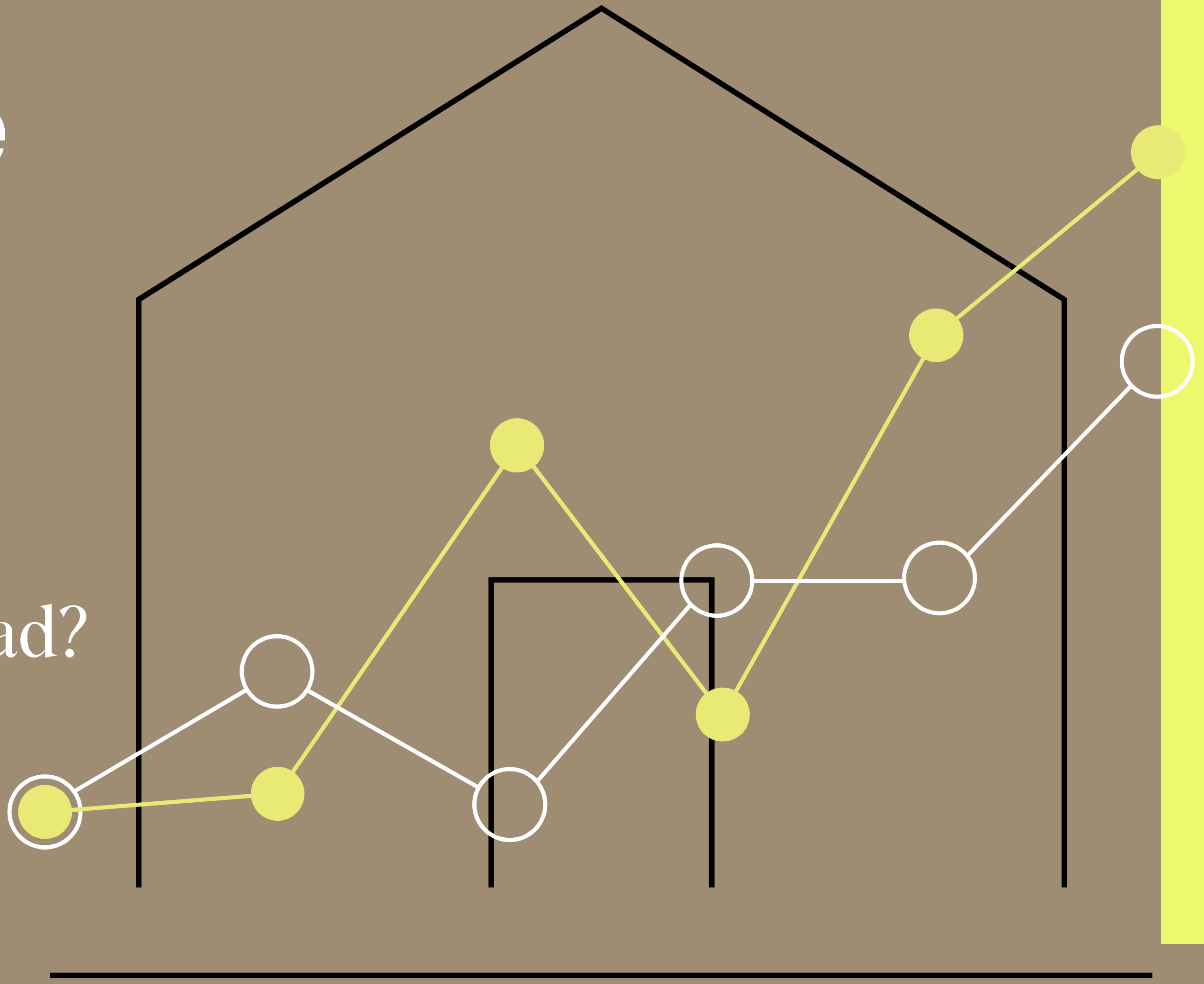
S&P Global
Ratings

RMBS Performance Watch: Australia

Market Overview

Refinancing, arrears, and prepayment rates – what lies ahead?



Q1 2023

This report does not constitute a rating action

Australian Macroeconomic Environment

Key Changes Since Last Quarter

Arrears momentum

Prime and nonconforming arrears are rising, but are still below long-term averages, for now. Competitive refinancing conditions, savings buffers, and a strong labor market have bolstered borrower resilience.

