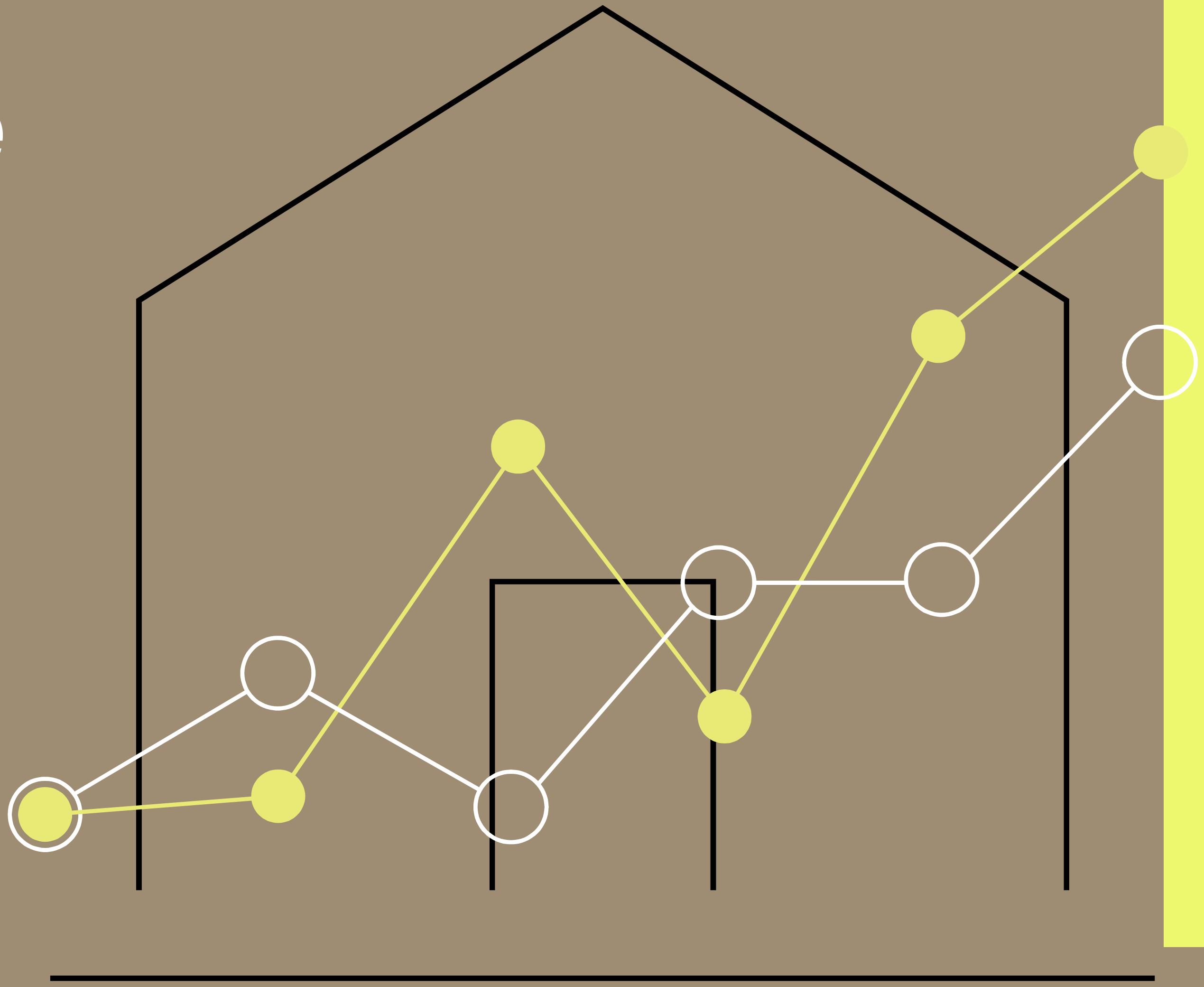
S&P Global
Ratings

RMBS Performance Watch: Australia

Market Overview

Headwinds and tailwinds



Q2 2023

This report does not constitute a rating action

Australian Macroeconomic Environment

Key Changes Since Last Quarter

Uneven arrears effect

Prime arrears crept up during the quarter but remained around long-term averages. Rising interest rates are affecting households differently because demographics influence debt serviceability.

Prepayment elevation

Prepayment rates are still increasing, bolstered by competitive refinancing conditions. This is likely to persist until the fixed-rate rollover has progressed far enough and competition abates.

Household spending signals

Cutting discretionary spending is a cautionary approach by households to free up cash flow. This helps to alleviate debt serviceability pressures and avoid going into arrears.

Property price reprieve

Property prices can help or hinder debt serviceability. Property price growth improves borrowers' loan-to-value (LTV) positions. This enhances refinancing prospects, which eases debt serviceability pressures and can help avoid arrears.

S&P Global Ratings Economic Outlook: Australia

	2023f	2024f	Outlook	Effect on credit quality
Real GDP forecast (% year over year)	1.4	1.2	We forecast weaker economic growth in 2023 and 2024 because the full effect of interest rate rises hasn't yet manifested. But the resilience of the Australian economy underpins positive, albeit weaker, GDP growth.	**Neutral.** Strong balance sheets across the household and business sectors have underpinned household resilience so far. Inflationary and mortgage pressures will erode these buffers, creating debt-serviceability pressures for some borrowers.
Unemployment rate (year average; %)	3.9	4.6	We forecast unemployment will continue to rise, but levels should remain low by historical standards.	**Neutral.** Lower unemployment is helping keep arrears low. We note the correlation between unemployment and mortgage defaults.
CPI (%)	6.0	3.8	Inflation will take time to return to the RBA's 2%-3% target range. We do not expect inflation to reach its target range until 2025.	**Negative.** Inflationary pressures are eroding real income. This hits lower-income households disproportionately, given that they are more likely to rent. Inflation's "stickiness" will dampen household budgets for some time.
Policy rate, end of year (%)	4.6	4.1	We expect there may still be some further rate rises, given the stickiness of inflation.	**Negative.** The extent of recent rate rises will continue to drive up arrears due to a high proportion of variable-rate loans in the RMBS sector. Low unemployment should temper the transition from arrears to default.

f--Forecast. CPI--Consumer price index. RBA--Reserve Bank of Australia. Source: S&P Global Ratings.

