Wealth Personal Finance Home loans

Seven ways to cut mortgage stress as rates rise yet again

As households struggle with the 12th interest rate rise since May last year, it pays to know which strategies will cost you less over the long term.

Duncan Hughes [/by/duncan-hughes-j7gc6] *Reporter*

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Middle-class families are at "breaking point" as interest rates continue to rise [https://www.afr.com/policy/economy/rba-s-12th-rate-rise-shows-lowe-has-lost-patience-20230606-p5ded6], expenses increase and tax breaks fall, says Bridget Salvatore, a mother of four children aged under 10.

Bridget, who recently had to reduce her maternity leave, says rate rises are devouring their income and exhausting family savings used to cushion the impact of inflation, increasing fears about more rises.

"After every rate rise, I think 'there go our savings'," she says. "We are being hit so hard in so many places. I am not sure how much more the middle class can keep getting hit without breaking."

Feeling the squeeze: Bridget and Steve Salvatore with twins Charlie and Luca, Indy and baby Steel. **Drew Ryan**

Bridget and husband Steve, who runs an electrical business in Victoria's surf resort of Torquay, say they have had to abandon many of their long-term plans, such as sending their children to private schools [https://www.afr.com/wealth/personal-finance/private-schools-out-caravan-ditched-as-rate-rises-hit-families-20230505-p5d61r], to focus on paying their mortgage and rising household expenses, such as childcare. "Each rate rise takes big bites of $300 to $400 out of our monthly budget," she says.

The family has cut health insurance cover, shops at discount supermarkets and reduced children's activities, such as swimming lessons.

The Salvatores' troubles dealing with rapidly rising costs are being reflected in households across the nation, according to analysis by AMP.

Diana Mousina, AMP deputy chief economist, says household savings have plunged to the lowest level since the global financial crisis in 2008 and that the “war chest” accumulated during the pandemic will be depleted by mid-2024 if spending continues at its current pace.

“There is an unequal spread of savings across households, so some have already run down their savings, but a lot of the accumulation in savings has been in the older households, which are less likely to have large mortgage debt,” she adds.

Bridget says another middle-income setback is that earners on less than $126,000 a year are losing a tax offset that increased the size of a refund or decreased tax payable by up to $1500.
Mark Chapman, a tax director for H&R Block, says: “The first that many taxpayers will know about this is when they do their 2023 return.”

The 12th rate rise in 13 months will affect more than three million households with a mortgage, according to government analysis.

For a household on a 30-year, $1 million, principal and interest mortgage, the latest rise will add about $152 to their monthly repayments, says Sally Tindall, research director for research house RateCity. All up, that’s $2269 more than they were paying in May last year – a 49 per cent increase.

The one thing borrowers shouldn’t do is nothing, says RateCity’s Sally Tindall. **Michael Quelch**

Higher interest rates also lower the amount a household can borrow to buy a house. A family with two children and a household income of $250,000 has seen borrowing capacity fall by about 32 per cent to $1.21 million over the past 12 months, according to RateCity. A single person earning $100,000 will be able to borrow about $516,400, a decrease of $243,100.

Many property buyers are fearful another rate rise could force them to sell, warns Louis Christopher, managing director of SQM Research, which monitors property markets.

“The expectation is many will go over the edge [https://www.afr.com/companies/retail/westpac-is-fielding-more-home-loan-hardship-calls-as-rate-rises-bite-20230607-p5demn] and be forced to sell if there is another rise in the second half,” says Christopher, despite the number of distressed sales this year being nearly 4 per cent lower than last year.

Many borrowers' repayments are higher than the level they were stress-tested for in 2020-21 when the cash rate was between 0.75 per cent and 0.1 per cent, according to SQM.

"There is no question that some home buyers are doing it particularly tough and some are getting communications from their lenders that they are missing payments, and it may be time to sell," Christopher says.

He also warns that a 4 per cent rise in property prices this year has been a "false dawn" and that gains are likely to be surrendered in the second half.

According to research house Roy Morgan, mortgage stress has increased to its highest since August 2008 with nearly 28 per cent of mortgage holders "at risk" – meaning they are spending 25-45 per cent of their after-tax household income on their home loan.

Michelle Levine, chief executive of Roy Morgan, says mortgage stress is heavily concentrated in lower income bands, but it is "growing across the spectrum".

For mortgage brokers, such as Matt Turner, managing broker for GSC Finance Solutions, there is compelling anecdotal evidence from his clients that middle-class buyers, typically with loans of about $700,000, are on edge.

"Rate rises are beginning to bite," says Turner, who adds his phone started ringing minutes after Tuesday's rate rise announcement from property buyers wanting to know how they could save on repayments. "If they are not at breaking point, then they could not be far away," he adds.

Clayton Safi, a Sydney-based industrial chemist and father of two, has ruled out buying a family home in Sydney because his income cannot match fast-rising house prices, interest rates and inflation-fuelled living costs.