Prepayment divergence

Prepayment rates are still increasing across prime borrowers but are slowing for nonconforming borrowers. As mortgage competition eases, we expect overall prepayment rates to slow.

Refinancing hurdles

The ‘mortgage wars’ have enabled many borrowers to refinance their home loans, tempering arrears increases. Higher interest rates combined with buffers will increase refinancing hurdles for some borrowers, contributing to higher arrears.

Property price pause

Property prices appear to have paused, with recent data showing small increases. Supply shortfalls, and the resumption of immigration are offsetting the impact of rate rises. This is credit positive for RMBS.

S&P Global Ratings Economic Outlook: Australia

	2023f	2024f	Outlook	Effect on credit quality
Real GDP forecast (% year over year)	1.6	1.7	Higher interest rates and rising inflation will drag the economy, with constrained household budgets likely to dampen consumer spending. GDP growth is still on the horizon, thanks to the economy's resilience amid uncertainty.	**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; %)	4.0	4.3	We forecast unemployment will continue to rise throughout the year, 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 (%)	6.2	3.9	Inflation will take time to return to the RBA's 2%-3% target range. Inflation in the prices of goods appears to be slowing as supply chain disruptions ease, but inflation in the prices of services is still high.	**Negative.** Inflationary pressures are eroding real income. This hits lower-income households disproportionately, given that they are more likely to rent. The 'stickiness' of inflation will dampen household budgets for some time.
Policy rate, end of year (%)	3.85	3.35	The RBA increased the cash rate to 3.85% in May. Further rate rises are possible given the central bank's strong commitment to return inflation to target.	**Negative.** Rising interest rates will 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

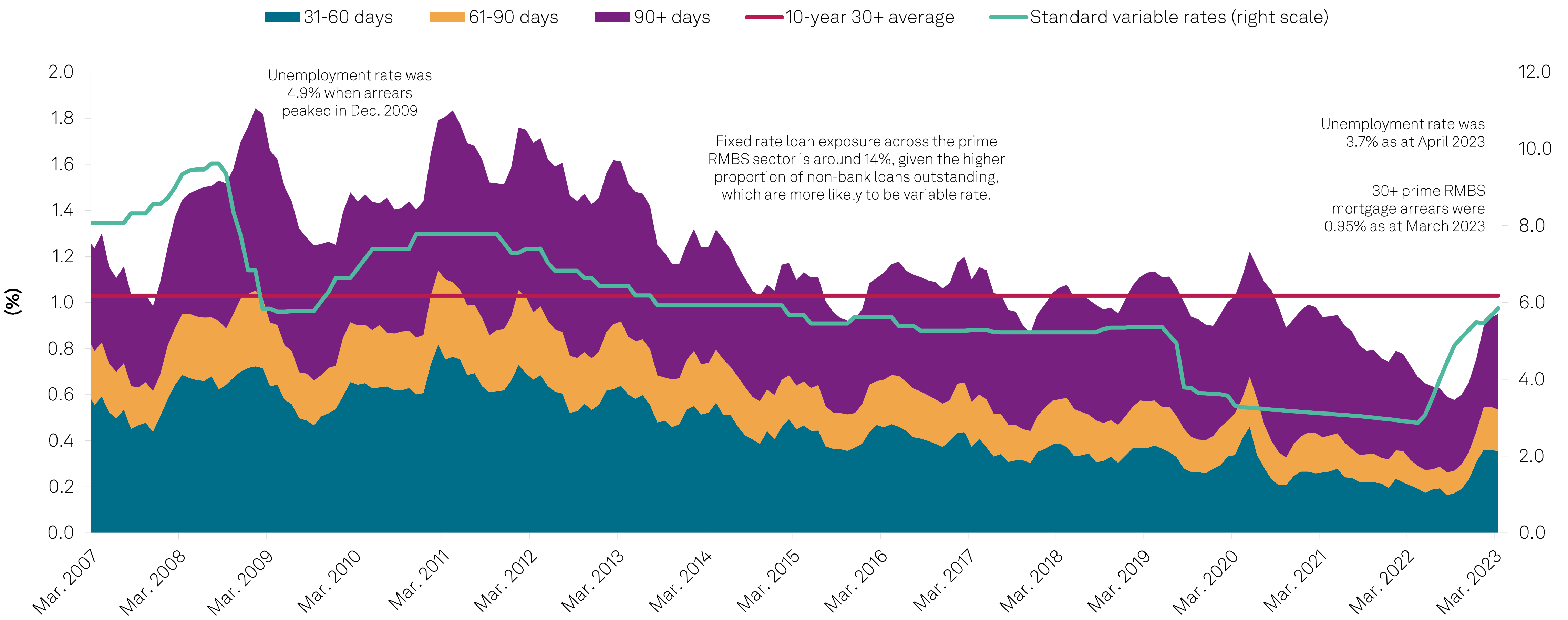
- As of March 2023, prime mortgage arrears are 0.95%, up from 0.76% in Q4 2022. Most of the increase is in the later-arrears category of 90 days. This reflects increased migration to advanced arrears categories as interest rate rises continue apace, exacerbating the arrears situation of financially stressed borrowers. We expect this trend to continue over the next six months.
- Nonconforming arrears continue to rise, reaching 3.70% in Q1 2023 from 3.20% in Q4 2022. Arrears increases were much higher in the more advanced arrears categories. As nonconforming loan arrears started rising earlier in this monetary tightening cycle, they have transitioned faster to later arrears categories. Nonconforming arrears are subject to greater volatility given the smaller overall pool of loans.
- Prime prepayment rates rose to 24.99% during Q1, up from 19.62% in Q4 2022. This reflects strong refinancing conditions for prime borrowers in the market as banks compete for prime quality borrowers. We expect this to slow in the coming quarters.
- Nonconforming prepayment rates declined to 33.72% in Q1 from 38.91% in Q4 2022. The decline reflects tougher refinancing conditions for this profile of borrowers, in addition to rising cost-of-living pressures, constraining borrowers' ability to make additional mortgage repayments.
- Strong prepayment rates have enhanced the build up of credit support in transactions, contributing to ratings stability and positive rating bias across the sector in the past 12 months.
- Property price declines have paused as the resumption of immigration and an undersupply of housing stock offset weaker home loan demand due to higher interest rates. Most RMBS transactions are well insulated from property price declines given the modest LTV profile of most transactions.
- Strong employment conditions continue to underpin low levels of defaults.

