

Tightening the Mortgage Belt

Introduction

The recent decision by the Reserve Bank of Australia (RBA) to increase interest rates following seventeen months of unchanged, historically low rates has generated interest in the impact of this decision on the approximately 32 per cent of Australian households with mortgages.¹ It has also prompted speculation about further rate rises in the next few months.

This Research Note updates previous IRS research from early 2001 which estimated that the size of the average mortgage was considerably less than the figure used by some commentators at the time.² It also assesses the impact of the recent interest rate rise on both first home buyers (FHBs) and repeat buyers (RBs) who have taken out loans in the last ten years. Readers' attention is also drawn to other recent Research Notes on housing.³

New Versus Average Mortgage

Despite the efforts of the Governor of the RBA⁴ to focus attention more on the average of all mortgages in existence rather than the average new mortgage (i.e. for the latest month available), the erroneous tendency for commentators to look only at the impact of the recent rate rise on the average new mortgage persists. Examples of the description of the impact of the rate rise in the media include 'the interest payable on variable home loans will rise by about \$30 a month for a 25-year, standard \$200 000 mortgage'⁵ and 'the cost of servicing your average mortgage went up \$30 a month yesterday'.⁶

However, a more accurate and appropriate basis for analysis and debate is provided by the average mortgage which covers all loans in existence regardless of when they were taken out.

Growth in New Mortgage Size

Table 1 shows the average new mortgage has increased in each of the last ten years except 2000-01 for both FHBs and RBs.

Using the same methodology as previously,⁷ from Table 2 it is estimated that the average FHB mortgage is currently in the range \$118 000 to \$123 000 while for RBs it is in the range \$127 000 to \$132 000. Again this is much less than the figure typically used in media reports.

Table 1 also shows that the surge in the size of new loans is not just a recent development. The average mortgage size for all borrowers has

increased at an annual average of over 8 per cent since 1995-96.

Impact of interest rate increases

On 5 November 2003, the RBA increased the cash rate by 25 basis points to 5.0 per cent. This has resulted in the indicator standard variable interest rate for bank housing loans increasing from 6.55 per cent to 6.8 per cent.

Table 3 shows that homebuyers who took out their loan during the five

Table 1: Number and size of new mortgages, and housing interest rates
1993-94 to 2002-03

	First home buyers		Repeat buyers		All buyers		Housing interest rate ¹ (%)
	No.	Average mortgage (\$'000)	No.	Average mortgage (\$'000)	No.	Average mortgage (\$'000)	
1993-94	121 034	84.7	426 600	89.0	547 634	88.1	8.9
1994-95	102 025	90.0	349 323	95.0	451 348	93.8	10.0
1995-96	96 406	92.2	355 114	98.0	451 520	96.7	10.4
1996-97	108 045	98.8	373 392	105.3	481 437	103.8	8.3
1997-98	97 372	106.5	384 801	115.1	482 173	113.3	6.7
1998-99	103 643	119.6	384 530	127.3	488 173	125.7	6.6
1999-00	112 129	132.6	433 368	137.3	545 497	136.3	7.0
2000-01	127 067	124.8	427 228	136.5	554 295	133.8	7.6
2001-02	142 318	145.3	488 502	155.2	630 820	153.0	6.3
2002-03	99 488	162.2	530 683	170.5	630 171	169.2	6.6

1 RBA indicator rate for variable rate bank mortgages.

Sources: ABS *Housing Finance for Owner Occupation* (cat. no. 5609.0) and Reserve Bank of Australia *Statistical Bulletin*, various issues.

Table 2: Summary of new mortgages 1993-94 to 2002-03

	First home buyers		Repeat buyers		All buyers	
	No.	Average mortgage (\$)	No.	Average mortgage (\$)	No.	Average mortgage (\$)
5 years 1993-94 to 1997-98	524 882	88 968	1 889 230	95 053	2 414 112	93 737
5 years 1998-99 to 2002-03	584 645	136 725	2 264 311	147 079	2 848 956	144 954
Ten years 1993-94 to 2002-03	1 109 527	116 546	4 153 541	125 812	5 263 068	123 859

Source: Derived from Table 1.

years 1993–94 to 1997–98 will, on average, be paying an extra \$15 per month while for those who took out their loan between 1998–99 and 2002–03 the increase in repayments will average \$23 per month. For the average mortgage, the increase will be about \$19 per month. Again this is significantly lower than the figure used in media reports.

