ABC NEWS

Forced home sales set to rise as borrowers struggle with surging interest rates and mortgage repayments

By business reporter Rhiana Whitson

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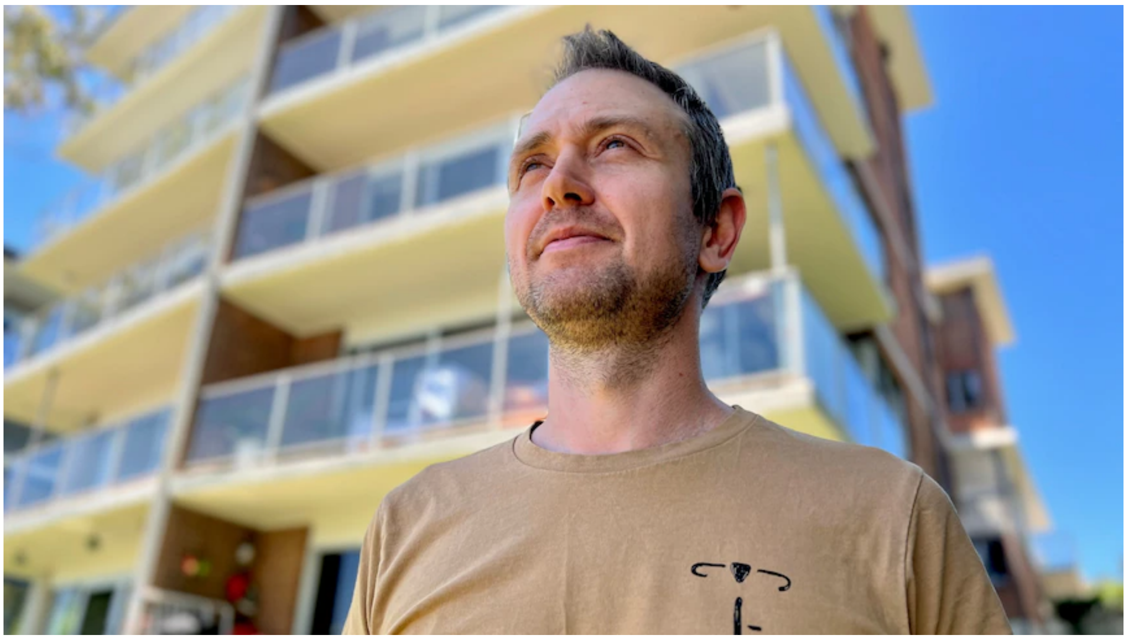

Aaron Doull and his wife Saori may not have borrowed as much if they'd known interest rates would rise so quickly. *(ABC News: John Gunn)*

As COVID hit and the Reserve Bank cut interest rates to record lows to stimulate the economy, Aaron Doull and his wife Saori took out an $850,000 loan to buy their first home.

Most of their mortgage was fixed at a 2.2 per cent interest rate.

But next year, when the couple come off that fixed loan, they'll face variable interest rates of around 6 per cent. That's well above the 2.5 per cent serviceability buffer that their loan was based on.

Mr Doull says they'll need to find another $1500 a month to service their mortgage, at a time when they'd like to be planning for their first child.

"If we do decide to have kids and my wife stops working, I think it's going to be a lot more challenging without her salary as well," Mr Doull says.

Mr Doull reckons they have about six months worth of savings to get them through interest rates of around 6-7 per cent.

"We don't know what the future holds, or where we could be in one or two years' time," he says.

"We could be back having to rent and going through the rental system all over again, which isn't really an enjoyable place to be."

Fortunately the couple's three-bedroom apartment in the waterside Sydney suburb of Drummoyne has significantly increased in value since they bought it, which makes Mr Doull feel slightly more secure.

He's also grateful they didn't max out their borrowing capacity. Despite Mr Doull's partner being on JobKeeper payments at the time, the banks were willing to lend them almost $1.3 million.

> "If that had happened we would be up for a fortune in interest, and we would be selling now."

'It's very bad'

Experts estimate almost 300,000 borrowers who took out home loans in the two years to May are at serious risk of default or forced sales.

Accountant Kennedy Weldemariam estimates more than 100 of his clients will need to sell their homes because of interest rate increases.

Most of them are first home buyers and from multicultural communities in Melbourne's outer-western suburbs.

"It's very bad, especially in the emerging communities, because of lack of financial literacy," Mr Weldemariam says.

"Every time the interest rate goes up, the stress goes up, and the demand goes up," he says.

> "They come and knock on our office, and they say, 'What is my future? Is my bank going to take the property?'"

Accountant Kennedy Weldemariam says first home buyers are suffering as interest rates rise. *(ABC News: John Gunn)*

Mr Weldemariam's clients were too worried about their financial situation to go on the record.

The ABC has spoken to half a dozen other people for this story who are either actively selling or thinking about putting their property on the market because of rate increases, who were also unwilling to be interviewed for the same reason.

"We talk about exit strategy most of the time," Mr Weldemariam says, referring to the advice he's giving his clients who are struggling with rate rises.

> "We talk about their budget, about disposable income, about their repayments, and if it's getting tighter, we advise them to sell it."

Mr Weldemariam says one of his recent clients is a single mum with two kids who already works multiple jobs.

"She has gone from paying $2,000 a month [in mortgage repayments] to more than $3,000 a month," he says.

After paying her mortgage, what is left over is no longer enough to cover her family's expenses — she needs to find an extra $200 a month to cover costs. When rates rise another 25 basis points, she'll be short around $500 a month.

Mr Weldemariam says for clients like her selling the property and renting is a better option.

