S&P Global Ratings

RMBS Performance Watch: Australia

Market Overview

Cautious households curtail spending to avoid arrears

Q1 2024

This report does not constitute a rating action

Australian Macroeconomic Environment

What To Look Out For

New issuance momentum

New issuance got off to a cracking start as tighter spreads boosted momentum. The “relative value” credentials of Australian RMBS continue to bolster offshore investor interest.

Prepayment deceleration

The “great refinance” is moderating as the fixed-rate conversion nears its completion. Prepayment rates are decelerating as interest rates have stabilized and refinancing competition eases.

Persistent inflation

Higher rents will persist as vacancy rates remain low. Insurance and energy costs have also added to household costs. These inflationary pressures are unlikely to be tempered in the short term.

Larger loans

Rising property prices beget larger loan sizes. Higher interest rates used in debt serviceability tests could lock more borrowers out of bank lending. Nonbanks will continue to capitalize on these lending opportunities.

S&P Global Ratings Economic Outlook: Australia

	2024f	2025f	Outlook	Effect on credit quality
Real GDP forecast (% year over year)	1.4	2.3	We forecast weaker economic growth in 2024 because of the lagged effects of monetary policy and global economic conditions. But the general resilience of the Australian economy underpins positive, albeit weaker, GDP growth.	**Negative.** Households continue to prioritize debt commitments over discretionary spending, putting a drag on economic growth.
Unemployment rate (year average; %)	4.3	4.4	We forecast unemployment will continue to rise, but levels should remain low by historical standards and below pre-pandemic levels.	**Negative.** Strong labor market conditions have kept defaults low, but rising unemployment will put pressure on debt serviceability for some borrowers.
CPI (%)	3.7	3.2	Inflation is likely to remain high before falling back within the 2%-3% target range in 2026.	**Negative.** Inflationary pressures erode real income. This affects lower-income households disproportionately. Inflation’s stickiness will dampen household budgets.
Policy rate, end of year (%)	4.35	3.60	We expect the cash rate to remain at 4.35% in 2024 as inflationary pressures persist.	**Negative.** Higher unemployment in the context of a higher for longer interest rate environment, will put pressure on arrears. As arrears are a lagging indicator this will take time to flow through.

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

Australian RMBS State Of Play

- Low arrears, albeit rising, have been underpinned by low unemployment, savings buffers (for some), and refinancing opportunities . Borrowers also have been prudent in curtailing expenditures to service their debts.
- Households continue to prioritize debt commitments over discretionary spending while interest rates remain high. This cautionary behavior is helping to keep arrears low overall.
- Higher mortgage servicing costs have been helped more recently by a rise in gross disposable income. Upcoming tax cuts will also help ease future debt serviceability burdens.
- The household savings ratio has been bolstered, modestly, by these factors rising to 3.2% in Q4 from 1.9% in Q3. Despite the recent uptick, household savings are still well below their pandemic peaks of 24%.
- The share of housing loans with an offset account is also increasing according to Reserve Bank of Australia statistics, as borrowers who can, look to these products to ease debt serviceability burdens.
- While we expect unemployment to rise, forecast increases remain below pre-pandemic levels. Property price growth also affords existing homeowners greater agency in self-managing their way out of any financial stress.
- Higher unemployment will flow through to higher arrears. But as long as unemployment remains low overall, we don't expect these increases to be material.

