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Profit in home lending

The big four banks make $200,880 in profit on the average 30-year home loan for owner-occupiers.

Technical brief

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The Australia Institute - Research that matters

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Summary

Australian banks are very profitable by world standards. In their latest reporting year, the big four banks made aggregate pre-tax profits of $44.6 billion. The big four banks rank among the top seven listed companies in Australia when ranked by their profit. If ranked by capitalisation the big four banks are among the top six listed companies. Among their activities, these high profits reflect the high profit margins (1.59%) applied by the big four banks to owner-occupier housing loans, which are higher than the profit margins of *all* banks (1.24%). Between them, the big four banks extracted approximately profit of $17.6 billion from households with owner-occupier home loans in 2023-24. That means the profit on owner-occupied housing loans is 39.5% of the big four's total profit while those loans are just 24.6% of their business.

Australia Institute research shows the big four banks take profit of approximately $9,130 in the first year from households with an average owner-occupier home loan. This is $761 each month, or $176 per week, from homeowners. Over the life of an average 30-year loan, that will amount to $200,880. This is almost 35% of the average mortgage.

Introduction

The purpose of this study is to estimate the amount mortgages for owner-occupiers contributed to the profits of the big four banks (big four): ANZ Bank, the Commonwealth Bank of Australia, the National Australia Bank and Westpac Banking Corporation. The background to this study is the suggestion that the corporate sector in Australia has contributed to the cost -of -living crisis through price gouging. Data is presented for the big four together with data for all Authorised Deposit-taking Institutions (ADIs) which includes *all* banks together with the credit unions and building societies. The results of this study will throw some light on the issue of whether there is price gouging in the banking sector and whether the banks are contributing to cost-of-living pressures.

Australian banks are profitable

In our 2012 paper of the same name, we mentioned Australia's big four are extremely profitable by world standards and by the standards of other companies in Australia.[1] In their latest financial reports the big four report aggregate pre-tax profits of $44.6 billion.[2] The Commonwealth Bank is the 12th largest bank in the world and, from among that top 12, its return on equity at 13.31% is third highest.[3] The returns on equity for the other big four are not far behind. Research by *Trading Economics* based on World Bank data shows Australia is ninth among 32 "advanced countries" when its banks are ranked by return on equity.[4] One of those ranked higher than Australia is New Zealand which, in any event, is dominated by Australia's banks.

Within Australia the top seven most profitable listed companies are shown in Table 2.

Table 1: Top seven most profitable companies by rank

Rank	Company	Profit US$billion
1	Rio Tinto	$10.06
2	BHP Group	$7.90
3	Commonwealth Bank	$6.48
4	Fortescue	$5.68
5	ANZ Group Holdings	$4.78
6	National Australia Bank	$4.75
7	Westpac Banking	$4.47

Source: Finance charts (2024) Most Profitable Companies in Australia for Sep 2024, 24 September.

Apart from the three miners which are extremely profitable, the big four take up the rest of the top seven companies in Australia by profitability. Similar results are obtained if we rank the top listed companies by market capitalisation as is shown in Table 2. It can be argued that the market capitalisation of a company is the market's valuation of the expected future profit stream of that company.

[1] Richardson D (2012) *The profit in home lending*, https://australiainstitute.org.au/report/the-profit-in-home-lending/

[2] ANZ *2023 Annual Report*, Commonwealth Bank *2024 Annual Report*, National Australia Bank *2023 Annual Report* and Westpac *2023 Annual Report*.

[3] Gruber J (2024) "Is CBA the most expensive bank in the world?" *Morningstar Insights*, https://www.morningstar.com.au/insights/stocks/247374/is-cba-the-most-expensive-bank-in-the-world

[4] Trading Economics (2024) *Bank Return On Equity (%, After Tax) By Country*, at https://tradingeconomics.com/country-list/bank-return-on-equity-percent-after-tax-wb-data.html. "Advanced countries" refers to those included in the IMF classification of "advanced countries".

Table 2: Australian listed companies by capitalisation, A$billion.

Company	Capitalisation $billion
Commonwealth Bank	$239
BHP Grp	$213
CSL Ltd	$146
NAB	$120
Westpac	$111
ANZ Banking	$94

Source: The Australian (2024) “Top 150 Companies” *The Weekend Australian*, 18 October.

Table 2 shows that the big four banks are among the top six listed companies in Australia at close of business, 18 October 2024. Collectively those banks had a market capitalisation of $565,024 million.

We now turn to the main objective of this paper, to explore the profitability of the mortgage market and the implication for home-buyers.

Methodology

In this section we attempt to find out how much profit the banks make out of home loans to households for owner-occupation. The method used is to estimate the average profit margin on bank home loans and then to apply that to the outstanding loans to households. The estimates here are based on data which comes from statistics published by the Australian Prudential Regulation Authority. The data include some credit unions and building societies. The data for the Big 4 Banks includes include Suncorp-Metway as it has been recently absorbed by ANZ. The two sources are the monthly and quarterly publications for ADIs using average of the 4 quarters to June 2024.[5]

The operating items (Rows 6-9 in Table 3) include:

- interest income banks earn on housing loans for owner occupation (Row 6)
- total interest expenses (Row 7)
- total operating expenses (Row 8)
- charges for bad and doubtful debt (Row 9).