Investor Clayton Safi is feeling the pressure of rising property prices. **Louie Douvis**

Safi is renting and has bought a one-bedroom apartment, which is also leased. His property is held in a self-managed super fund.

"When rates started to rise last year, I thought prices would slow and I could afford a home," he says. "But $1.5 million doesn't get you anything decent within 40 kilometres of Sydney's central business district."

Many borrowers are not up-to-date with the 12 rate rises since May and are still making repayments based on February's rate increase.

That's because many borrowers update their loans on a quarterly or half-yearly basis, which means their repayments are still set at the ninth increase, rather than the 12th. While the banks do pass on the latest interest rate rises, they are slower to include these in the principal repayments.

"People think they have conquered 11 rate rises, but many have only just started paying for number nine," warns Tindall.

The accompanying table shows various options for an owner-occupier paying principal and interest for a $1 million, 25-year mortgage – ranging from doing nothing through to refinancing and switching to interest-only for two years.

Potential options for rate relief*

	Current repayments ($)			Cost over remainder of loan ($)	
	Rate after June RBA increase	Monthly repayment	Difference to 'do nothing'	Total cost	Difference to 'do nothing'
Do nothing	6.86	6979	–	1,097,493	–
Haggle (0.5% pt cut)	6.36	6665	-314	1,003,304	-94,189
Extend out loan term (from 25 yrs to 30 yrs)	6.86	6559	-419	1,365,256	+267,762
Switch to interest-only for 2 yrs	7.42	6183	-795	1,142,084	+44,591
Refinance	5.50	6141	-838	847,205	-250,289
Refinance + switch to interest-only for 2 yrs	5.94	4950	-2029	983,130	-114,364

* Based on an owner-occupier paying principal and interest with a $1m debt and 25 years remaining who hasn't negotiated their loan since the start of the increases. Includes switch fees where applicable and assumes the cash rate changes in line with ANZ's forecast.

SOURCE: RATECITY

Tindall says: "Whatever you do, do not do nothing. Be proactive because the Reserve Bank of Australia is not about to hand out a rate cut soon."

One of the best ways to reduce monthly repayments is to refinance and switch to interest-only for two years, the analysis shows.

The overall savings of refinancing to 5.94 per cent and switching to interest-only for two years are $114,000 over the 25-year term, or less than half the savings of only refinancing.

But the reduction in monthly repayments for this option is more than $2000, compared with around $840 for only refinancing.

"That's a huge get-out-of-jail card for buyers who cannot maintain repayments at current rates," says Tindall.

Strategies for reducing repayments include:

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- Check you are not paying too much for popular offset and redraw accounts. According to Canstar, which monitors rates, higher rates on offset accounts could cost an extra $1500 in monthly repayments for a $1 million variable loan compared with no-frills, low-rate accounts. Headline fees on offset accounts have been increasing by up to 1.38 percentage points. This means a borrower on the lowest variable rate of 4.94 per cent could be paying almost 70 per cent less interest than someone with an offset account on 7.27 per cent.

- Find a lender with a lower rate and an easier stress test. Resimac and Westpac have lowered borrowers' 3 percentage point servicing buffer set by the Australian Prudential Regulation Authority (APRA).

- Ask for a cheaper rate at your current lender. Mortgage brokers claim lenders are slashing standard variable rates to keep borrowers with a good savings record and repayment history. "All the lenders are discounting," says Chris Foster-Ramsay, of Foster Ramsay Finance. He says discounts typically range from 200 to 300 basis points, depending on the borrower's record and size of the loan."In lieu of cash backs, which many lenders recently withdrew, they are aggressively pricing and repricing for customers they want to recruit and keep," he says.

- Review your lifestyle. Borrowers should assess different rate scenarios to identify how much they can afford in additional repayments. "They should tally expenses and calculate remaining cash flow," says Phoebe Blamey, a director of mortgage broker Clover Financial Solutions. "Many borrowers have not adjusted their lifestyles to deal with rising rates and higher costs." Cut discretionary spending, credit cards, eating out and multiple subscriptions. Alternatively, generate more income with a side hussle, ask for a pay rise or sell off unnecessary assets. Blamey adds: "Consolidate high-interest debt into the home loan."

- Extend loan term. Distressed borrowers can extend the loan term, reducing monthly repayments. But this means paying more over the life of a loan, warns Tindall. For example, the accompanying table shows that extending a loan term from 25 to 30 years will only marginally reduce monthly payments but add nearly $270,000 to the total loan cost.

- Switch to interest-only. The table shows a borrower refinancing to a lower rate of 5.94 per cent and switching to an interest-only loan for two years will decrease monthly repayments by more than $2000. But switching to interest-only for two years and staying on the same rate will reduce monthly repayments by nearly $800 but increase total repayments over the term of the loan by more than $44,500.
- Consider cashback offers when refinancing. Several lenders, including AMP, Reduce Home Loans and Geelong Bank, are retaining cashback offers to help with the cost of refinancing.

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