"I told her that if you can't get enough money to pay for all your expenses, then you are better to sell it [her house], you have to prepare yourself for these things."

Mr Weldemariam says there should be better protections in place to stop people borrowing too much. *(ABC News: Rhiana Whitson)*

For Mr Weldemariam, the blame largely sits with the banks and regulators like APRA for allowing people to borrow too much.

"The banks are hungry for business, always," he says.

"This type of risk is not good for the bankers and is not good for the consumers also," he says.

"We need the bankers to take more responsibility in educating the clients about the risk side of things.

"If they prepared for an interest rate of 10 per cent, it would not be a problem."

'Human nature'

Increasing the serviceability buffer for borrowers is generally unpopular among those who make money from property sales, but it's something Brisbane buyer's advocate Wendy Russell supports.

"Serviceability buffers do need to be increased," Ms Russell says.

"I feel that it's human nature that people want to buy the best house that they can afford. So they're constantly stretching the budget."

Buyers' agent Wendy Russell says she expects buyers will avoid flood-prone areas in the short term. *(Supplied: Wendy Russell)*

Between December 2014 and July 2019, the buffer was 2 percentage points, but with a 7 per cent interest rate floor.

At the moment, that buffer is 3 percentage points above current mortgage rates, until late last year it was 2.5 per cent.

Like Ms Weldermariam, Ms Russell says a 10 per cent interest rate floor would provide better protection from future rate rises.

"I think it needs to be minimum 10 per cent, in my opinion."

As people from southern states escaped lockdowns and Queensland's property market boomed, Ms Russell saw firsthand how buyers were willing to do whatever it took to get a foot on the property ladder.

"In the heat of the moment, it's very easy to just keep bidding and place another bid," she says.

"And they don't think about the ramifications of what that might look like later down the track when obviously interest rates do rise."

Forced sales to compound house price falls

Before rates started rising, around a third of gross household income was needed to service a mortgage, according to data analysis by CoreLogic and ANU Centre for Social Research and Methods.

After recent rate rises households are, on average, spending around 41.5 per cent of their income on mortgage repayments.

If you assume further rate rises, but no change in income or property prices, it could go as high as 44 per cent, according to the data.

Date	National median dwelling value	Assumed mortgage rate	Monthly mortgage repayment	Monthly median household income (gross)	Portion of income required to service mortgage
Apr, 2022	$767,869	2.41%*	$2,399	$7,280	32.9%
Nov, 2022	$714,475	5.08%**	$3,096	$7,462	41.5%
Jun, 2023	$714,474	5.71%***	$3,321	$7,462	44.5%

** Average new owner occupier variable reported by the RBA in April '22*
*** Average new owner occupier variable reported by the RBA in Oct '22, plus 50 basis points*
**** Average new owner occupier variable reported by the RBA in Oct '22, plus 113 basis points (assumes the cash rate peaks at 3.73% in June 2023, based on median outcome of major bank forecasts)*

Get the data

CoreLogic Head of Research Eliza Owen says it's those on lower incomes who'll be hit hardest by rate rises.

"If you have a relatively high income, you could be spending 50-60 per cent of your income on your housing costs, and you still have plenty of money leftover," Ms Owen says.

> "But for those who bought into the market, perhaps when prices were near their highest, they're facing these rising interest costs and they're overextended."

CoreLogic Head of Research Eliza Owen expects forced sales to increase as borrowers come off fixed interest rates. *(ABC News: Dan Irvine)*

Ms Owen expects forced sales to increase next year as borrowers come off record low fixed interest rates.

"If we see more people needing to sell in 2023, it could compound the price falls that we're already seeing as a result of interest rates," she says.

"The housing market trajectory follows the cash rate – so with expectations that that peaks in mid 2023, that's when we could start to see a floor in the housing market."

Low rates unlikely to exist again

Economist Warren Hogan, a current adviser to Judobank, and former Treasury adviser and Chief Economist at ANZ, says Australia is in uncharted territory.

"The recession in the 1990s was the last real financial crisis we had and was mainly focused on commercial properties," Mr Hogan says.

"And that is a very different proposition compared to the residential housing market.

> "These record low interest rates, not only no longer exist in the market in late 2022, but are unlikely to exist again."

Economist Warren Hogan says if tens of thousands of people have to sell their houses because of rising interest rates the government may need to intervene. *(ABC News: Dan Irvine)*

He believes banks, the regulators and even the government may have to intervene to stop widespread forced sales.

> "There is a real risk in this cycle in 2023, that we see tens of thousands of people having to get out of properties and can no longer afford their mortgages."

"And I think that then becomes a policy issue.

"And of course, the burden will have to be shared between not just the individuals involved, but also the shareholders of banks – they'll take a hit, and potentially the taxpayer, depending on how severe the problem becomes."

Mr Hogan says intervention could involve restructuring the terms of loans to keep people in their houses, or a way for people to sell out in a property market without incurring huge debts.

'It is his job'

However, Mr Hogan isn't convinced increasing serviceability buffers for lending is the silver bullet.

He says APRA should be brought back into the Reserve Bank so regulatory and monetary policy is not set in isolation.

"The RBA as the central bank should have responsibility not just for the cost and supply and price of money, but also for the regulation of the financial system that operates around that," he says.

"We did get to a point last year when the RBA was cutting rates and people were concerned about this exact situation playing out with rates being so low, that the governor said that it's not his job to worry about where house prices are going, implying it was APRA's.

"I think it is his [RBA Governor Phillip Lowe's] job.

"And I think that would be best formulated by APRA being under the auspices of the RBA and the RBA governor having responsibility for bank regulation as well."