Australian RMBS Outlook

- As of June 2023, prime mortgage arrears were 0.97%, up modestly from 0.95% in Q1 2023. Most of the increase is in the later-arrears category of 90-plus days. This reflects increased migration to advanced arrears categories as households continue to adjust to interest rate rises, exacerbating the arrears situation of financially stressed borrowers. We expect this trend to continue over the next six months.
- Nonconforming arrears declined in percentage terms to 3.47% in Q2 2023 from 3.70% in Q1 2023 but rose in dollar terms. The increase in outstanding balances during the quarter masked the effect of rising arrears. The debt serviceability effect will vary more across the nonconforming sector, given a broader spectrum of borrowers in these transactions.
- Prime prepayment rates rose to 25.25% during Q2 from 24.99% in Q1 2023. This reflects strong refinancing conditions for prime borrowers in the market as banks compete for prime-quality borrowers. While we expect this to slow in line with the broader economic slowdown, competition for prime borrowers is unlikely to abate until the fixed-rate rollover has progressed further.
- Nonconforming prepayment rates increased to 37.52% in Q2 from 33.72% in Q1 2023. Nonconforming prepayment rates should slow before prime prepayment rates, given their borrower profile. But there is likely to be competition for better-quality nonconforming borrowers from prime nonbank originators.
- Property price growth alongside competitive refinancing conditions will help ease debt serviceability pressures by giving borrowers more agency to self-manage their way out of financial stress, tempering arrears.
- Strong employment conditions and job mobility continue to underpin low levels of defaults.

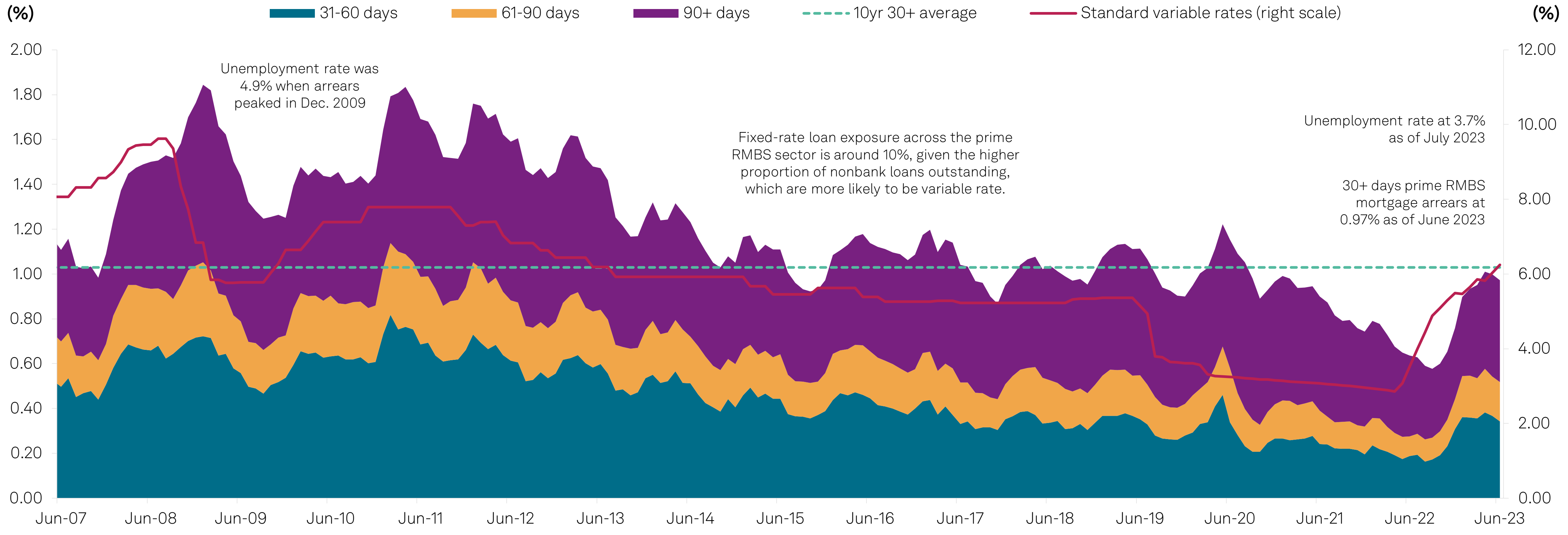
Australian RMBS Performance

Performance Observations: What To Expect

- **Prime arrears:** As of June 2023, prime RMBS arrears increased year on year but are hovering around long-term averages. Arrears are a lagging indicator. They also had a delayed start in this monetary policy tightening cycle, given the savings buffers available to many borrowers going into this period. We expect arrears to peak toward the end of the first half of next year, based on our interest rate forecasts.
- **Nonconforming arrears:** Nonconforming arrears have been more resilient thus far, compared with previous periods of economic uncertainty. This reflects the mixed pool of borrowers in post-financial crisis transactions; the higher arrears of credit-impaired borrowers are offset by the lower arrears of borrowers with larger but more complex income streams. Self-employed borrowers, highly represented in these transactions, are a diverse cohort with a wide range of income profiles.
- **Investor versus owner-occupier arrears:** Investor arrears in the prime and nonconforming RMBS sectors are 1.07% as of June 2023, compared with 1.44% for owner-occupiers. We anticipate owner-occupier arrears will continue to rise faster than investor arrears, given many investors' higher income profiles and their ability to offset higher mortgage repayments against strong rental price growth due to low vacancy rates.
- **Prepayment rates:** Prepayment rates rose for the prime and nonconforming sectors. There is a seasonal element to the trend, with prepayment rates typically rising in June from their March lows. We expect prepayment rates to move toward longer-term averages. Nonconforming prepayment rates are likely to slow earlier, reflecting borrowers' tougher refinancing prospects as the economy slows.
- **Losses:** Exposure to loans with an LTV ratio greater than 80% is about 7% for the prime RMBS sector and 9% for the nonconforming RMBS sector. This modest exposure will temper losses in the event of borrower default.
- **Ratings outlook:** Broadly stable. Senior tranches are benefitting from the build up of credit support, enhanced by strong prepayment rates. Structural features are also enhancing ratings stability in many transactions.

