5.2 Focus Topic: An Update on Fixed-rate Borrowers

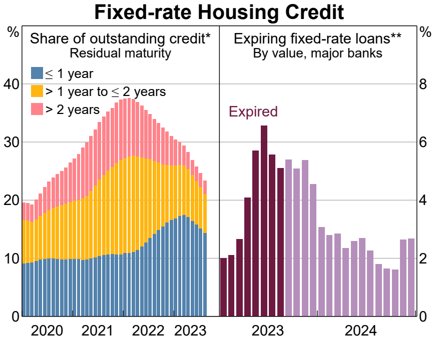
Between March 2020 and January 2022, when interest rates were at their lowest, the share of fixed-rate housing credit almost doubled, nearing 40 per cent of housing credit outstanding (Graph 5.2.1). Since the first increase in the cash rate in May 2022, around 45 per cent of these loans (by value) have rolled off onto higher interest rates, with the vast majority of these borrowers opting for variable-rate loans.

This Focus Topic explores how borrowers who have already rolled off fixed rates have managed the transition and assesses the risks for the remaining fixed-rate borrowers. It finds that:

- **The vast majority of borrowers who have rolled off fixed rates have managed the transition to higher interest rates well.** Arrears rates among this group have increased a little, in line with the increase observed among variable-rate borrowers.
- **The majority of current fixed-rate borrowers are estimated to have sufficient income to continue meeting their obligations after moving onto higher mortgage payments.** The majority also have large savings buffers.[1]
- **Fixed-rate loans yet to roll off do not appear materially riskier than those that have already rolled off.** This group contains a slightly larger share of higher risk borrowers; however, these borrowers have also benefited from low rates for longer.

Graph 5.2.1

Fixed-rate Housing Credit



* Share of outstanding housing credit. Latest observation August 2023.

** Value of fixed-rate housing loans outstanding from a survey of major banks as at end-December 2022. Loans expiring beyond 2024 not available monthly.

Sources: APRA; Major banks; RBA.

The vast majority of fixed-rate borrowers who have rolled off to date have managed the transition well.

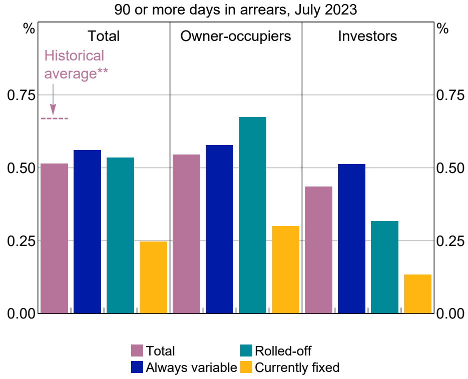
Arrears rates for borrowers who have recently rolled off fixed-rate loans have increased slightly from low levels and are generally similar to arrears rates among other variable-rate borrowers (Graph 5.2.2).[2]

Arrears rates for borrowers who have recently rolled off fixed rates are also similar to those of other variable-rate borrowers when considered by borrower risk characteristics. Borrowers who took out (or refinanced) loans at low rates could be expected to be riskier given the larger increase in interest rates they face compared with other borrowers. However, arrears rates have remained low for these borrowers to date (Graph 5.2.3).[3] By contrast, arrears rates tend to be higher for borrowers with high ratios of loan-to-value (LVR) or loan-to-income (LTI), and moderately higher for first home buyers.[4] As might be expected, arrears rates are lower for borrowers still on fixed rates irrespective of their risk characteristics.

Graph 5.2.2

Arrears Rates by Loan Type*

90 or more days in arrears, July 2023



* Loans originated before May 2022. Rolled-off loans rolled onto variable rates by July 2023.

** Average rate of loans in 90 or more days in arrears from 2015 to the March quarter of 2022 from APRA data.

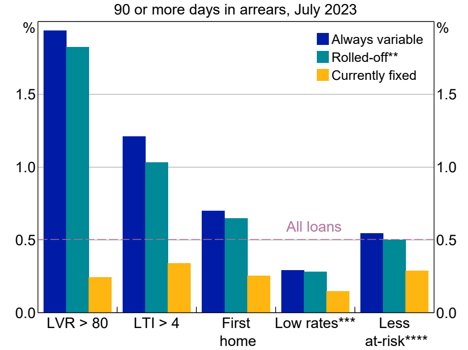
Sources: APRA; RBA; Securitisation System.