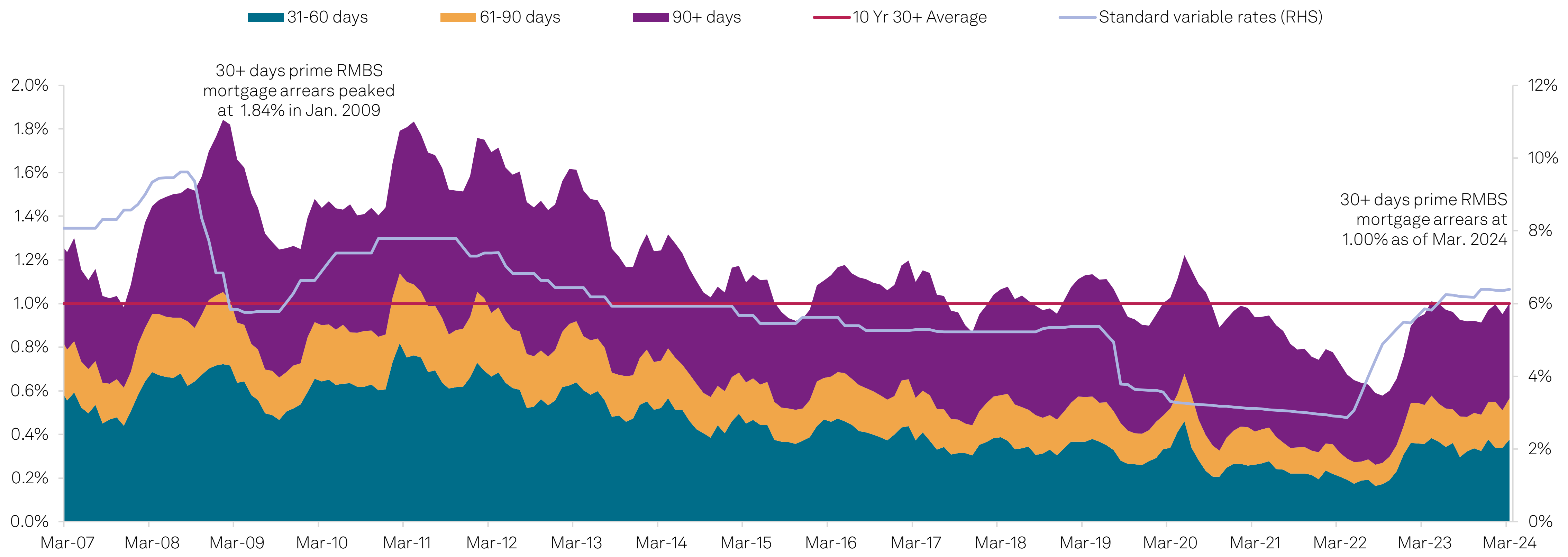
Australian RMBS Performance

Performance Observations: What To Expect

- **Prime arrears:** As of March 2024, prime RMBS arrears are at 1.00%, up from 0.95% a year earlier and a historic low of 0.58%. We expect upward pressure on arrears as the unemployment rate rises. Arrears increases are likely to be modest, though, because unemployment is forecast to remain low overall.
- **Nonconforming arrears:** Nonconforming arrears hit 4.18% in Q1, up from 4.02% in Q4. Nonconforming arrears will continue to grow faster than prime arrears, given the sector's greater sensitivity to weaker economic conditions. Property price growth will help to minimize losses.
- **Investor versus owner-occupier prime arrears:** Investor arrears were at 0.77% in Q1 compared with 1.12% for owner-occupiers. While we expect both investor and owner-occupier arrears to increase, investor arrears increases are likely to be buffeted by higher rentals to some extent.
- **Prepayment rates:** Prepayment rates are falling as refinancing competition eases and interest rates stabilize. Given nonconforming borrowers' larger loan sizes and higher leverage levels, this is likely to constrain refinancing prospects more for these borrowers, adding more downward pressure to prepayment rates for this sector.
- **Losses:** Exposure to loans with an LTV ratio greater than 80% is about 6% for the prime RMBS sector and 9% for the nonconforming RMBS sector. This modest exposure will minimize losses in the event of borrower default, particularly in a rising property price environment.
- **Ratings outlook:** Broadly stable. Senior tranches are benefitting from the buildup of credit support, enhanced by strong prepayment rates. Structural features are also enhancing ratings stability in many transactions.

Australian Prime RMBS Arrears Are Edging Up

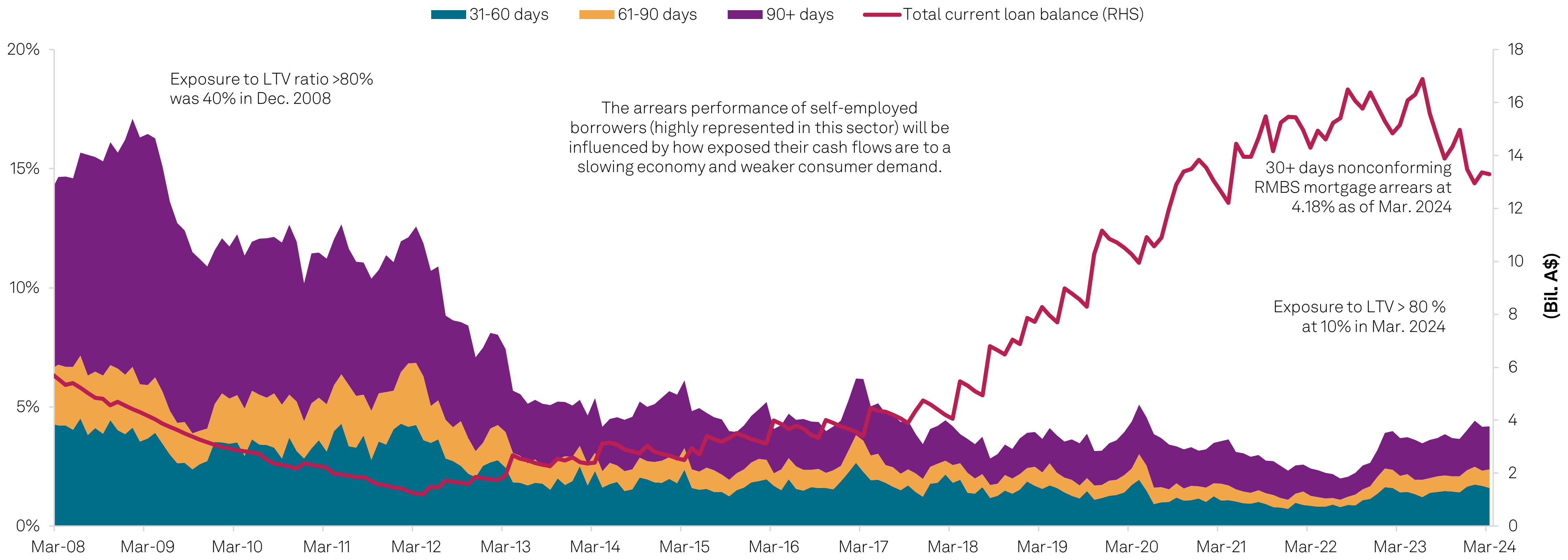
Prime RMBS loans more than 30 days in arrears (%)



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. S&P Global Ratings.