Prime Arrears Remain Well Below Financial Crisis Peaks

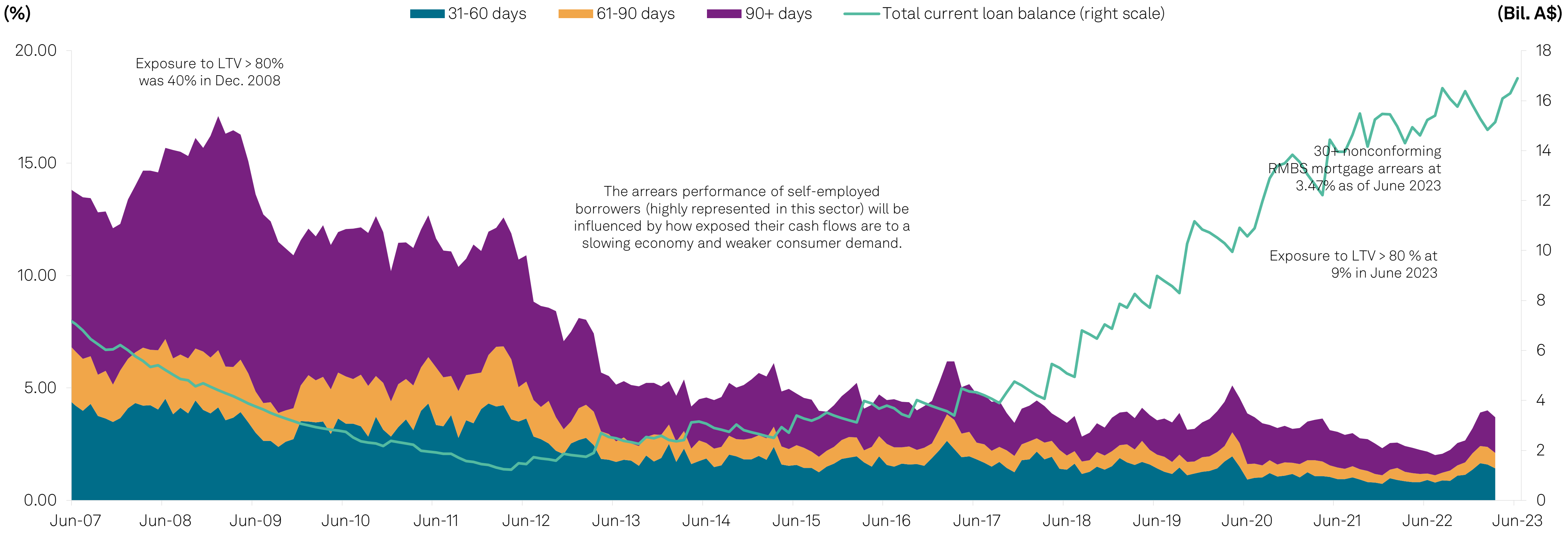
Prime RMBS loans more than 30 days in arrears



Prime data SPIN shown excludes noncapital market issuance transactions. Prime RMBS arrears exclude noncapital market issuance transactions. Standard variable rates are based on outstanding mortgages.
Sources: Reserve Bank of Australia. Australian Bureau of Statistics. S&P Global Ratings.

Nonconforming Arrears Are Mortgage Stress Frontrunners

Nonconforming RMBS loans more than 30 days in arrears



LTV--Loan to value ratio. Bil.--Billion. A$--Australian dollar. Source: S&P Global Ratings.

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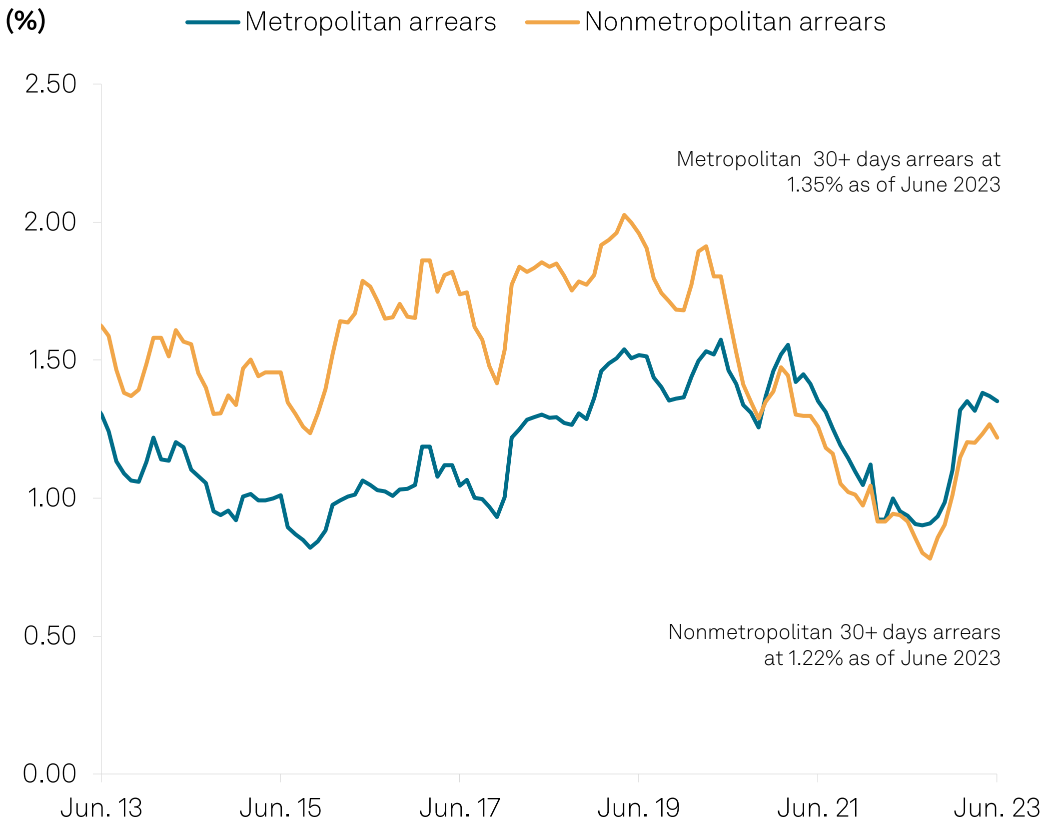
Regional Resilience