Arrears rates for borrowers who have transitioned from fixed to variable rates are higher for owner-occupiers than investors (Graph 5.2.2). This may be partly attributed to investors tending to have higher savings on average, and to the strong growth in rental incomes helping them to partially offset the increase in their borrowing costs. Investors are also more likely to sell an investment property before entering arrears compared with owner-occupiers, for whom selling their home can come with significant financial and personal costs.

Graph 5.2.3

Arrears Rates by Risk Factor and Loan Type*

90 or more days in arrears, July 2023



* Includes loans originated prior to May 2022. LTI is measured as the ratio of current loan value (net of redraw balances) relative to an estimate of current income. LVR is scheduled loan balance adjusted for redraw and offset account balances divided by an estimate of current value of the property. Property valuation at origination adjusted using house price changes at GCCSA level.

** Includes loans that rolled off fixed to variable rates since May 2022.

*** Originated between March 2020 and April 2022.

**** Loans that do not possess the other listed factors.

Sources: ABS; CoreLogic; RBA; Securitisation System.

Most remaining fixed-rate borrowers appear well placed to manage the transition to higher interest rates when their loans roll off.

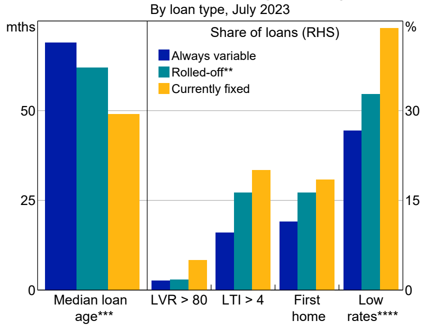
This is supported by three factors:

1. **Fixed-rate loans yet to roll off do not appear materially riskier than those that have rolled off already.** However, there is a somewhat higher share of risky characteristics among current fixed-rate borrowers than those whose loans have already rolled off. In part, this reflects that these loans are generally newer, so borrowers have had less time to repay their principal (i.e. reduce the size of the loan) and build up savings buffers (Graph 5.2.4). The majority of these loans can be expected to become less risky over time; however, in the meantime they will likely be more at risk if unemployment were to rise.

Graph 5.2.4

Loan Characteristics by Rate Type*

By loan type, July 2023



* LTI is measured as the ratio of current loan value (net of redraw balances) relative to an estimate of current income. LVR is scheduled loan balance adjusted for redraw and offset account balances divided by an estimate of current value of the property. Property valuation at origination adjusted using house price changes at GCCSA level.

** Includes loans that rolled off fixed rates to variable rates since May 2022.

*** Excludes externally refinanced loans.

**** Originated between March 2020 and April 2022.

Sources: ABS; CoreLogic; RBA; Securitisation System.

2. **Most fixed-rate borrowers are estimated to have sufficient incomes to meet their higher mortgage payments and necessary expenses.** Current fixed-rate borrowers are expected to face slightly larger increases to their scheduled mortgage payments when their fixed-rates loans roll off compared with those whose loans have already rolled off. As at July 2023, around 10 per cent of fixed-rate borrowers who have rolled off their fixed rates since May 2022 have faced an increase in their payments of more than 60 per cent. By comparison, around 14 per cent of current fixed-rate borrowers are expected to face an increase in mortgage payments of more than 60 per cent when they roll off, based on variable rates as at July 2023. This in part reflects that a larger share of these loans were originated (or refinanced) at very low interest rates during the COVID-19 pandemic compared with fixed-rate loans that have already rolled off.

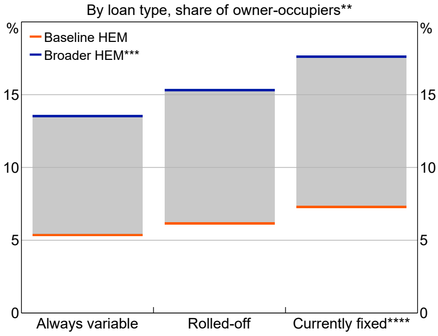
   Nevertheless, the vast majority of fixed-rate borrowers have sufficient income to service these higher loan payments and meet their essential expenses. Around 7 per cent of fixed-rate owner-occupier borrowers are estimated to have their required mortgage payments and essential spending rise to be above their incomes after rolling off their fixed rates, based on baseline living expenses from the Household Expenditure Measure (Graph 5.2.5; see also Chapter 2: Resilience of Australian Households and Businesses). This estimated share increases to around 18 per cent when using a broader measure of expenses.