Nonconforming Arrears Will Grow As Refinancing Gets Tougher

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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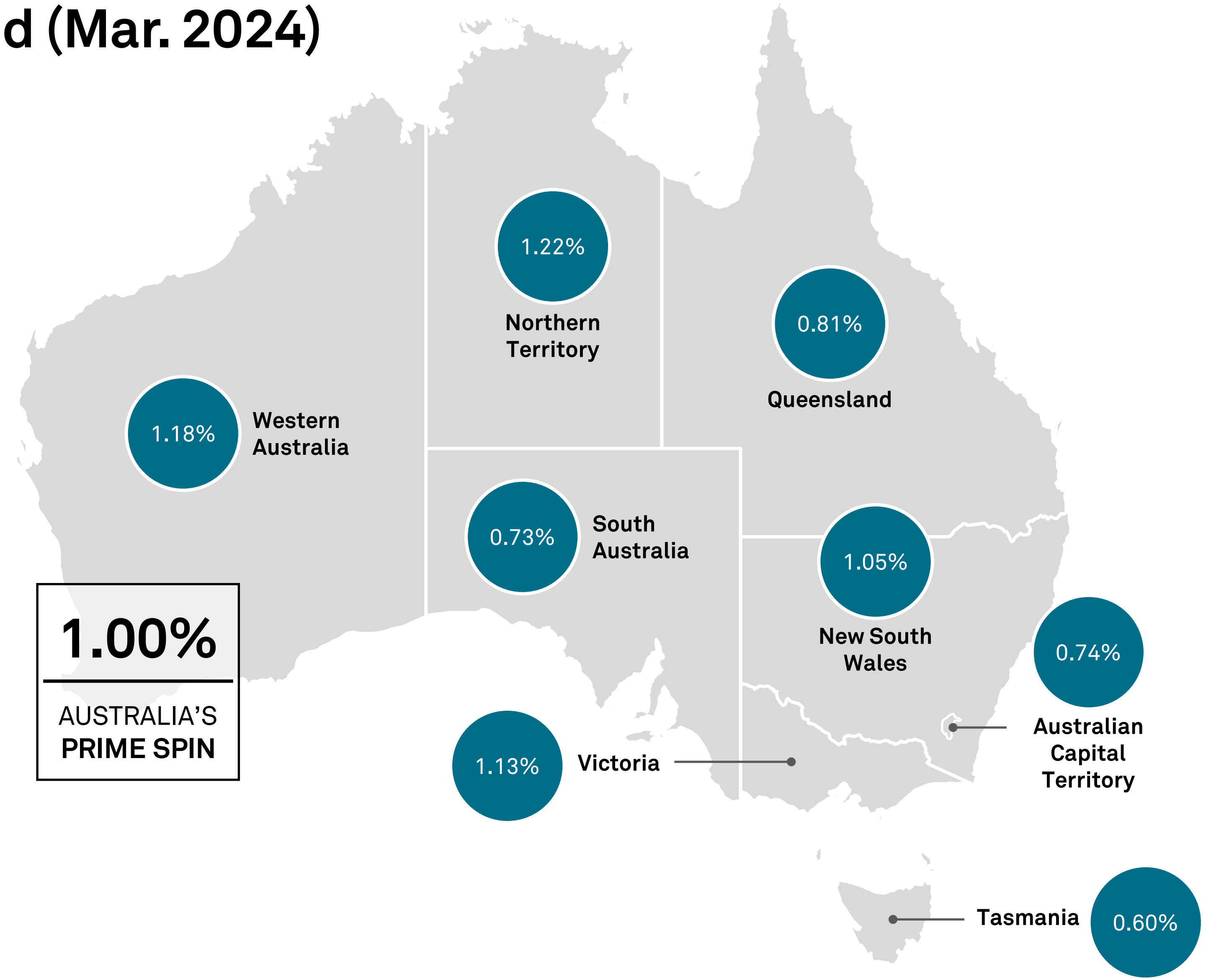
State Arrears Trend (Mar. 2024)



Data as of March 2024 based on prime RMBS loans (excluding non capital market issuance). Source: S&P Global Ratings.

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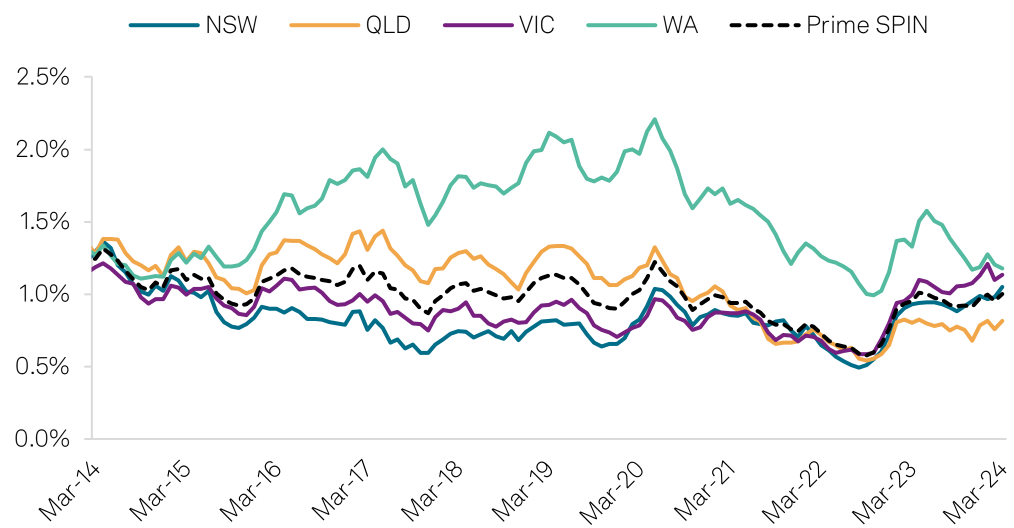
Arrears Increases Are More Pronounced In Populous States

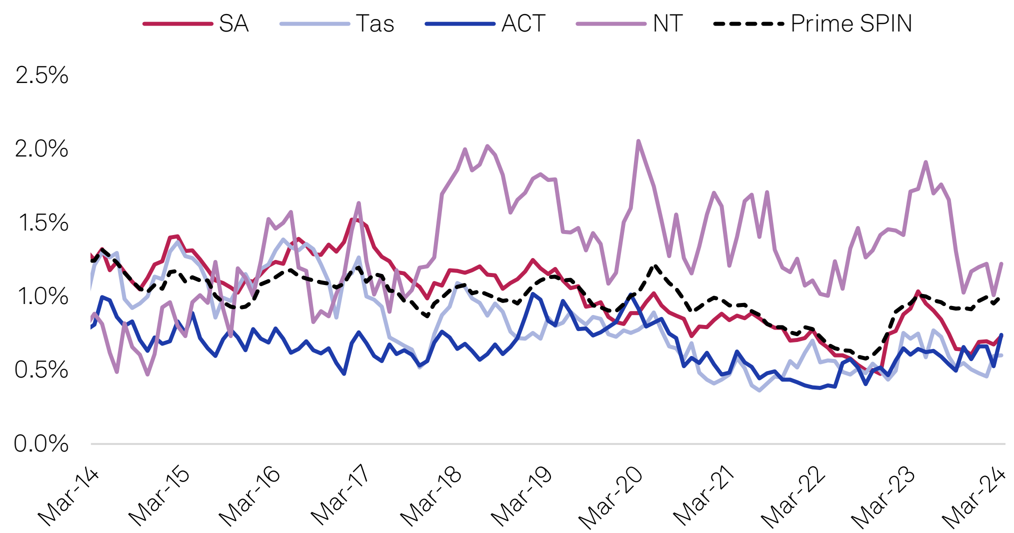
- New South Wales and Victoria have experienced the largest year-on-year arrears increases.
- In addition to rising interest rates and cost-of-living pressures, property price dynamics can influence arrears performance.
- Western Australia's arrears have noticeably improved due to its stronger economic and property price growth.
- Property price declines can add to debt serviceability pressures for more leveraged borrowers by restricting "sale of property" options for households in financial stress.