Metropolitan vs. nonmetropolitan 30-plus days mortgage arrears

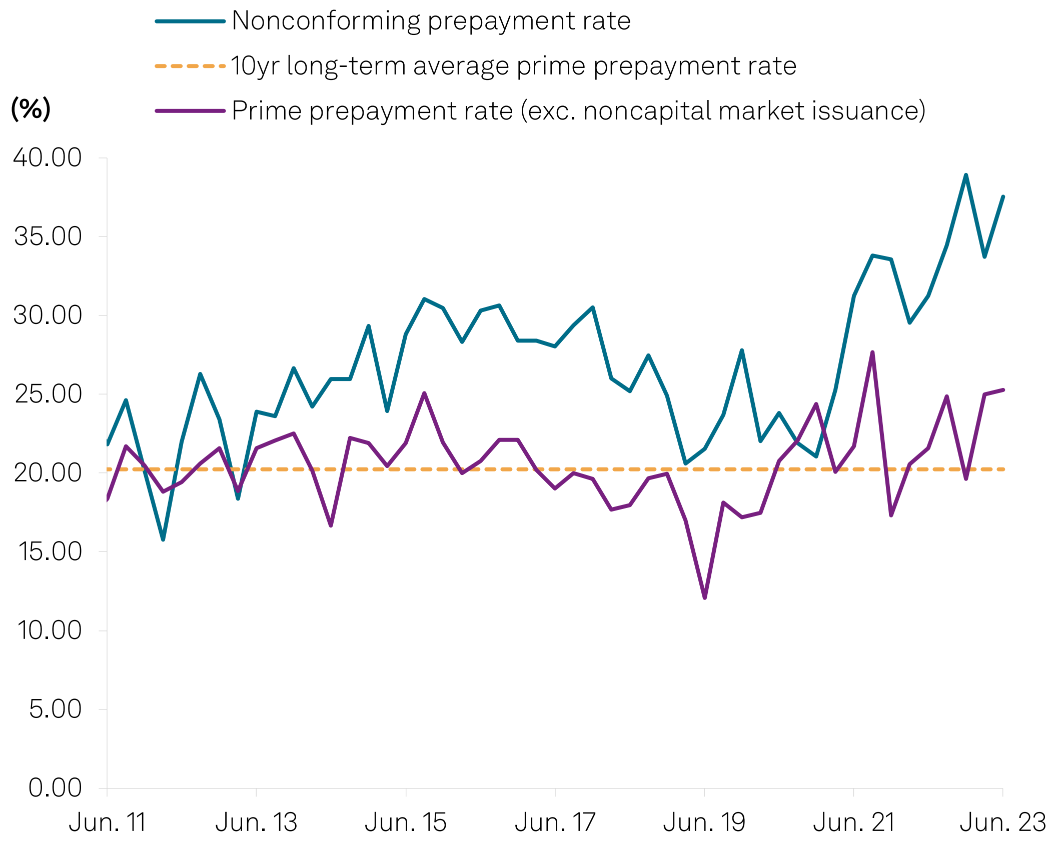


Data as at Jun. 2023. Metropolitan areas are localities within Greater Capital City areas.
Source: S&P Global Ratings.

S&P Global Ratings

- Since COVID-19, nonmetropolitan arrears have fallen below those of metropolitan arrears for the first time in the RMBS series history.
- This partly reflects the less restrictive COVID-19 lockdowns in many regional areas during the pandemic, resulting in fewer disruptions to local economic conditions.
- The synchronized pandemic property boom may have enabled some regional borrowers to cure their arrears positions through selling properties at an opportunistic time.
- Before the pandemic, regional areas with higher mortgage arrears were typically where a higher proportion of the workforce were directly or indirectly affected by the downturn in the mining industry.
- Remote work models implemented during the pandemic also may have altered the income profiles of some regional areas by enhancing job mobility and reduced reliance on local employment for income.
- Higher household debt-to-income levels in larger cities, where property prices are more expensive, has increased borrowers' sensitivity to interest-rate rises. This has resulted in higher arrears, particularly on the fringes of capital cities.
- Normalizing patterns of overseas and internal migration are likely to result in a return to prepandemic population trends, given overseas migrants' preference to settle in capital cities.
- The future of hybrid work models and population patterns will influence mortgage arrears trends in regional areas, given their effect on employment.

Prepayment Rates Remain Above Long-term Averages



Source: S&P Global Ratings.

- Prime prepayment rates increased to 25.25% in Q2 2023 from 24.99% in Q1 2023.
- Nonconforming prepayment rates increased to 37.52% in Q2 from 33.72% in Q1 2023.
- Prepayment rates typically rise in June from their seasonal low in March before peaking in September or December.
- Prepayment rates remain above long-term averages, reflecting the strong refinancing conditions in the broader mortgage market.
- Nonbanks, which have been the main securitization issuers in recent years, have seen higher levels of refinancing to larger lenders, which can offer more competitive mortgage rates and cash back offers.
- We expect prepayment rates to ease as rising interest rates raise debt serviceability hurdles, constraining some borrowers' refinancing prospects.
- Competition among lenders will influence prepayment trends. The withdrawal of cash back offers and recent rate rises above cash rate rises by several lenders will dampen refinancing activity .
- This could be offset by the lowering of serviceability buffers by some lenders, which will help maintain momentum in refinancing activity.

