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Mortgage arrears remain contained despite high rates and cost of living pressures

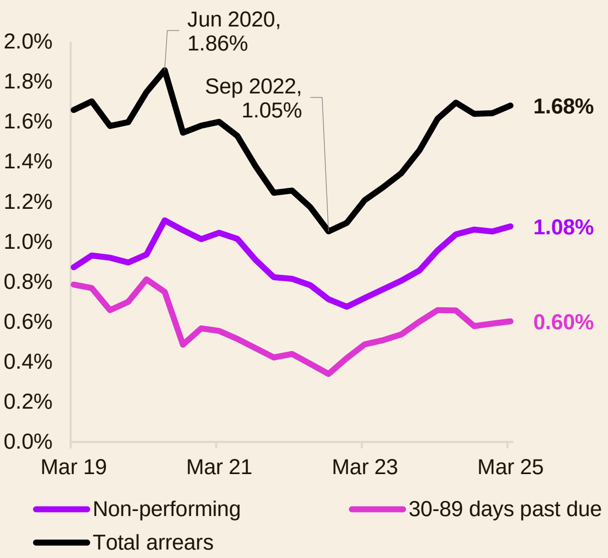
While mortgage arrears have risen from record lows, the portion of borrowers falling behind on their repayments remains well below 2% of the Australian loan book.

APRA data measuring the proportion of borrowers who are overdue or impaired on their mortgage repayments ticked slightly higher through the March quarter, from 1.64% in Q4 2024 to 1.68% in Q1 2025. Despite the subtle lift, mortgage arrears remain below the recent high of 1.86% recorded in Q2 2020.

Mortgage arrears include loans that are 30-89 days overdue as well as those categorised as non-performing. A non-performing loan is one where the borrower is 90 days or more past due on their repayments or where the lender considers the borrower unlikely to pay their credit obligations without recourse from the lender.

A more detailed breakdown of mortgage arrears can be found in the latest Financial Stability Review from the RBA. The review showed that while highly leveraged borrowers and lower-income households tend to have higher arrears rates, even in these categories, arrears are generally low and trending lower. Mortgage arrears for borrowers with a loan to valuation ratio of 80% or higher peaked around 2.5% in 2024 but are now falling, while borrowers with a loan-to-income ratio above four reached roughly 1.5% and are also trending lower.

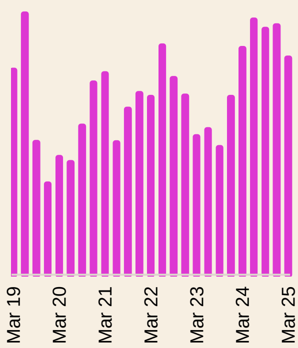
Mortgage arrears



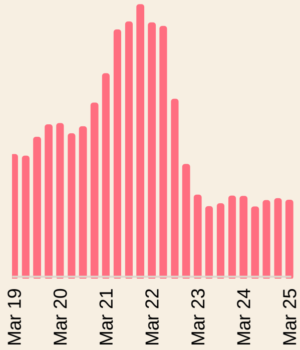
Several factors help explain how the vast majority of mortgagors have kept on top of their mortgage repayments during a period of elevated interest rates and severe cost of living pressures, including strong prudential standards, tight labour markets, extremely low levels of negative equity, and accrued liquidity buffers.

Lending standards have been unquestionably strong throughout the recent cycle, with a consistently low portion of mortgage originations considered ‘risky’. Interest-only lending comprised 19.7% of originations in the March quarter and has consistently held well below the previous temporary limit of 30% set by APRA between 2017 and 2018. High LTI and high DTI lending remains well below pre-rate hike levels, tracking at 3.1% and 5.8% of loan originations respectively in Q1. Similarly, high LVR lending has come in around 7% of originations or lower since mid-2022.

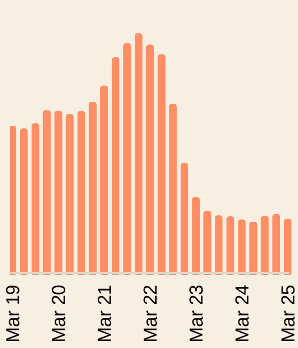
% of loans on interest only terms



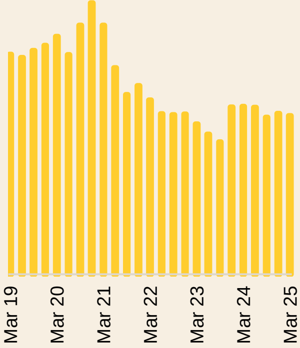
% of loans originated with a loan to income ratio >=6x



% of loans originated with a debt to income ratio >=6x



% of loans originated with an LVR >=90%



Sources: Cotality, APRA

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Mortgage arrears

The mortgage serviceability buffer, which assesses prospective borrowers on their ability to repay a mortgage at three percentage points above the current mortgage rate, has also played into the resilience of borrowers. Lifting the buffer from 2.5 percentage points to 3.0 percentage points in October 2021 has helped to lower the default risk, even though mortgage rates have risen a lot more than three percentage points from their 2022 lows. Although interest rates are now falling and expected to reduce further, there has been no sign from APRA that the serviceability buffer will be lowered.