Australian RMBS Performance

Performance Observations: What To Expect

- **Prime arrears:** As of March 2023, prime RMBS arrears increased year on year but remain just below long-term averages. Rising arrears got off to a delayed start due to the build-up in savings for many borrowers. Nonbank arrears are increasing at a faster rate, albeit off lower bases, given the lower seasoning profile of this sector. We believe arrears will continue to rise over the next six months, with more pronounced increases in advanced arrears categories.
- **Nonconforming arrears:** While nonconforming arrears are up on a quarterly and yearly basis, they are down month-on-month. Some of this is seasonal, following elevated spending in the Christmas and Summer holiday period. We expect further arrears increases for this sector as interest rate continue to rise, exacerbating arrears pressure for more cash flow sensitive borrowers, including credit-impaired borrowers and some self-employed borrowers, who are more highly represented in these portfolios.
- **Investor versus owner-occupier arrears:** Investor arrears across both the prime and nonconforming RMBS sector are 1.06% as of March 2023, compared with 1.40% for owner-occupiers. We anticipate owner-occupier arrears will continue to increase at a faster rate than investor arrears, given the higher income profile of many investors and the ability to offset higher mortgage repayments against strong rental price growth due to low vacancy rates.
- **Prepayment rates:** Prepayment rates rose for prime borrowers over the quarter but declined for nonconforming borrowers. This reflects the difference in refinancing prospects across these loan segments. We expect prime prepayment rates to move toward longer-term averages later in the year as competition in home lending subsides and refinancing becomes harder.
- **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.