State 30-plus days RMBS arrears (%)



Arrears based on loan balances in outstanding prime RMBS transactions rated by S&P Global Ratings. Source: S&P Global Ratings.

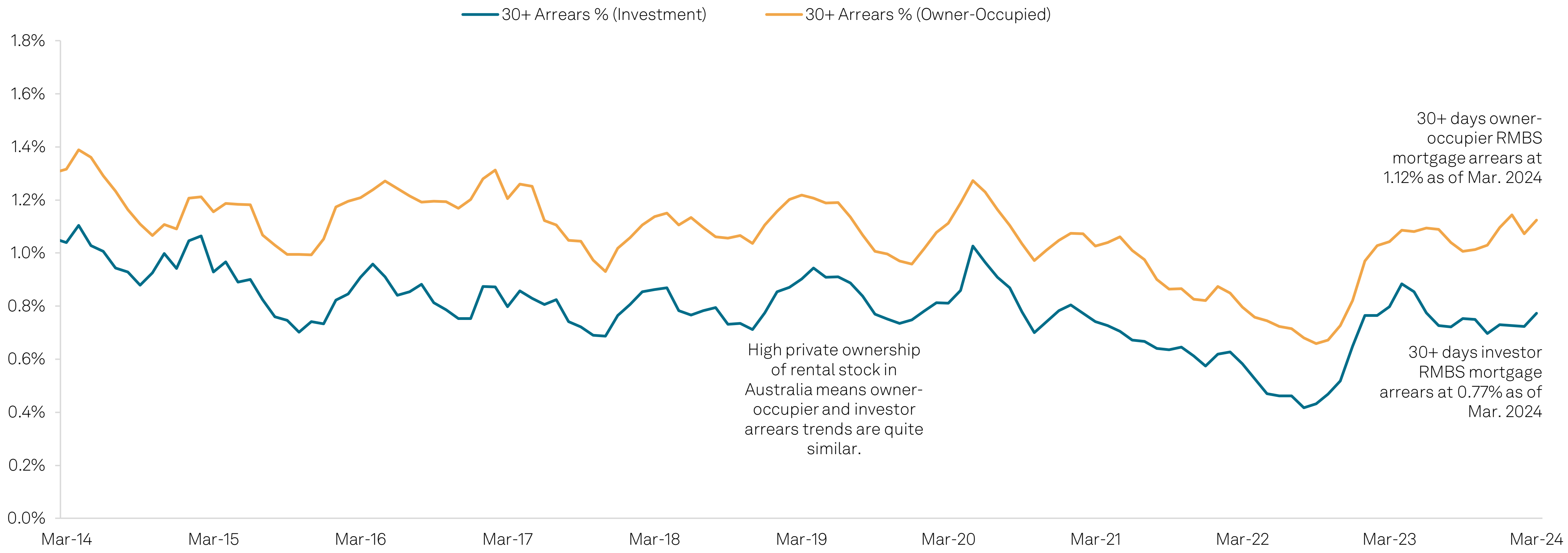
State 30-plus days RMBS arrears (%)



Note. Arrears in NT and ACT are subject to greater volatility given the small size of loans outstandings . Arrears based on loan balances in outstanding prime RMBS transactions rated by S&P Global Ratings. Source: S&P Global Ratings.

Higher Rental Inflation Offsets Higher Investor Mortgage Costs

Investor and owner-occupier loans more than 30 days in arrears (%)



Source: S&P Global Ratings. Investor and Owner-Occupier arrears are included in prime RMBS transactions rated by S&P Global Ratings excluding non-capital market issuance transactions.

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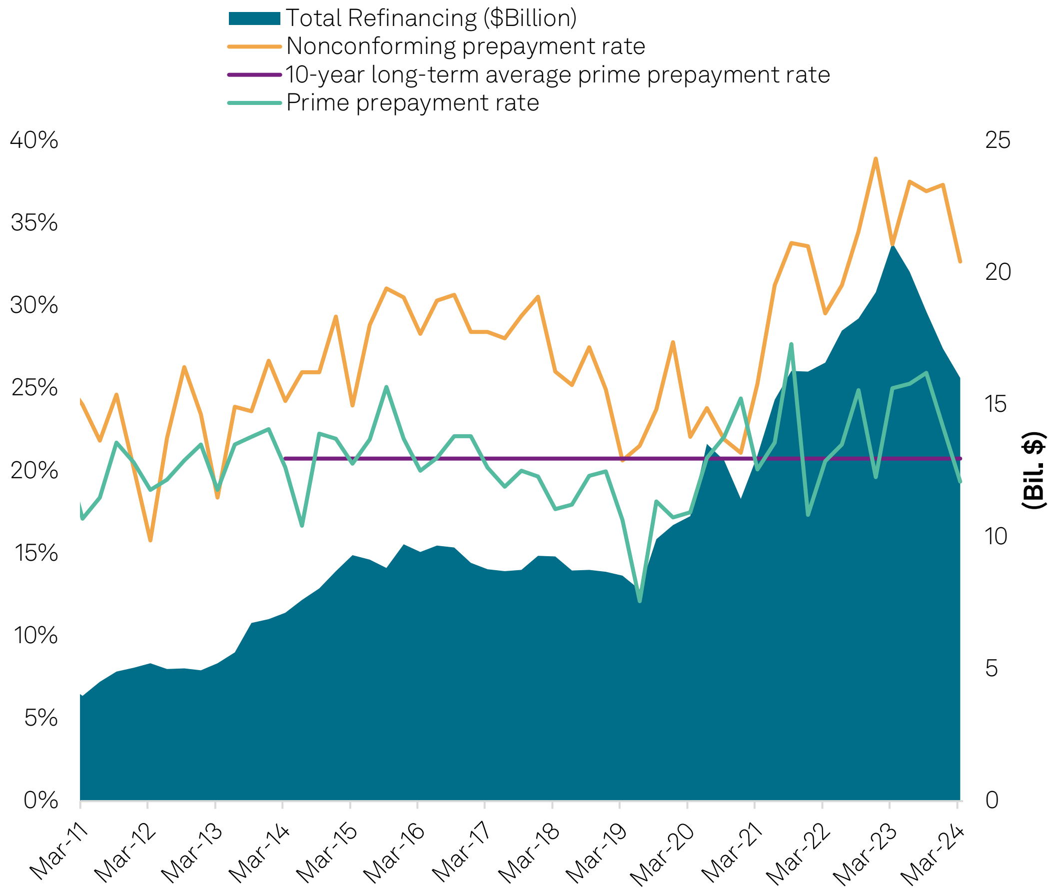
Prepayment Rates Dip As Refinancing Competition Eases