Losses Less Likely In Current Environment

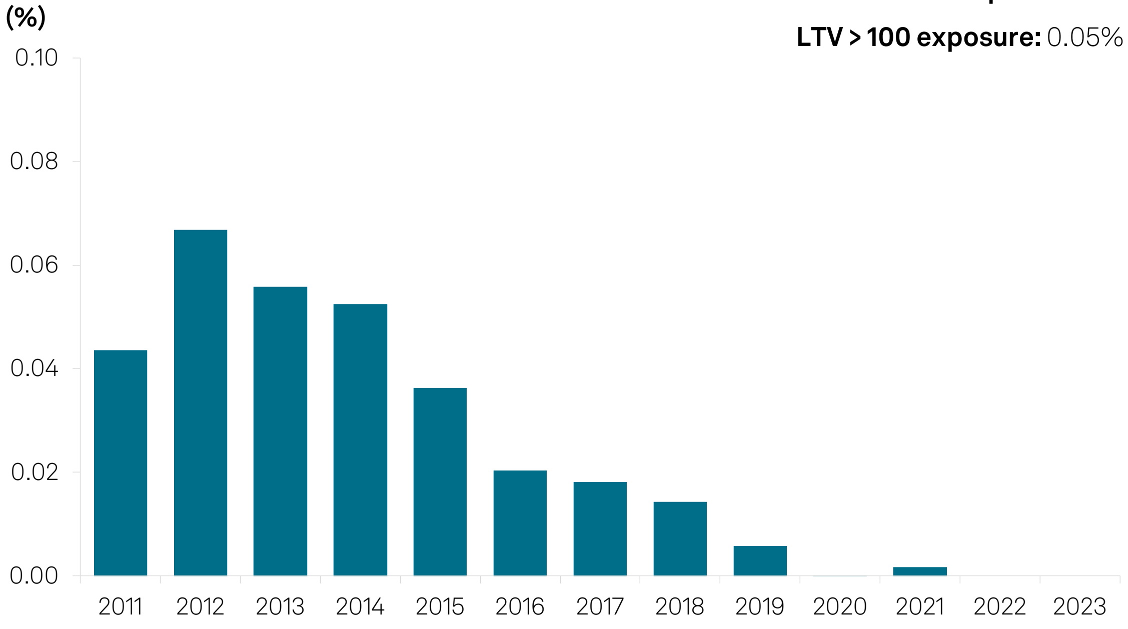
Losses are likely to be limited by the sector's modest LTV ratio profile, low exposure to high LTV ratio loans, and a recent turnaround in property prices, with property prices growing again.

Cumulative gross loss by vintage of origination

Prime RMBS

LTV > 80 exposure: 7%

LTV > 100 exposure: 0.05%



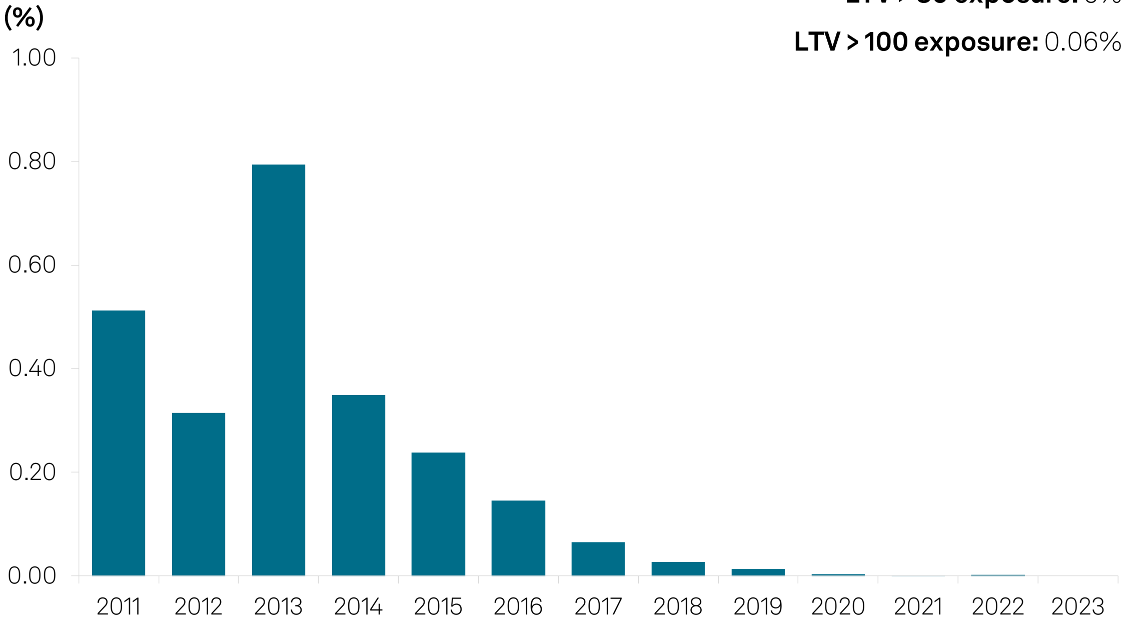
LTV--Loan to value ratio. Source: S&P Global Ratings.

