph C.3

Major Banks' Variable Housing Rates

New loan discount to SVR at end-December*



* New loans are those originated during the year

Sources: APRA; major banks' websites; RBA; Securitisation System

Endnotes

[1] Lenders usually advertise a number of SVRs; often the applicable rate will depend on whether the property will be used for an owner-occupied or investment purpose, and whether the borrower elects to repay the principal of a loan or the interest only.

[2] For more information see RBA (2019), 'Box D: The Distribution of Variable Housing Interest Rates', *Statement on Monetary Policy*, November, pp 59–60.

[3] A typical package mortgage has additional features beyond a 'basic' mortgage, such as an offset account, but will attract a higher fee. It may be offered in conjunction with discounts on other products, such as credit cards and insurance policies.