Source: S&P Global Ratings. Australian Bureau of Statistics.

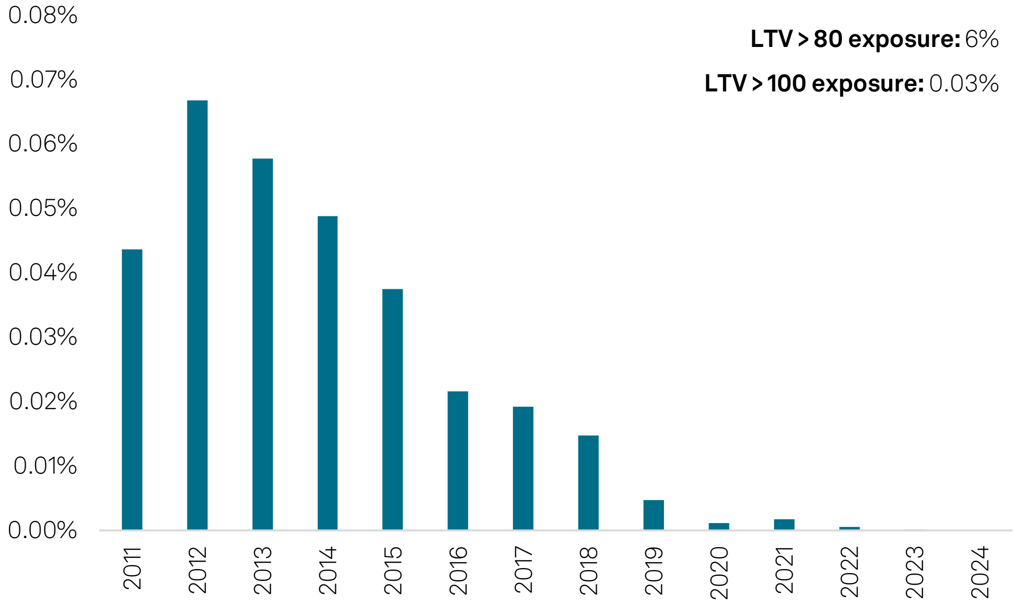
- Prime prepayment rates fell to 19.32% in Q1 from 22.67% in Q4.
- Nonconforming prepayment rates decreased to 32.66% in Q1 from 37.29% in Q4.
- A lessening in fierce competition and stabilization in interest rates, means fewer borrowers in transactions are refinancing their home loans, lowering prepayment rates.
- Nonconforming borrowers will face tougher refinancing prospects, given their higher credit risk profiles. This will lead to sharper falls in prepayment rates for this sector and pressure on arrears.
- These trends will narrow the gap between the nonbank and bank prime prepayment rates, which have widened due to strong competition for prime borrowers.
- Higher unemployment, slower economic growth, and cost-of-living pressures will also impinge on borrowers' ability to make additional repayments, further slowing prepayment rates.

Losses Less Likely With Rising Property Prices

RMBS sector's modest LTV ratio profile, low exposure to high LTV ratio loans, and continued property price growth will limit losses

Cumulative gross loss by vintage of origination

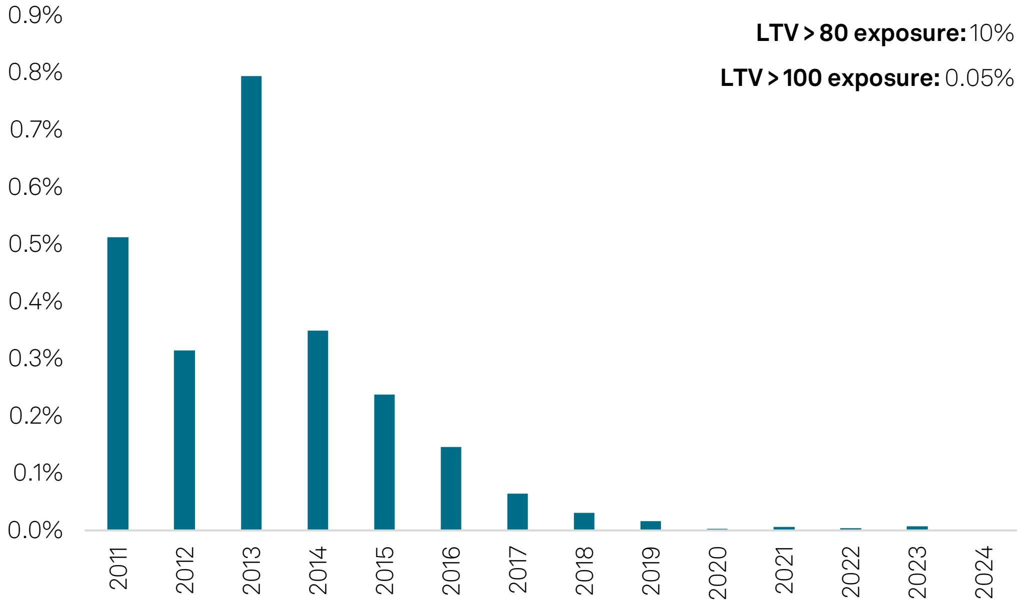
Prime RMBS (%)