Cumulative gross loss by vintage of origination

Nonconforming RMBS

LTV > 80 exposure: 9%

LTV > 100 exposure: 0.06%

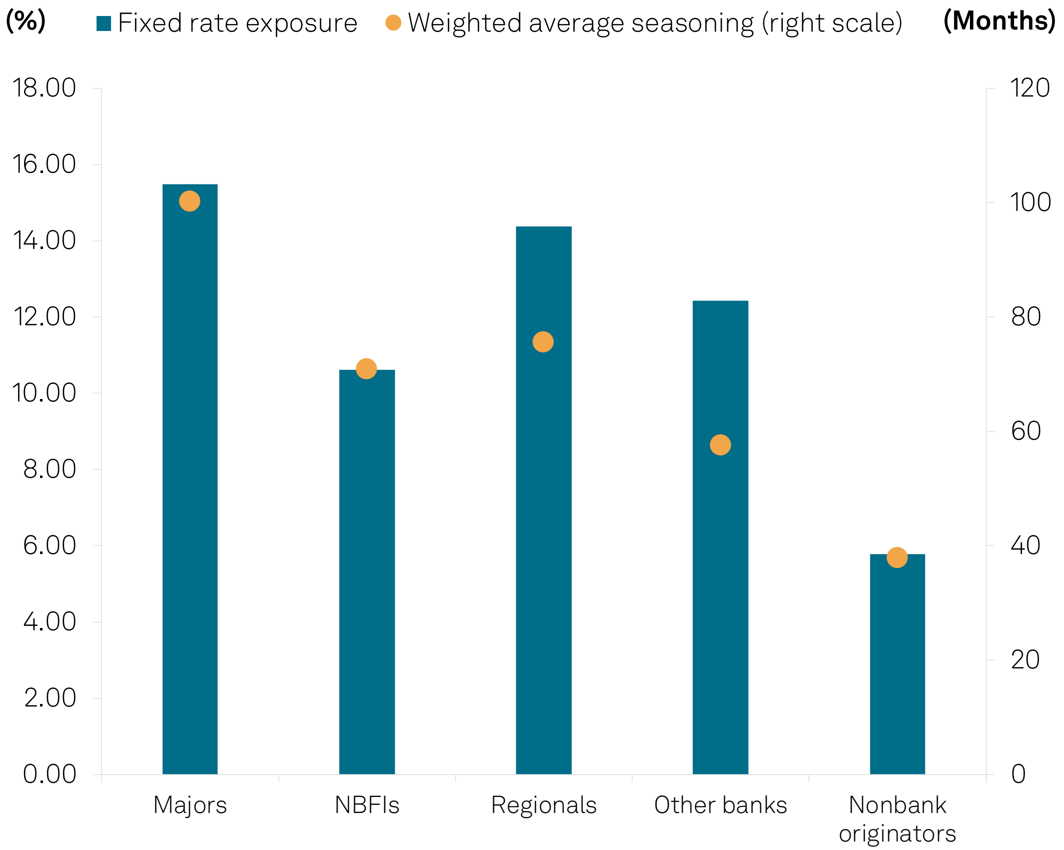


Source: S&P Global Ratings.

Hot Topics

Fixed Rates In Focus

RMBS originators' fixed-rate exposures

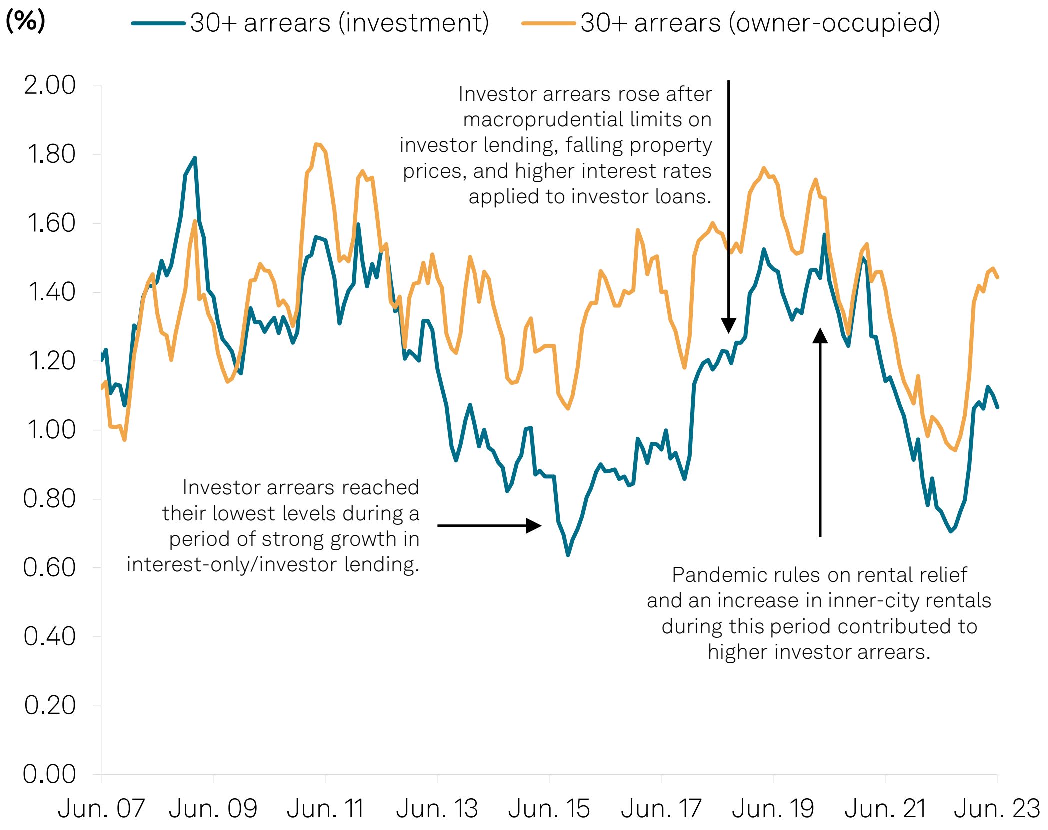


Data as at Jun. 2023. NBFI--Nonbank Financial Institution. Source: S&P Global Ratings.

- Across the wider RMBS sector, the weighted-average exposure to fixed-rate loans is modest, at around 10%.
- This reflects nonbank originators' strong issuance in recent years compared with banks' RMBS issuance.
- Nonbanks' exposure to fixed-rate loans is modest because they typically originate variable-rate loans.
- The rollover of lower fixed rates onto higher variable rates has not resulted in a spike in arrears across RMBS transactions to date.
- This partly reflects borrowers' preparedness for upcoming increases in mortgage repayments and proactive outreach by lenders in advance of upcoming maturities.
- The high level of fixed rate loans in the broader mortgage market still has some way to go, however we do not expect this to translate to systemic issues in mortgage or property markets.
- We expect refinancing conditions to remain competitive until the end of the first half of 2024, when most low fixed-rate mortgages will have rolled onto variable rates.

Investor Idiosyncrasies

Investor and owner-occupier 30-plus days mortgage arrears



Data includes loans underlying prime and nonconforming Australian RMBS trusts rated by S&P Global Ratings.
Source: S&P Global Ratings.

