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One in five interest-only borrowers could run into mortgage repayment arrears: UBS



by Su-Lin Tan

One in five interest-only loan borrowers will struggle to make mortgage repayments when their interest-only loan expires, the latest UBS housing and banking survey reveals.

The Reserve Bank previously indicated almost half a trillion dollars in interest-only mortgages - or about 30 per cent of all outstanding mortgages - will convert to principal and interest loans over the next four years, jacking up monthly repayments for almost 1.5 million borrowers and cooling housing markets further.

"This last finding is quite concerning, in our view, as it implies that 18 per cent of interest-only customers will not be able to afford to pay their monthly mortgage repayment when their Interest-only period expires," the 2018 UBS Evidence Lab Mortgage Survey said.

"With a lack of refinancing options available and the banks reluctant to roll interest-only loans, these mortgagors will have to significantly pull back on their spending, sell their property or could potentially end up falling into arrears."

Interest-only borrower confusion

Many borrowers continue to show a lack of understanding of interest-only loans, even though there has been a greater overall awareness as well as a fall in interest-only loans issued since the survey was taken last year and since the commencement of the banking royal commission, UBS added.

UBS was concerned that of the interest-only loans issued to owner-occupiers, rather than investors, a third of borrowers signed up for the mortgage to benefit from negative gearing, a

concession only available to investors.

Additionally, about 14 per cent of those borrowers "expect house price to rise and sell the property before the interest-only period expires", the survey findings show.

UBS also found mortgage brokers were still encouraging customers to take out interest-only loans even despite the Australian Prudential Regulation Authority's clamp down of the product in March, capping it at 30 per cent of new loans.

"We also found that there was a statistically significantly larger number of respondents who secured their loan via the broker channel that stated the "mortgage banker/broker advised me to take out an interest-only loan", the report said.

Poor product knowledge

The number of borrowers who didn't know they had interest-only loans has however fallen to 5 per cent from 11 per cent last year, although one in three still didn't know how much their repayments will increase when their interest-only loan period expires.

"We believe interest-only product knowledge remains poor and the more we delve into the data the more concerning the responses," UBS said.

UBS takes a view that a credit crunch in the next two years is likely as will a persistent fall in house prices, particularly in the next year, caused by a cocktail of moving levers including the outcomes of the banking royal commission, the federal election and rising household debt-to-income ratios.

Sydney house prices have fallen 5.6 per cent in the year to August, while Melbourne's prices declined 1.7 per cent in the same period.