The repayment increases shown in Table 3 are based on the assumption that all borrowers have only been making the minimum interest rate rise

most bank borrowers were ahead of their mortgage repayments.¹¹

Other factors which will affect the impact of the rate rise on borrowers include whether they have a fixed rate loan¹² and whether their loan agreement provides for interest rate changes to be applied to the actual or scheduled balance outstanding.

Mortgage Affordability

Despite recent concerns expressed by the RBA about trends in housing related household debt, it is worth

Table 3: Impact of November 2003 interest rate rise

		Average mortgage (\$)	Monthly repayments pre 5/11/03	Monthly repayments post 5/11/03	Increase in monthly repayments
5 years 1993–94 to 1997–98	First home buyers	88 968	\$604	\$618	\$14
	Repeat buyers	95 053	\$645	\$660	\$15
	All	93 737	\$636	\$651	\$15
5 years 1998–99 to 2002–03	First home buyers	136 725	\$927	\$949	\$22
	Repeat buyers	147 079	\$998	\$1021	\$23
	All	144 954	\$983	\$1006	\$23
Ten years 1993–94 to 2002–03	First home buyers	116 546	\$791	\$809	\$18
	Repeat buyers	125 812	\$853	\$873	\$20
	All	123 859	\$840	\$860	\$19

Source: Derived from Table 2.

repayments on their loans. However, as reported previously⁸ it is common practice for borrowers to make repayments ahead of the scheduled minimum level, especially when interest rates fall, thereby establishing a buffer against future rate rises.

There are a number of strong indications that the majority of borrowers have such a buffer:

- nearly 60 per cent of borrowers in the decade to 2002–03 borrowed at interest rates in excess of 6.8 per cent (see Table 1) and history suggests they are very likely to have left their repayments unchanged when rates fell⁹
- just over half of the households who bought their first home in the three years to 1999 were making above the minimum repayments,¹⁰ and
- recent reports conclude that the average home loan customer at National Australia Bank was 20 per cent ahead of repayments and

noting that mortgage repayments have accounted for a declining share of the gross income of house purchasers during the 1990s—down from 20 per cent in 1990 to 17 per cent in 1999–2000.¹³ All income groups recorded a fall. Given this and the above discussion on the impact of the rate rise, a little tightening of the mortgage belt is likely to be quite manageable for the average borrower.

This Research Note has canvassed the financial impact of last month's interest rate rise on existing mortgage holders. However, possibly of greater importance, is the extent to which expectations about the amount and timing of any further short-term rate increases will affect the future borrowing patterns of existing and potential mortgagees.

1. During the last ten years 17 per cent of borrowers have taken out other than variable rate mortgages. These households, that is about 5 per cent of Australian households, may therefore not be

immediately affected by the rate increase.

2. Peter Hicks, 'HTrends in mortgages'H, *Research Note no. 22*, Department of the Parliamentary Library, 2000–01.
3. Stephen Barber, 'HHome Loans: Size, Interest and Repayments'H, *Research Note no. 20*, Department of the Parliamentary Library, 2003–04. Tony Kryger, 'HMortgage Stress'H, *Research Note no. 16*, Department of the Parliamentary Library, 2003–04.
4. See HMr Macfarlane's [comments](#)H to the House of Representatives Standing Committee on Economics, Finance and Public Administration, 31 May 2002, p. 19.
5. Morgan Mellish, 'Rate rise: RBA taps the brakes', *Australian Financial Review*, 6 November 2003, p. 1.
6. Mike Seccombe, 'Security makes grist for the scare mill', *The Sydney Morning Herald*, 6 November 2003 p. 6.
7. Peter Hicks, op. cit.
8. *ibid.*
9. Matt Wade, 'Mortgage rate rises eat into borrowers' payments buffer', *The Sydney Morning Herald*, 28 August 2000, p. 39.
10. Australian Bureau of Statistics 'Housing and lifestyle: First home buyers', *Australian Social Trends*, 2003
11. Lisa Murray and Joyce Moullakis, 'Borrowers well aware it was on the way', *Australian Financial Review*, 6 November 2003, p. 7.
12. Over the last decade about 12 per cent of loans have had fixed interest rates.
13. Treasury 'International House Prices' *Economic Roundup*, Autumn 2003, pp. 111–129.

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