Prime Arrears Are Nudging Up Against Long Term Averages



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

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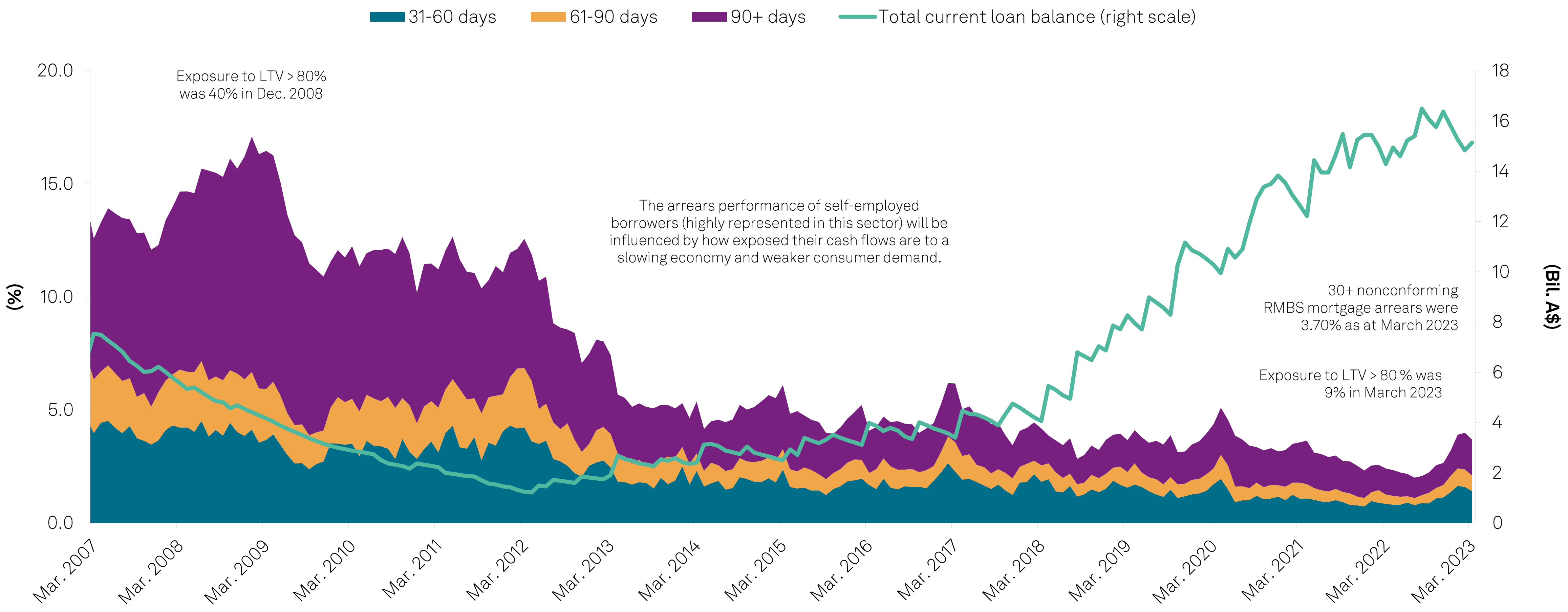
Nonconforming Arrears Unlikely To Reach Financial Crisis Peaks