- Investor arrears have typically outperformed owner-occupier arrears due to many investors' higher debt-servicing capacity.
- This reflects the alternate income streams available to investors plus their often-higher income profiles.
- Investors typically behave more opportunistically than owner-occupiers, given an investment property is not a primary place of residence.
- This may induce more speculative behavior, motivated by factors such as the various taxation advantages available to investors.
- Investor behavior is also influenced by property market dynamics.
- In this market, strong rental yields and property price growth are being offset by uncertainty over limits on rental increases, property taxes, and higher mortgage repayments.
- How these factors influence investor behavior will be household-specific, given the many private investors in the Australian market.
- Opportunistic behavior by investors, including property sales, could add to housing supply pressures by taking more rental properties off the market.
- We do not expect a large increase in distressed investor property sales, given low unemployment and low investor arrears.

The 10 Worst-Performing Postcodes

State	Suburb	Postcode	Loans in arrears (%)
VIC	Broadmeadows	3047	6.85
NSW	Dolls point	2219	6.49
NSW	Bonnyrigg	2177	6.12
NSW	Katoomba	2780	5.93
VIC	South Melbourne	3205	4.93
WA	Forrestfield	6058	4.60
QLD	Barkly	4825	4.50
NSW	Blaxcell	2142	4.46
NSW	Smithfield	2164	4.45
VIC	Addington	3352	4.01

Data as of Jun., 2023. For a full list of suburbs/localities attached to these postcodes, please refer to the Australia Post website. Postcode data is subject to greater volatility given the small sample size of loans in a postcode area.
Source: S&P Global Ratings.

SA4 Listing Arrears And Exposure

Geographic area map code	Regional name	State	30+ days arrears level Jun. 2023	30+ days arrears level Mar. 2023	Exposure across RMBS
101	Capital Region	NSW	1.34%	1.19%	1.19%
102	Central Coast	NSW	1.26%	1.00%	1.60%
103	Central West	NSW	1.35%	1.28%	0.49%
104	Coffs Harbour - Grafton	NSW	1.04%	0.93%	0.37%
105	Far West and Orana	NSW	1.81%	1.95%	0.18%
106	Hunter Valley exc Newcastle	NSW	1.05%	1.00%	1.51%
107	Illawarra	NSW	1.51%	1.64%	1.91%
108	Mid North Coast	NSW	1.09%	0.89%	0.48%
109	Murray	NSW	1.01%	0.98%	0.68%
110	New England and North West	NSW	0.86%	1.04%	0.24%
111	Newcastle and Lake Macquarie	NSW	0.99%	0.83%	1.64%
112	Richmond - Tweed	NSW	1.35%	1.58%	1.10%
113	Riverina	NSW	1.70%	2.42%	0.10%
114	Southern Highlands and Shoalhaven	NSW	1.74%	1.46%	0.28%
115	Sydney - Baulkham Hills and Hawkesbury	NSW	1.46%	1.27%	2.06%
116	Sydney - Blacktown	NSW	1.77%	1.44%	2.46%
117	Sydney - City and Inner South	NSW	0.97%	0.98%	3.05%
118	Sydney - Eastern Suburbs	NSW	0.89%	0.73%	0.85%
119	Sydney - Inner South West	NSW	1.64%	1.78%	3.49%
120	Sydney - Inner West	NSW	1.24%	0.93%	1.25%
121	Sydney - North Sydney and Hornsby	NSW	0.71%	0.52%	2.19%
122	Sydney - Northern Beaches	NSW	0.93%	0.79%	1.40%

Geographic area map code	Regional name	State	30+ days arrears level Jun. 2023	30+ days arrears level Mar. 2023	Exposure across RMBS
123	Sydney - Outer South West	NSW	1.80%	2.45%	1.18%
124	Sydney - Outer West and Blue Mountains	NSW	1.79%	1.43%	0.97%
125	Sydney - Parramatta	NSW	1.39%	1.28%	2.31%
126	Sydney - Ryde	NSW	1.16%	0.83%	0.54%
127	Sydney - South West	NSW	2.49%	2.12%	1.03%
128	Sydney - Sutherland	NSW	0.91%	1.18%	0.84%
201	Ballarat	Vic	1.59%	1.23%	0.70%
202	Bendigo	Vic	0.89%	1.21%	0.34%
203	Geelong	Vic	1.03%	1.01%	1.22%
204	Hume	Vic	1.31%	1.47%	0.28%
205	Latrobe - Gippsland	Vic	1.44%	1.35%	0.62%
206	Melbourne - Inner	Vic	1.35%	1.46%	4.65%
207	Melbourne - Inner East	Vic	1.32%	1.12%	1.87%
208	Melbourne - Inner South	Vic	1.13%	1.11%	2.25%
209	Melbourne - North East	Vic	1.67%	1.52%	2.75%
210	Melbourne - North West	Vic	2.26%	2.06%	1.38%
211	Melbourne - Outer East	Vic	1.35%	1.42%	2.49%
212	Melbourne - South East	Vic	1.74%	1.54%	2.72%
213	Melbourne - West	Vic	1.82%	1.86%	2.93%
214	Mornington Peninsula	Vic	1.56%	1.69%	1.37%
215	North West	Vic	0.82%	0.97%	0.11%
216	Shepparton	Vic	2.68%	2.46%	0.11%