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

Cumulative gross loss by vintage of origination

Nonconforming RMBS (%)



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

The 10 Worst-Performing Postcodes

State	Suburb	Postcode	Loans in arrears (%)
NSW	CASULA	2170	3.47%
VIC	DOREEN	3754	2.74%
VIC	CRAIGIEBURN	3064	2.47%
WA	ARMADALE	6112	2.37%
VIC	BURNSIDE	3023	2.32%
NSW	BELIMBLA PARK	2570	2.16%
VIC	FOUNTAIN GATE	3805	1.93%
VIC	CRANBOURNE	3977	1.93%
NSW	ALISON	2259	1.91%
VIC	POINT COOK	3030	1.90%

Data as of Mar. 2024. 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 Mar. 2024	Exposure across RMBS
101	Capital Region	NSW	0.91%	1.34%
102	Central Coast	NSW	1.07%	1.55%
103	Central West	NSW	0.74%	0.51%
104	Coffs Harbour - Grafton	NSW	1.01%	0.39%
105	Far West and Orana	NSW	0.52%	0.18%
106	Hunter Valley exc Newcastle	NSW	1.01%	1.49%
107	Illawarra	NSW	1.10%	1.97%
108	Mid North Coast	NSW	0.60%	0.49%
109	Murray	NSW	0.77%	0.72%
110	New England and North West	NSW	1.00%	0.26%
111	Newcastle and Lake Macquarie	NSW	0.62%	1.58%
112	Richmond - Tweed	NSW	1.14%	1.06%
113	Riverina	NSW	1.92%	0.09%
114	Southern Highlands and Shoalhaven	NSW	0.96%	0.26%
115	Sydney - Baulkham Hills and Hawkesbury	NSW	0.81%	2.01%
116	Sydney - Blacktown	NSW	1.04%	2.42%
117	Sydney - City and Inner South	NSW	0.75%	2.94%
118	Sydney - Eastern Suburbs	NSW	1.05%	0.78%
119	Sydney - Inner South West	NSW	1.61%	3.19%
120	Sydney - Inner West	NSW	0.71%	1.17%
121	Sydney - North Sydney and Hornsby	NSW	0.65%	2.10%
122	Sydney - Northern Beaches	NSW	0.75%	1.33%

Geographic area map code	Regional name	State	30+ days arrears level Mar. 2024	Exposure across RMBS
123	Sydney - Outer South West	NSW	2.02%	1.16%
124	Sydney - Outer West and Blue Mountains	NSW	0.93%	0.91%
125	Sydney - Parramatta	NSW	1.33%	2.14%
126	Sydney - Ryde	NSW	1.06%	0.50%
127	Sydney - South West	NSW	1.43%	0.93%
128	Sydney - Sutherland	NSW	0.60%	0.85%
201	Ballarat	Vic	0.82%	0.76%
202	Bendigo	Vic	0.55%	0.35%
203	Geelong	Vic	0.56%	1.28%
204	Hume	Vic	1.67%	0.30%
205	Latrobe - Gippsland	Vic	1.16%	0.69%
206	Melbourne - Inner	Vic	0.87%	4.43%
207	Melbourne - Inner East	Vic	0.65%	1.70%
208	Melbourne - Inner South	Vic	0.80%	2.08%
209	Melbourne - North East	Vic	0.97%	2.65%
210	Melbourne - North West	Vic	1.59%	1.24%
211	Melbourne - Outer East	Vic	1.12%	2.39%
212	Melbourne - South East	Vic	1.29%	2.57%
213	Melbourne - West	Vic	1.34%	2.92%
214	Mornington Peninsula	Vic	1.12%	1.28%
215	North West	Vic	0.71%	0.12%
216	Shepparton	Vic	2.01%	0.11%

Source: S&P Global Ratings Data as of Mar. 2024.. Loan level data is based on loans underlying prime RMBS transactions rated by S&P Global Ratings.

SA4 Listing Arrears And Exposure

Geographic area map code	Regional name	State	30+ days arrears level Mar. 2024	Exposure across RMBS
217	Warrnambool and South West	Vic	1.17%	0.18%
301	Brisbane - East	Qld	0.95%	1.51%
302	Brisbane - North	Qld	0.63%	2.13%
303	Brisbane - South	Qld	0.66%	2.88%
304	Brisbane - West	Qld	0.48%	1.28%
305	Brisbane Inner City	Qld	0.54%	0.94%
306	Cairns	Qld	0.96%	0.73%
307	Darling Downs - Maranoa	Qld	0.79%	0.92%
308	Fitzroy	Qld	1.24%	0.71%
309	Gold Coast	Qld	0.93%	3.52%
310	Ipswich	Qld	1.08%	1.36%
311	Logan - Beaudesert	Qld	1.16%	0.72%
312	Mackay	Qld	1.25%	0.56%
313	Moreton Bay - North	Qld	1.12%	1.42%
314	Moreton Bay - South	Qld	0.54%	0.71%
315	Queensland - Outback	Qld	3.69%	0.11%
316	Sunshine Coast	Qld	0.57%	1.76%
317	Toowoomba	Qld	0.00%	0.01%
318	Townsville	Qld	1.05%	0.79%
319	Wide Bay	Qld	0.90%	0.57%
401	Adelaide - Central and Hills	SA	0.72%	1.57%
402	Adelaide - North	SA	0.62%	1.29%

Geographic area map code	Regional name	State	30+ days arrears level Mar. 2024	Exposure across RMBS
403	Adelaide - South	SA	0.56%	1.42%
404	Adelaide - West	SA	0.72%	0.83%
405	Barossa - Yorke - Mid North	SA	1.57%	0.15%
406	South Australia - Outback	SA	0.53%	0.13%
407	South Australia - South East	SA	0.70%	0.34%
501	Bunbury	WA	0.86%	0.43%
502	Mandurah	WA	1.97%	0.31%
503	Perth - Inner	WA	0.92%	0.87%
504	Perth - North East	WA	1.24%	1.12%
505	Perth - North West	WA	1.20%	1.70%
506	Perth - South East	WA	1.20%	1.75%
507	Perth - South West	WA	1.17%	1.44%
508	Western Australia - Outback	WA	1.68%	0.29%
509	Western Australia - Wheat Belt	WA	1.00%	0.12%
601	Hobart	Tas	0.57%	1.01%
602	Launceston and North East	Tas	0.36%	0.38%
603	South East	Tas	2.04%	0.03%
604	West and North West	Tas	0.60%	0.25%
701	Darwin	NT	0.92%	0.54%
702	Northern Territory - Outback	NT	2.72%	0.08%
801	Australian Capital Territory	ACT	0.62%	1.92%