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

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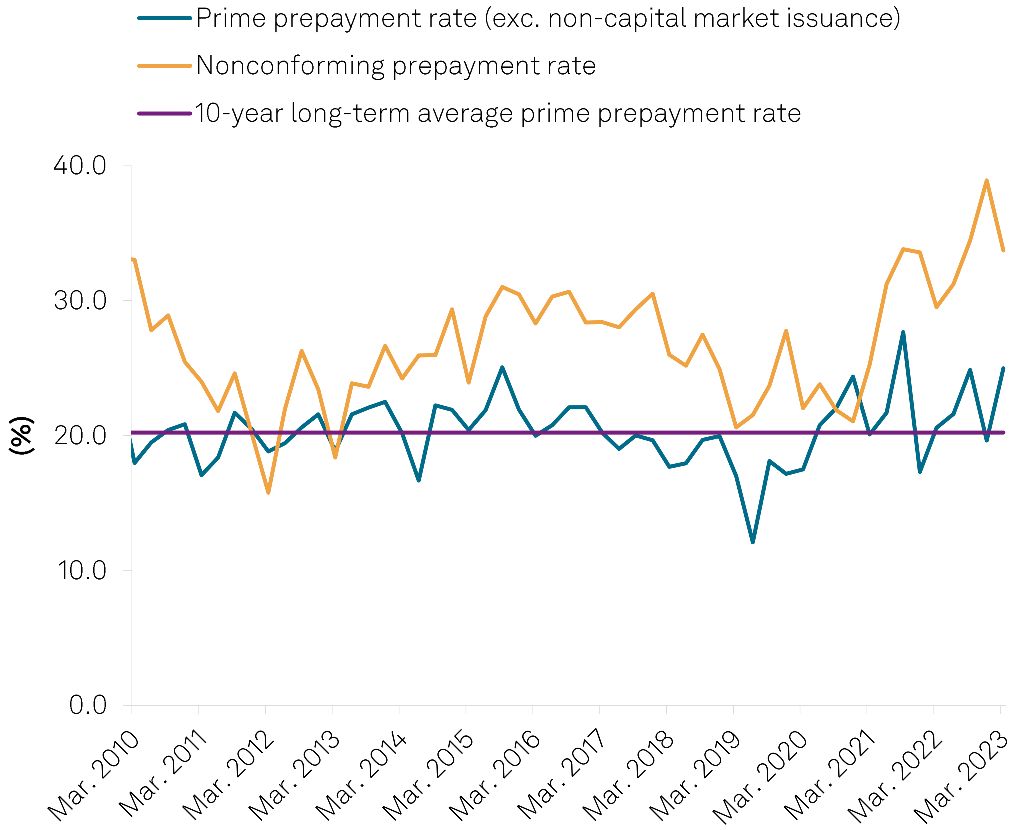
Prepayment Rates Reflect Refinancing Prospects



Source: S&P Global Ratings.

- Prime prepayment rates increased to 24.99% in Q1 2023 from 19.62% in Q4 2022.
- Nonconforming prepayment rates decreased to 33.72% in Q1 from 38.91% in Q4 2022.
- Prime prepayment rates increased over the quarter, reflecting the strong competition for prime borrowers by banks.
- Prime prepayment rates for nonbanks continue to outpace banks, given the funding cost advantage of banks.
- Nonconforming prepayment rates are slowing but remain above long-term averages.
- Given the larger loan sizes in many nonconforming transactions and credit profile of borrowers, refinancing prospects for these borrowers are more diminished.
- We expect prepayment rates to ease as rising interest rates increase debt serviceability hurdles, constraining refinancing prospects for some borrowers.
- 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 keep up momentum in refinance activity.

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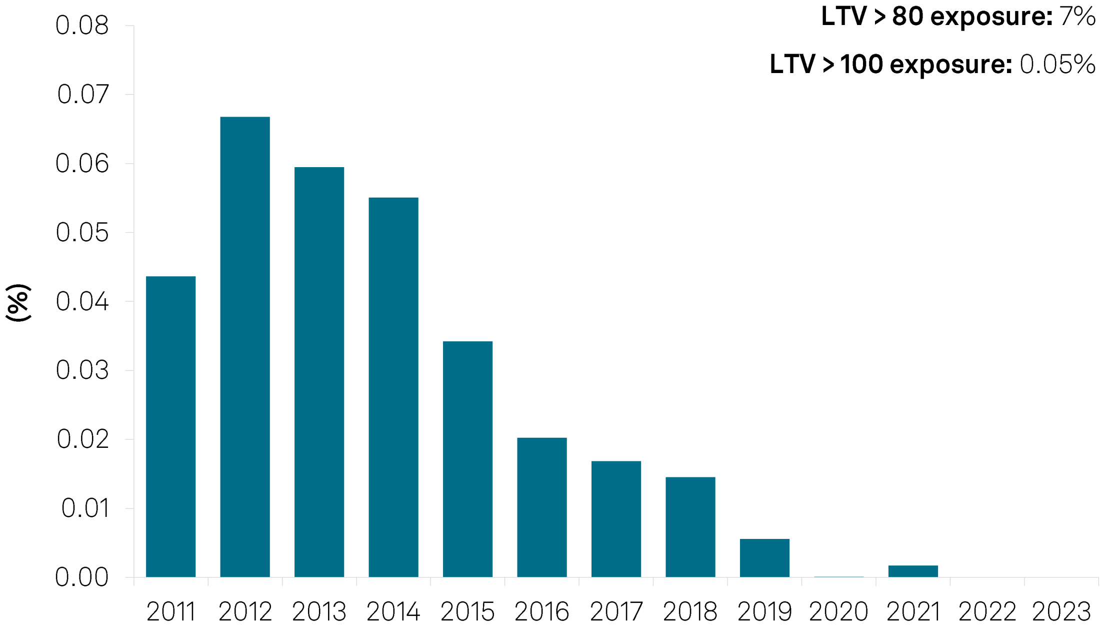
Buildup In Equity Will Temper Losses

The modest LTV ratio profile of most RMBS transactions and low exposure to high LTV loans will provide support against falling house prices.