The interest income banks earn on housing loans for owner occupation is based on our own calculations derived from the outstanding loans to owner-occupiers (Row 3) and the interest rates for owner-occupiers reported (Row 11).

The interest rate was calculated by a 12-month average of the monthly averages over 2023-24 for interest rates charged to owner-occupiers as given by the Reserve Bank of Australia (RBA) for all lending institutions and the major institutions. Rather uniquely, these happened to be the same in each month at 5.79%. The figures also happened to be the same for “large institutions” which we take to be the big four banks. Unfortunately, the RBA does not give separate figures for the smaller banks, credit unions and building societies.

The operating expenses (Row 8) include advertising and marketing which for the big four banks amount to a total of $877 million in the latest year available.[6] Total operating expenses as a rule also include charges for bad and doubtful debt but we have listed them separately in Table 3 because of the intrinsic interest in that item.

[5] APRA (2024) *Monthly authorised deposit-taking institution statistics back-series, March 2019 to August 2024*, 30 September and APRA (2024) *Quarterly authorised deposit-taking institution statistics, September 2004 to June 2024*, 12 September.

[6] The operating and marketing expenses were calculated from banks’ annual reports and refer to the financial years ending September 2023 except for the Commonwealth Bank which reports on a financial year ending June 2024. These $877m expenses are relatively minor part of the $43bn overall operating expenses and were included even though there is a lack of consistency of time frames to maintain the most conservative results.

The average percent interest expense allocated over all assets (Row 12) is based on calculations by the Australia Institute. Average interest expenses were allocated over all assets and taken to be the cost of funds for the institutions concerned. Interest expenses arise from a bank's liabilities (deposits, loans and other debts), and we then allocate them over the asset base to get the cost of raising the funds lent for housing and other purposes.

Other bank costs have been allocated across the bank businesses in the same way as interest expenses. We assume that non-interest expenses are allocated pro rata across the banks' businesses. Likewise, the charge for bad and doubtful debt is allocated pro rata. Both are expressed as a margin or percentage charge on housing loans. In this instance the pro rata allocation of the charge for bad and doubtful debts may be too high given that home loans tend to be insured and that they tend to be much better risks than other lending. However, the pro rate allocation lends a conservative bias to our results. As a result, we are confident that our estimates of the profit margins earned by the big four banks on their mortgages are likely to be lower than that which are produced in reality. We have chosen to take a conservative position because bankers tend to use risk of default and fraud as a justification for high interest charges.[7]

The profit margin for owner-occupier loans is calculated by deducting the interest expense and the expense margin, which includes the bad and doubtful debt margin, from the average interest rate on housing.

[7] This excuse has come up again recently in the context of the debit card surcharge issue. See Eyers J (2024) "Why you pay $5.08 for a $5 coffee", *Australian Financial Review*, 6 September.

Findings and analysis

The results in Table 3 show that the big four banks produced profit margins of 159 basis points (or 1.59%) of the value of their housing loans. These figures exceed the total ADIs figure of 124 basis points (or 1.24%).

Table 3: Authorised Deposit-taking Institutions and big four banks

		All ADIs	Big four banks
1	**Balance sheet items**		
2	Total assets ($ billion)	6,216	4,507
3	Housing loans to households for occupiers ($ billion)	1,466	1,109
4	Housing loans for investors ($ billion)	697	561
5	**Operating items**		
6	Interest income on housing loans ($ billion) for owner-occupiers	85	64
7	Total interest expense ($ billion)	219	146
8	Total operating expenses ($ billion)	64	43
9	Charge for bad and doubtful debt ($ billion)	2.4	2.6
10	**Rates per dollar of housing loan**		
11	Average interest rate on housing loans	5.79%	5.79%
12	Average interest expense allocated over all assets	3.52%	3.24%
13	Expense margin	1.04%	0.96%
14	Bad and doubtful debt margin (included in row 13)	0.04%	0.06%
15	Pre-tax profit margin for owner-occupier loans	1.24%	1.59%

Source: Author's calculations based on Table 1, APRA (2024) Quarterly authorised deposit-taking institution statistics, September 2004 to June 2024, 12 September and RBA (2024) *Statistics*.

Further, our estimate is conservative because we have not included the fees banks charge on housing loans in addition to the interest rates they charge. According to the RBA, bank fees on housing loans were $811 million in 2022-23 equal to approximately 0.1% of housing loans.[8] In principle, that estimate of fees could be added to the interest charge to obtain the full profit figure.