While tight lending policies have contributed to financial stability and provided protection for borrowers, there is a counter argument that lending policies may be too tight, reducing access to credit.

The 'double trigger' hypothesis for higher mortgage rates

The RBA has previously theorised that higher mortgage arrears rates would need to be predicated by a "double trigger" of both an inability to repay the loan and for the loan to be in a negative equity position. So far, most borrowers have retained their ability to pay despite higher debt servicing costs, thanks to persistently tight labour market conditions, while instances of negative equity remain rare across the Australian housing market.

Debt servicing costs have risen substantially over the recent rate cycle. Variable mortgage rates have roughly moved in-line with the cash rate, bottoming out below 3% in 2022 before surging by around four percentage points. A borrower with a $750k mortgage saw their monthly repayments rise by around $1,550+ (depending on the type of borrower and loan) between the low point and high point of the rates cycle.

However, most Australian's have retained an ability to service their mortgage through gainful employment, with labour markets holding tight. The unemployment rate came in at 4.1% in May and has held around this level or lower since early 2022. Similarly, underemployment, which measures workers who want to work more hours, remains close to multi-decade lows.

The second component of the 'double trigger' hypothesis relates to negative equity in housing markets – or simply, where the value of property is less than the debt owed. The RBA estimated in their most recent Financial Stability Review that less than 1% of households are experiencing a negative equity situation. Given the low portion of homes in negative equity, most borrowers facing financial hardship should be able to sell their property and clear their debt before moving into default.

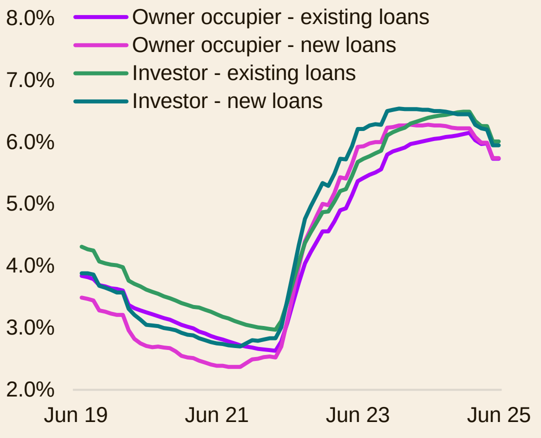
Another factor staving off higher arrears relates to an accrual of savings through the pandemic. The household saving ratio held above 10% between mid-2020 and early 2022. Households have been able to draw down on their savings as higher debt servicing costs and cost of living pressures eroded balance sheets.

Although it's harder to measure, we have probably also seen households tightening the purse strings, acting out the "wagyu and shiraz" scenario, where households pull back on non-essential spending, focus on debt repayments and fund essential cost of living expenses.

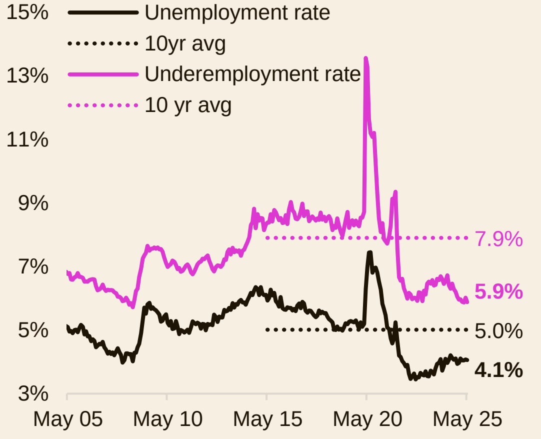
The "wagyu and shiraz" reference relates to the federal court ruling from Justice Nye Perram in the ASIC v Westpac hearing: "I may eat Wagyu beef everyday washed down with the finest shiraz but, if I really want my new home, I can make do on much more modest fare."

Overall, it's likely mortgage arrears will trend lower from here as mortgage rates continue to reduce and cost of living pressures ease further. With housing values once again on a broad-based rise, instances of negative equity are expected to remain a tiny portion of Australian housing stock, providing further resilience to default.

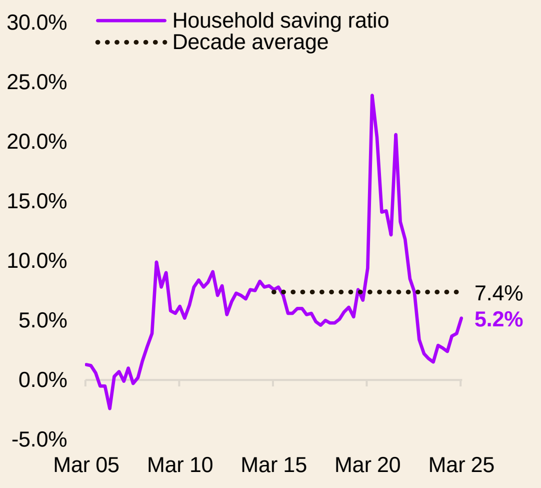
Average variable mortgage rate by borrower and loan type



Unemployment and underemployment, Australia



Household saving ratio



Sources: Cotality, ABS, RBA

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