Cumulative gross loss by vintage of origination

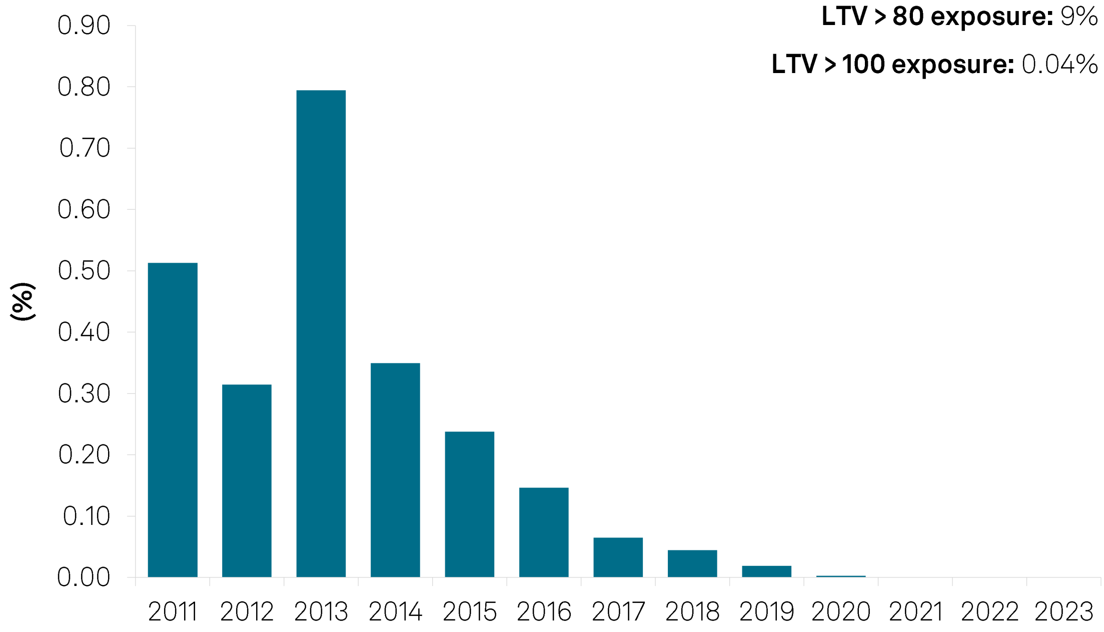
Prime RMBS



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

Cumulative gross loss by vintage of origination

Nonconforming RMBS



Source: S&P Global Ratings.

The 10 Worst-Performing Postcodes

State	Suburb	Postcode	Loans in arrears (%)
NSW	Katoomba	2780	5.62
NSW	Bonnyrigg	2177	4.91
WA	Forrestfield	6058	4.86
NSW	Dolls Point	2219	4.86
NSW	Alpine	2575	4.45
VIC	West Melbourne	3003	4.17
SA	Avoca Dell	5253	4.14
VIC	Broadmeadows	3047	4.09
QLD	Barkly	4825	4.01
NSW	Allawah	2218	3.99

Data as of Mar. 31, 2023. For a full list of suburbs/localities attached to these postcodes, please refer to the Australia Post website. Source: S&P Global Ratings.

