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Mortgage arrears are rising from record lows, and likely to rise further

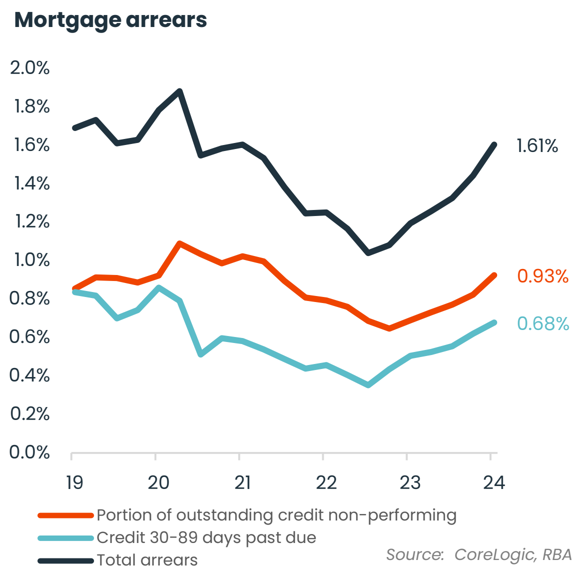
June 2024 I By Tim Lawless, Research Director at CoreLogic Asia Pacific

Mortgage arrears have been rising from their COVID lows of just 1.0% in Q3 2022, reaching 1.6% in the March quarter of 2024. Although this was the highest reading on mortgage arrears since Q1 2021, the portion of loans falling behind on their repayment schedules was slightly higher at the onset of COVID at 1.8%.

The upwards trends in arrears has been most influenced by non-performing loans, where the arrears rate has risen to 0.93%. A non-performing loan is one that is at least 90 days past due or where the lender expects it won't be able to collect the full amount due. The non-performing arrears rate is now slightly higher than it was at the onset of COVID (0.92%) and above the series average of 0.86%.

Borrowers who are 30-89 days overdue on their repayments comprise 0.68% of loans, up from just 0.35% in Q3 2022 but the highest level since Q2 2020. This early measure of mortgage arrears is now above the series average (0.59%) but still slightly lower than levels recorded at the onset of COVID (0.86%).

Mortgage arrears



Source: CoreLogic, RBA

A key factor in higher mortgage arrears is of course the sharp rise in the cost of debt. With the average variable interest rate on outstanding owner occupier home loans rising from 2.86% in April 2022 to 6.39% in March 2024, a borrower with $750k of debt would be paying nearly $1,600 more each month on their scheduled repayments.

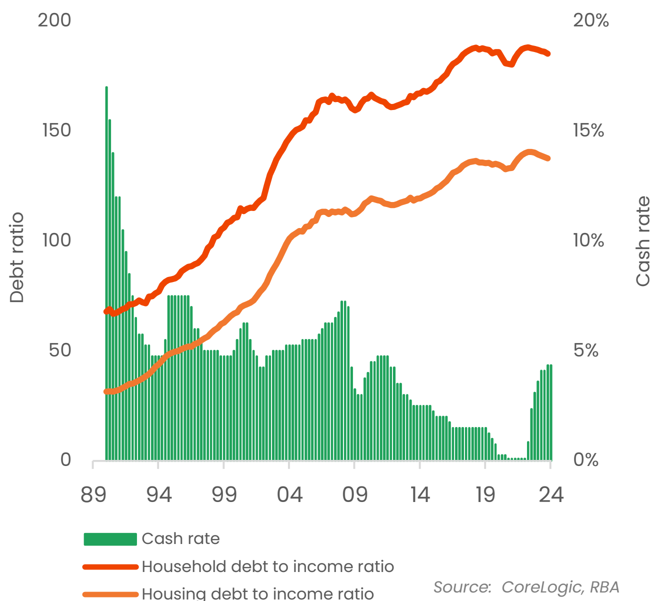
But there are other factors at play as well. Cost of living pressures are consuming a larger portion of household income, households are paying more tax than ever before and household savings are being drawn down, eroding the savings buffer accrued through the pandemic. There is also the fact that households are more sensitive to sharp adjustments in interest rates, given historically high levels of debt, most of which is housing debt. Loosening labour market conditions would also be playing a role.

Although each measure of mortgage arrears has risen to be above the series average, which is relatively short at only five years, despite the headwinds outlined above, most borrowers have kept on track with their home loan repayments. They have done this by drawing down on their savings, working more hours or multiple jobs, and contributing less to mortgage offsets or redrawn facilities.