However, bank fees are heavily loaded in favour of establishment fees but include on-going loan servicing fees. In addition, they are typically applied as fixed monthly or annual charges that do not vary with the size of the loan. On top of that there is no breakdown by type of fee, nor allocation between the big four and other ADIs provided by the RBA.

[8] RBA (2024) *Statistics*, Table C9. These figures include owner-occupied loans as well as other housing loans such as those for investment purposes and non-household borrowers.

By deducting expenses but not adding fees the results are necessarily a conservative estimate of the true profit margin on housing loans.

Implications for home buyers

The average value of new home loans for owner-occupied housing was $574,200 in the six months to July 2024.[9] Applying the profit margin to a loan of that size means that the average big four bank would be making a profit of around $9,130 in the first year on a loan of that size.[10] Put another way, a household in Australia that has taken out the average new loan would be paying $176 per week in profit to their bank or on a monthly basis they are paying $761 towards the banks' profit.[11]

Over the life of the loan the value of the outstanding principle will decline and so the annual profit on the loan will gradually decline. A common Australia loan is for 30 years and requires monthly repayments. We can estimate the bank profit on that loan by estimating the repayments with and without the banks' 159 basis points margin. Over the life of that loan the average profit received by a big four bank on an average home loan would be $200,880.[12] This is the Australia-wide average and can be expected to be higher in inner-city areas and lower in outer suburbs and regions reflecting the variability in loan sizes.

Total profit on loans to owner-occupiers was $17.6 billion or 39.5% of all profits. From the figures in Table 3 we can calculate housing loans for owner-occupation (Row 3) are just under a quarter (24.6%) of total assets. Those figures suggest that profits on housing loans to owner-occupiers contribute disproportionately to bank profits, 39.5% of profits on just 24.6% of banks' assets. As emphasised above, our estimates are conservative as the fees banks charge on housing loans have not been included in these calculations. Nevertheless, the results presented above show that the burden of bank profits fall heavily on homebuyers.

Furthermore, among the big four banks close to a billion dollars is spent on advertising which feeds into the banks' cost structure. Traditionally advertising is justified as performing a public benefit in providing information to the market. In this case the justification is hard to see. As all the big four banks are offering virtually identical products there is little financial benefits to consumers from advertising as the similarity of the products and the lack of disclosure of any terms and conditions means that the advertising cannot be thought to be helping to meaningfully inform the market. Indeed, not only is the genuine

[9] ABS (2024) *Lending indicators, July 2024*, 6 September.

[10] This calculation is simply 1.59% of the value of the loan, $574,200.

[11] All figures have been rounded down to the nearest dollar.

[12] This estimate is based on the total interest cost as calculated in the ANZ home loan calculator. The profit is estimated by using the ratio of the profit margin estimated in Table 1 to the average interest rate on housing. That ratio is applied to the value of the interest cost over the life of the loan. The interest rate used, 7.24%, is the standard variable with a 80% or less LVR. To get the profit we compared total repayments at the standard variable with that rate less the 159 basis point in profit.

information content absent consumers may even be misled by some bank advertising. For example, Westpac deliberately advertises its St George banking brand in a way that conceals from most viewers that St George is in fact wholly-owned by Westpac.[13]

[13] David Richardson (2018) *Submission to Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, The Australia Institute, March.

Discussion and conclusions

Of course, a good part of the bank profitability reflects high profit margins extracted from Australian homebuyers. The high profits are clear in the estimated $9,130 profit extracted from the average new mortgages for owner occupiers as well as the $200,880 profit over the life of a home mortgage. Overall, it looks like the big four banks alone extracted profit of $17.6 billion from households on their home loans for owner-occupation.[14]

We mentioned that total profits for the big four banks were $44.6 billion in their last financial years. Profit on loans to owner-occupiers was $17.6 billion or 39.5% of all profits yet these are just under a quarter (24.6%) of banks' total assets. Those figures suggest that profits on housing loans to owner-occupiers contribute disproportionately to bank profits, 39.5% of profits on just 24.6% of banks' assets.

Profit margins for home loans are lower at many of the smaller banks and so it is worth consumers shopping around. Canstar research shows the large variability in home loans with rates on offer that are much better than the offers from the big four banks.[15] A quick inspection of the figures for a sample of 53 offers shows loans ranging from 5.39% to 7.39% on 10 October 2024. Small changes in interest rates can translate into quite large savings over the life of the loan and even over the first year. For example, 100 basis points on a $500,000 loan is worth around $5,000 in the first year.

It can also be a good idea to bargain with your own bank. On the latest RBA figures for September 2024, the average standard variable home loan from a big four for owner-occupiers is 6.3% but the average actually charged by the big four is 6.1% when other types of loans for the same type of borrower are included.[16] The difference was up to 100 basis points in December 2022. That suggests considerable scope to bargain.

[14] This figure is obtained by applying the profit margin in row 15 in Table 1 to the loans in row 3.

[15] Sale J and Duncan A (2024) "Compare variable home loan rates", *CANSTAR*, 10 October

[16] Calculated from RBA *Statistics* Table F5.