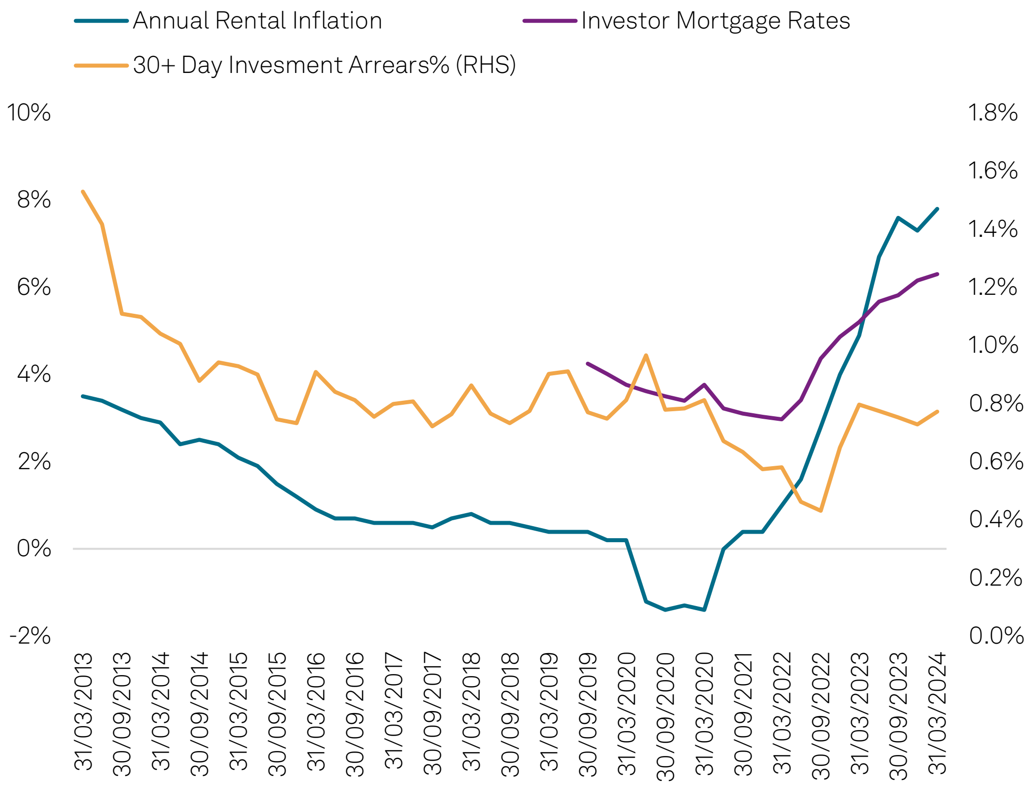
Source: S&P Global Ratings Data as of Mar. 2024.. Loan level data is based on loans underlying prime RMBS transactions rated by S&P Global Ratings.

Hot Topics

In Focus: Investors

Higher Rents Aid Investor Arrears

Rental inflation, investor arrears and mortgage rates



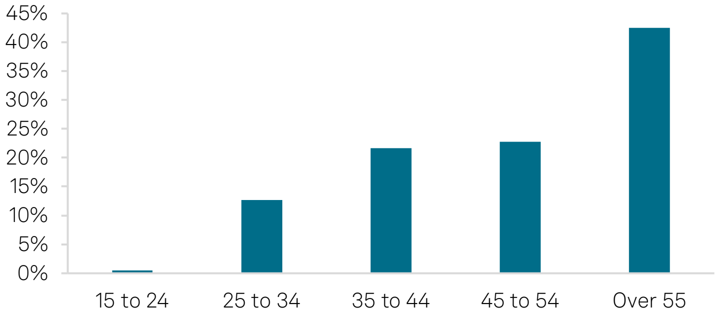
Standard variable rate is the variable mortgage rate for outstanding investor loans. Sources: Australian Bureau of Statistics. Reserve Bank of Australia. S&P Global Ratings. Investment loans in arrears are based on loans in Australian RMBS transactions rated by S&P Global Ratings.

- Low vacancies, strong immigration, and an undersupply of housing are driving demand for rentals.
- Rent increases are likely to be more infrequent than mortgage repayment increases in the current market.
- This timing mismatch may cause cashflow pressures for some investors that are more highly leveraged.
- Higher rents though will be helping many investors to offset higher mortgage costs.
- Because many residential property investors are “mum and dad investors,” there are common household factors affecting debt serviceability for both owner-occupiers and investors.
- Lenders consider investors’ household expenses, other debts, and household income sources in underwriting decisions, in addition to rental income from underlying properties.