3. **Most fixed-rate borrowers have substantial savings.** Further supporting borrower resilience, fixed-rate owner-occupier borrowers have benefited from lower interest rates during their fixed-rate period and accumulated material savings buffers over that time (and in some cases, added to their existing savings).[5] Around two-thirds of these borrowers have liquid savings equivalent to at least 12 months of scheduled mortgage payments. This is comparable to the savings of variable-rate owner-occupier borrowers (Graph 5.2.6). However, there is also a smaller share of fixed-rate borrowers (less than 20 per cent) who will roll off onto higher interest rates with much lower savings buffers, equivalent to less than three months of scheduled mortgage payments.

Graph 5.2.5

Estimates of Borrowers with Cost of Living Exceeding Income*

By loan type, share of owner-occupiers**



* Estimates of borrowers with mortgage payments and essential expenses (HEM) in excess of income as at July 2023.

** Investors excluded; investor incomes are likely observed with greater error in the Securitisation System as they tend to rely less on regular income sources.

*** This factors in some other expenses that are excluded from the baseline HEM (mainly private health insurance and private school fees).

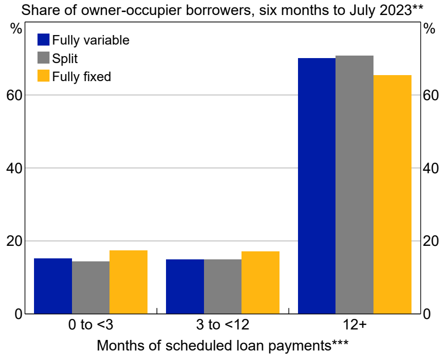
**** Estimates for fixed-rate borrowers assume they roll off on to the outstanding variable rate in July 2023.

Sources: ABS; Melbourne Institute; RBA; Securitisation System.

Graph 5.2.6

Liquid Assets of Mortgage Holders*

Share of owner-occupier borrowers, six months to July 2023**



* Balances in deposit accounts (including offset and redraw), shares and managed funds.

** Includes all loans held by owner-occupier respondents, which could include loans on investment properties. Respondents who only hold investor loans are excluded.

*** Monthly scheduled payment assuming borrowers face average outstanding variable rate as at June 2023.

Sources: RBA; RFI Global's DBM Atlas.

Endnotes

[1] See Lovicu G-P, J Lim, A Faferko, A Gao, A Suthakar and D Twohig (2023), 'Fixed-rate Housing Loans: Monetary Policy Transmission and Financial Stability Risks', RBA *Bulletin*, March.

[2] Earlier-stage arrears are also similar for borrowers who have rolled off fixed-rate loans and variable-rate borrowers. The level is higher for the share of rolled-off loans that are 30 days or more in arrears, at around 1.2 per cent, but liaison with lenders suggests that some of this reflects borrowers needing to update their payments rather than borrowers experiencing servicing difficulties.

[3] This is consistent with the analysis in 5.3 Focus Topic: Indicators of Household Financial Stress, which finds that a similar share of these borrowers have estimated costs of living in excess of income and similar savings buffers as other borrowers.

[4] For discussion of these risk factors, see 5.3 Focus Topic: Indicators of Household Financial Stress.

[5] Some borrowers were on variable-rate loans previously and already had large savings before fixing their rate. Fixed-rate borrowers are limited in their ability to save in offset and redraw accounts associated with their mortgages and therefore hold their savings largely outside of such accounts. While around one-fifth of recently rolled-off borrowers move over significant savings once they regain access to redraw and offset accounts associated with their new variable-rate loans, most keep their savings in their existing structures. This could reflect inertia or potential transaction costs (e.g. when selling shares). As a result, their saving buffers as measured by savings in their offset and redraw accounts (visible in the Securitisation System data) appear significantly lower on average than those of comparable variable-rate borrowers even a few months after roll-off. We are instead able to monitor their other forms of savings via private survey data as shown in Graph 5.2.6.