SA4 Listing Arrears And Exposure

Geographic area map code	Regional name	State	30+ days arrears level Jun. 2023	30+ days arrears level Mar. 2023	Exposure across RMBS
217	Warrnambool and South West	Vic	1.18%	1.30%	0.18%
301	Brisbane - East	Qld	0.81%	0.71%	1.44%
302	Brisbane - North	QLD	0.56%	0.66%	2.01%
303	Brisbane - South	QLD	0.80%	0.84%	2.77%
304	Brisbane - West	QLD	0.59%	0.47%	1.25%
305	Brisbane Inner City	QLD	1.10%	0.74%	0.94%
306	Cairns	QLD	1.19%	1.25%	0.71%
307	Darling Downs - Maranoa	QLD	1.35%	1.33%	0.86%
308	Fitzroy	QLD	1.47%	1.47%	0.71%
309	Gold Coast	QLD	1.03%	1.04%	3.41%
310	Ipswich	QLD	1.04%	0.98%	1.21%
311	Logan - Beaudesert	QLD	1.47%	1.84%	0.63%
312	Mackay	QLD	1.69%	1.71%	0.56%
313	Moreton Bay - North	QLD	1.20%	1.44%	1.34%
314	Moreton Bay - South	QLD	1.12%	1.01%	0.65%
315	Queensland - Outback	QLD	3.64%	3.54%	0.11%
316	Sunshine Coast	QLD	0.86%	0.91%	1.73%
317	Toowoomba	QLD	1.06%	0.95%	0.01%
318	Townsville	QLD	1.31%	1.39%	0.77%
319	Wide Bay	QLD	1.61%	1.39%	0.51%
401	Adelaide - Central and Hills	SA	1.04%	1.13%	1.51%
402	Adelaide - North	SA	1.28%	1.41%	1.17%

Geographic area map code	Regional name	State	30+ days arrears level Jun. 2023	30+ days arrears level Mar. 2023	Exposure across RMBS
403	Adelaide - South	SA	0.94%	1.06%	1.26%
404	Adelaide - West	SA	1.35%	1.65%	0.77%
405	Barossa - Yorke - Mid North	SA	1.69%	1.49%	0.13%
406	South Australia - Outback	SA	1.79%	1.24%	0.11%
407	South Australia - South East	SA	1.42%	1.52%	0.29%
501	Bunbury	WA	1.82%	1.45%	0.40%
502	Mandurah	WA	1.96%	1.83%	0.28%
503	Perth - Inner	WA	1.09%	1.36%	0.90%
504	Perth - North East	WA	1.75%	2.20%	1.12%
505	Perth - North West	WA	1.72%	1.49%	1.69%
506	Perth - South East	WA	1.72%	1.75%	1.77%
507	Perth - South West	WA	1.48%	1.22%	1.38%
508	Western Australia - Outback	WA	2.70%	2.34%	0.30%
509	Western Australia - Wheat Belt	WA	2.28%	1.97%	0.13%
601	Hobart	Tas	0.87%	1.01%	0.89%
602	Launceston and North East	Tas	0.91%	1.04%	0.33%
603	South East	Tas	3.33%	2.22%	0.03%
604	West and North West	Tas	1.15%	1.22%	0.21%
701	Darwin	NT	2.60%	2.72%	0.50%
702	Northern Territory - Outback	NT	1.10%	1.43%	0.07%
801	Australian Capital Territory	ACT	0.69%	0.55%	1.74%

New Zealand

S&P Global Ratings Economic Outlook

	2023f	2024f	Outlook	Effect on credit quality
Real GDP forecast (year over year %)	0.2	1.7	Economic activity is slowing as higher interest rates, lower housing prices, and persistent inflation suppress demand. High net migration is helping to offset weaker domestic demand.	**Neutral.** Slower economic growth is being buttressed by strong labor market conditions, helping to keep arrears and defaults low.
Unemployment rate (year average; %)	4.0	4.7	Labor shortages persist, but positive net migration is helping to fill labor gaps. Unemployment is currently 3.6%.	**Neutral.** Low unemployment is credit positive because loss of income is a key cause of mortgage default. Higher interest rates will cause unemployment to rise, though off low levels.
CPI (%)	5.7	3.4	Weaker demand and improved supply are helping to reduce inflation, but it remains high.	**Negative.** Higher inflation erodes real wages. Wage increases will support debt serviceability, but this will be offset by rising mortgage rates.
Policy rate, end of year (%)	5.5	5.0	The Reserve Bank of New Zealand raised the cash rate to 5.5% in May 2023 where it has remained.	**Negative.** New Zealand's higher exposure to fixed rate loans indicates that the adjustment to higher rates still has some way to go. Rising interest rates can put pressure on arrears for more highly indebted households.

f--Forecast. CPI--Consumer price index. Source: S&P Global Ratings.

Households Resilient Despite Weaker Economic Conditions

- Prime RMBS mortgage arrears in New Zealand declined to 1.05% in Q2 from 1.07% in Q1, despite rising interest rates, cost of living pressures, falling house prices, and recent flooding.
- Losses are low in the New Zealand RMBS sector, despite a rapid rise in interest rates and correction in property prices.
- We estimate New Zealand's bank credit losses will likely increase over the next two years, reverting to their long-term historical average of about 10 bps in fiscal 2023 and continuing to rise in fiscal 2024 (see “Banking Industry Country Risk Assessment: New Zealand,” published May 21, 2023).
- Like Australia, New Zealand has high household debt. To date, the higher exposure to fixed-rate loans in New Zealand has shielded borrowers from interest-rate rises. But households will be tested when a large proportion of outstanding residential mortgages roll onto higher variable rates within the next 12 months.
- Lending standards in New Zealand are sound. The release of the Reserve Bank of New Zealand’s debt-to-income restriction framework will further enhance system stability and temper high household debt.
- The New Zealand RMBS sector has to date been relatively resilient to property price declines, given most transactions’ modest LTV ratio profiles.
- New Zealand RMBS transactions have a high proportion of fixed-rate loans, ranging from 40%-90%. This could see some later increases in arrears when these loans roll onto higher variable rates.

RMBS Sector Performance Remains Stable

- The credit quality of the New Zealand RMBS sector is strong, as indicated by:
  - A weighted-average LTV ratio of 59.83%.
  - An average loan size of NZ$331,061.
  - A weighted-average seasoning of 42 months.
  - Low levels of arrears in most portfolios.
- All losses to date have been fully covered by excess spread or lenders' mortgage insurance.
- Given the small overall pool of loans across the New Zealand RMBS sector, arrears movements are subject to greater volatility.

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How To Access RMBS Performance Watch

RMBS Performance Watch including arrears, prepayment, and pool statistics data can be accessed using the link below:

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