SA4 Listing Arrears And Exposure

Geographic area map code	Regional name	State	30+ days arrears level Mar. 2023	30+ days arrears level Dec. 2022	Exposure across RMBS
101	Capital Region	NSW	1.19%	1.22%	1.19%
102	Central Coast	NSW	1.00%	1.01%	1.60%
103	Central West	NSW	1.28%	1.09%	0.49%
104	Coffs Harbour - Grafton	NSW	0.93%	0.71%	0.37%
105	Far West and Orana	NSW	1.95%	1.24%	0.18%
106	Hunter Valley exc Newcastle	NSW	1.00%	1.11%	1.51%
107	Illawarra	NSW	1.64%	1.08%	1.91%
108	Mid North Coast	NSW	0.89%	0.68%	0.48%
109	Murray	NSW	0.98%	0.79%	0.68%
110	New England and North West	NSW	1.04%	0.62%	0.24%
111	Newcastle and Lake Macquarie	NSW	0.83%	0.73%	1.64%
112	Richmond - Tweed	NSW	1.58%	1.21%	1.10%
113	Riverina	NSW	2.42%	1.80%	0.10%
114	Southern Highlands and Shoalhaven	NSW	1.46%	0.80%	0.28%
115	Sydney - Baulkham Hills and Hawkesbury	NSW	1.27%	1.12%	2.06%
116	Sydney - Blacktown	NSW	1.44%	1.15%	2.46%
117	Sydney - City and Inner South	NSW	0.98%	0.63%	3.05%
118	Sydney - Eastern Suburbs	NSW	0.73%	0.81%	0.85%
119	Sydney - Inner South West	NSW	1.78%	1.46%	3.49%
120	Sydney - Inner West	NSW	0.93%	0.98%	1.25%
121	Sydney - North Sydney and Hornsby	NSW	0.52%	0.44%	2.19%
122	Sydney - Northern Beaches	NSW	0.79%	0.59%	1.40%

Geographic area map code	Regional name	State	30+ days arrears level Mar. 2023	30+ days arrears level Dec. 2022	Exposure across RMBS
123	Sydney - Outer South West	NSW	2.45%	1.76%	1.18%
124	Sydney - Outer West and Blue Mountains	NSW	1.43%	1.24%	0.97%
125	Sydney - Parramatta	NSW	1.28%	1.14%	2.31%
126	Sydney - Ryde	NSW	0.83%	0.90%	0.54%
127	Sydney - South West	NSW	2.12%	1.93%	1.03%
128	Sydney - Sutherland	NSW	1.18%	1.10%	0.84%
201	Ballarat	Vic	1.23%	0.99%	0.70%
202	Bendigo	Vic	1.21%	0.89%	0.34%
203	Geelong	Vic	1.01%	0.75%	1.22%
204	Hume	Vic	1.47%	1.40%	0.28%
205	Latrobe - Gippsland	Vic	1.35%	1.15%	0.62%
206	Melbourne - Inner	Vic	1.46%	1.22%	4.65%
207	Melbourne - Inner East	Vic	1.12%	0.78%	1.87%
208	Melbourne - Inner South	Vic	1.11%	1.09%	2.25%
209	Melbourne - North East	Vic	1.52%	1.40%	2.75%
210	Melbourne - North West	Vic	2.06%	1.79%	1.38%
211	Melbourne - Outer East	Vic	1.42%	1.33%	2.49%
212	Melbourne - South East	Vic	1.54%	1.27%	2.72%
213	Melbourne - West	Vic	1.86%	1.39%	2.93%
214	Mornington Peninsula	Vic	1.69%	1.10%	1.37%
215	North West	Vic	0.97%	1.40%	0.11%
216	Shepparton	Vic	2.46%	1.89%	0.11%

SA4 Listing Arrears And Exposure

Geographic area map code	Regional name	State	30+ days arrears level Mar. 2023	30+ days arrears level Dec. 2022	Exposure across RMBS
217	Warrnambool and South West	Vic	1.30%	1.18%	0.18%
301	Brisbane - East	Qld	0.71%	0.59%	1.44%
302	Brisbane - North	QLD	0.66%	0.60%	2.01%
303	Brisbane - South	QLD	0.84%	0.79%	2.77%
304	Brisbane - West	QLD	0.47%	0.44%	1.25%
305	Brisbane Inner City	QLD	0.74%	0.65%	0.94%
306	Cairns	QLD	1.25%	1.09%	0.71%
307	Darling Downs - Maranoa	QLD	1.18%	1.01%	0.86%
308	Fitzroy	QLD	1.47%	1.34%	0.71%
309	Gold Coast	QLD	1.04%	0.86%	3.41%
310	Ipswich	QLD	0.96%	0.85%	1.21%
311	Logan - Beaudesert	QLD	1.84%	0.97%	0.63%
312	Mackay	QLD	1.71%	1.42%	0.56%
313	Moreton Bay - North	QLD	1.44%	0.94%	1.34%
314	Moreton Bay - South	QLD	1.01%	0.88%	0.65%
315	Queensland - Outback	QLD	3.54%	3.24%	0.11%
316	Sunshine Coast	QLD	0.91%	0.73%	1.73%
317	Toowoomba	QLD	1.70%	1.64%	0.01%
318	Townsville	QLD	1.39%	1.06%	0.77%
319	Wide Bay	QLD	1.39%	1.47%	0.51%
401	Adelaide - Central and Hills	SA	1.13%	1.03%	1.51%
402	Adelaide - North	SA	1.41%	0.85%	1.17%