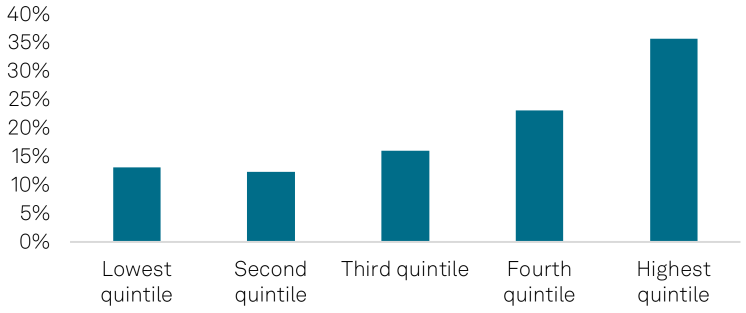
Investor Profiles

Profiles of households that own additional residential properties

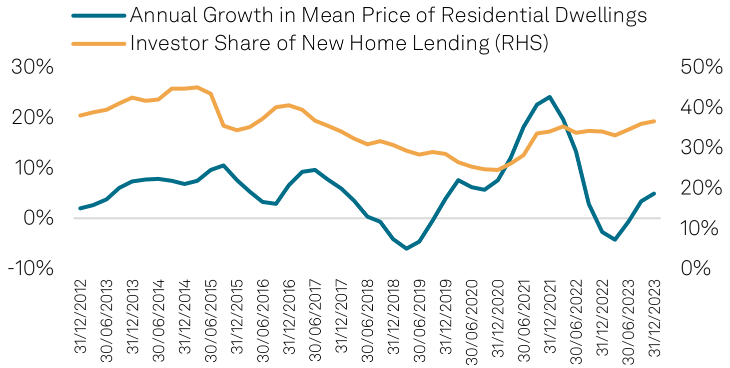
Investor age profile*



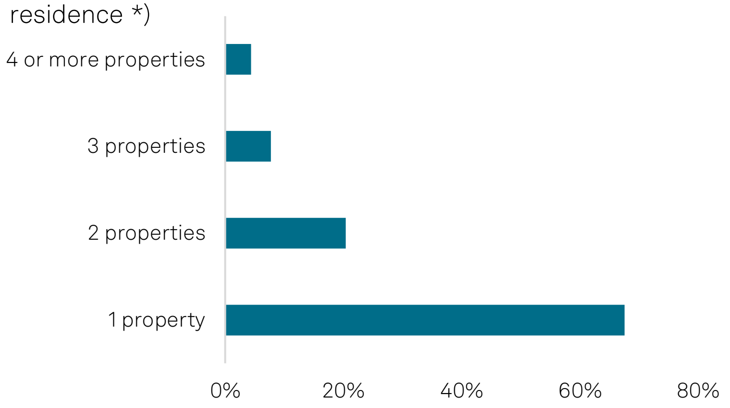
Investor income quintiles*



Annual growth in property prices vs. investor share of new home lending



No. of properties owned (excluding place of residence *)



Sources: Australian Bureau of Statistics, S&P Global Ratings. Note*: Data is from the Australian Bureau of Statistics Housing Occupancy and Costs., Australia, 2019-2020 (latest published series available). Data is based on households that own residential property other than their primary place of residence.

- Private ownership of rental stock in Australia is high.
- Many investor households have higher incomes and are older.
- Investor lending growth is influenced by property price dynamics.
- Rising property prices lure investors, given the prospects of capital gains.
- Around 70% of new investor loans are for the purchase of established dwellings.
- Investor loans make up around 36% of loans underlying Australian RMBS transactions. The figure is higher in nonbank transactions, at around 47%.

Where Are Investor Arrears Higher?

SA4 Areas With The Highest Investor Arrears

State	SA4 Area Name	Loans in arrears > 30 days (%)
NSW	Sydney - Outer South West	2.60%
VIC	Melbourne - North West	2.01%
NSW	Sydney - Outer West and Blue Mountains	1.64%
NSW	Sydney – Parramatta	1.61%
WA	Mandurah	1.59%
NSW	Sydney - South West	1.39%
NSW	Sydney - Inner South West	1.38%
NT	Darwin	1.30%
NSW	Sydney - North Sydney and Hornsby	1.25%
WA	Perth - Inner	1.22%

Sources: S&P Global Ratings. Data based on prime RMBS Australian transactions. Data as at Mar. 2024

- Several areas in Sydney have investor arrears that are higher than in other parts of the country.
- Higher investor arrears in Sydney, may reflect the larger loan sizes required to buy investment properties in this market relative to household income.
- Given the high private ownership of rental stock in Australia, many investors also will be facing higher repayments on their home mortgages, in addition to general cost-of-living pressures.
- Property price growth will be helping to keep investor arrears low overall by granting a way out to investors who are more financially stretched, through voluntary sale of their properties.

New Zealand

S&P Global Ratings Economic Outlook

	2024f	2025f	Outlook	Effect on credit quality
Real GDP forecast (% year over year)	1.4	2.5	Higher interest rates are dragging on consumer demand. This is being offset by high net migration	**Negative.** Slower economic growth is being buttressed by strong labor market conditions so far, helping to keep arrears and defaults low.
Unemployment rate (year average; %)	4.4	4.6	Labor shortages persist, but positive net migration is helping to fill labor gaps.	**Negative.** Rising unemployment will lead to higher arrears, albeit off a low base in New Zealand.
CPI (%)	3.0	2.6	Inflation is sticky. We do not forecast inflation to return to its target range until 2025.	**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 (%)	5.00	4.25	The Reserve Bank of New Zealand in May 2023 raised the cash rate to 5.5%, where it has remained.	**Negative.** New Zealand RMBS has a higher exposure to fixed-rate loans and the transition from ultra-low fixed rates during the pandemic to higher variable rates occurred earlier in New Zealand. Arrears increases have been modest so far and we do not expect them to rise materially from these levels.

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

Higher Interest Rates Are Constraining Affordability And Lending Growth

- Higher interest rates are reducing aggregate demand. But inflation is still above its target band, keeping rates higher for longer.
- Population growth has eased demand for labor, but the effects on aggregate demand could add to inflationary pressures.
- We expect house prices to continue their mid-single digit recovery over the next two years. Ongoing supply shortages, high net migration, an expected easing of interest rates, and a slight loosening of macroprudential lending restrictions should continue to support the recovery in property prices in New Zealand under our base case (see "Banking Industry Country Risk Assessment: New Zealand," May 14, 2024).
- Credit demand remains subdued due to higher interest rates. Despite the risks, arrears and losses remain low in the New Zealand RMBS sector.
- New issuance has been more of an ABS affair, with only one RMBS transaction issued in New Zealand in 2023.
- Higher interest are likely to weigh on credit demand as affordability becomes a higher barrier for many prospective homeowners, potentially restricting new RMBS issuance in 2024.
- Subdued consumer spending due to higher interest rates may also slow ABS issuance. But the short tenors of ABS securities means a more frequent cadence of issuance is possible.

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 53.65%.
  - An average loan size of NZ$333,103.
  - A weighted-average seasoning of 52 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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