Geographic area map code	Regional name	State	30+ days arrears level Mar. 2023	30+ days arrears level Dec. 2022	Exposure across RMBS
403	Adelaide - South	SA	1.06%	0.91%	1.26%
404	Adelaide - West	SA	1.65%	1.28%	0.77%
405	Barossa - Yorke - Mid North	SA	1.49%	1.16%	0.13%
406	South Australia - Outback	SA	1.24%	0.97%	0.11%
407	South Australia - South East	SA	1.52%	1.26%	0.29%
501	Bunbury	WA	1.45%	1.01%	0.40%
502	Mandurah	WA	1.83%	1.40%	0.28%
503	Perth - Inner	WA	1.36%	1.17%	0.90%
504	Perth - North East	WA	2.20%	1.53%	1.12%
505	Perth - North West	WA	1.49%	1.44%	1.69%
506	Perth - South East	WA	1.75%	1.67%	1.77%
507	Perth - South West	WA	1.22%	1.28%	1.38%
508	Western Australia - Outback	WA	2.34%	2.34%	0.30%
509	Western Australia - Wheat Belt	WA	1.97%	1.99%	0.13%
601	Hobart	Tas	1.01%	0.58%	0.89%
602	Launceston and North East	Tas	1.04%	1.01%	0.33%
603	South East	Tas	2.22%	1.34%	0.03%
604	West and North West	Tas	1.22%	1.10%	0.21%
701	Darwin	NT	2.72%	2.13%	0.50%
702	Northern Territory - Outback	NT	1.43%	1.51%	0.07%
801	Australian Capital Territory	ACT	0.55%	0.48%	1.74%

New Zealand

S&P Global Ratings Economic Outlook

	2023f	2024f	Outlook	Effect on credit quality
Real GDP forecast (year over year %)	0.8	1.7	Strong employment conditions, and a large pipeline of infrastructure and construction activity will support growth along with the recent return of positive net migration. This will help to offset recent economic contraction after severe flooding in many parts of the country.	**Positive.** The economy is benefiting from a strong return to international tourism and low unemployment.
Unemployment rate (year average; %)	4.0	4.7	Labor shortages are acute in New Zealand, holding back output in some sectors. We forecast the unemployment rate to average 4.7% during 2024 compared with 4.0% in 2023.	**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 (%)	6.0	3.4	High headline and core inflation and a tighter labor market than we expected are driving up inflation. Infrastructure rebuilding efforts following the recent floods will also add to inflationary pressures.	**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 (%)	5.75	4.50	The Reserve Bank of New Zealand raised the cash rate to 5.5% in May 2023.	**Negative.** Rising interest rates can put pressure on arrears for more highly indebted households. New Zealand has higher exposure to fixed-rate loans than Australia.

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

Despite Flooding, Rising Rates and Falling Property Prices, Losses Remain Low

- Recent flooding and rising interest rates have contributed to a pronounced jump in arrears across the New Zealand RMBS sector with the New Zealand Prime RMBS SPIN increasing from 0.63% in Q4 2022 to 1.07% in Q1 2023.
- Losses across the New Zealand RMBS sector are very low despite a rapid rise in interest rates and falling property prices.
- S&P Global Ratings estimates 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 on to 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 the modest LTV ratio profile of most transactions.
- New Zealand RMBS transactions have a high proportion of fixed-rate loans, ranging from 40%-90%.

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 60%.
  - An average loan size of NZ$331,660.
  - A weighted-average seasoning of 39 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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