Its likely mortgage arrears will rise further as unemployment lifts, household savings deplete further and, more broadly, economic conditions navigate a period of weakness. However, arrears are unlikely to experience a material 'blow out' unless labour markets weaken substantially more than forecast.

For home owners that do fall behind on their repayments, there is a good chance most will be able to sell their asset and clear their debt. The latest estimates on negative equity from the RBA estimate only around 1% of residential dwellings across Australia would have a debt level that is higher than the value of the home. With housing values continuing to rise, the risk of negative equity is reducing.

Household/Housing debt ratios v interest rates



Source: CoreLogic, RBA

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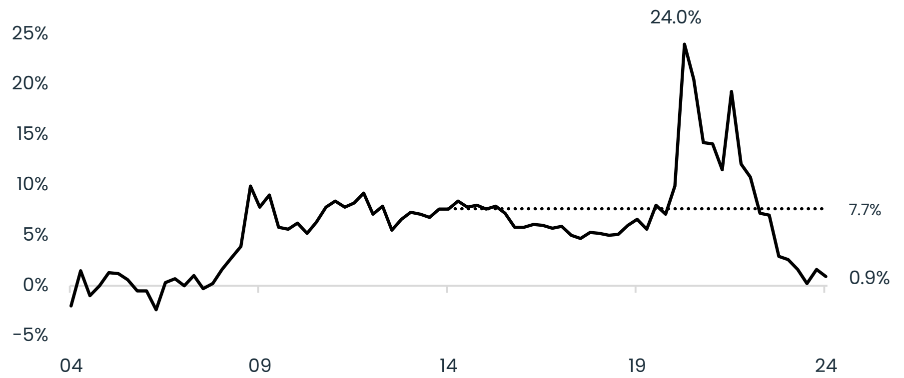
How are households coping?

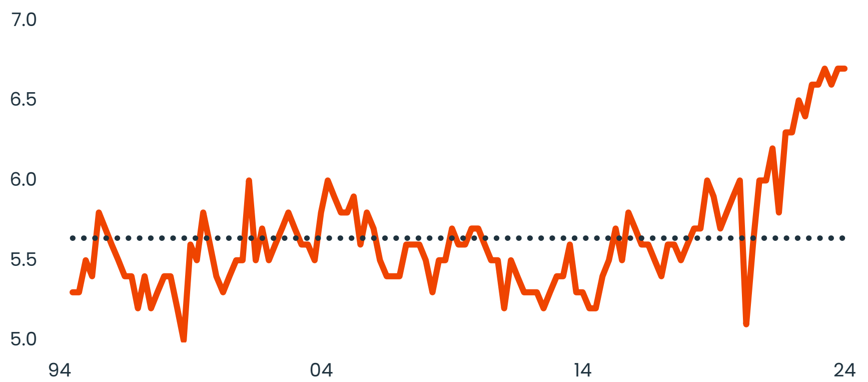
By saving less

Household saving ratio



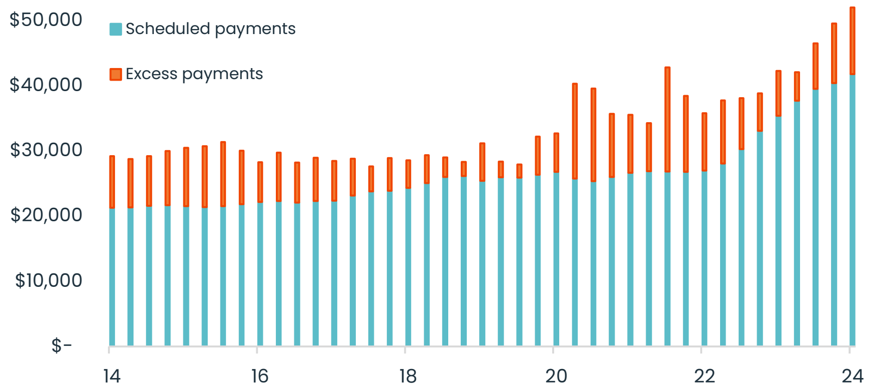
Working more jobs/hours

Multiple job-holding rate (%)



Putting less into redraws and offsets

Monthly mortgage payments ($ million)



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Another factor in low mortgage arrears is likely to be a history of strong underwriting standards from Australian lenders and the prudential regulator, APRA.

Borrower serviceability continues to be assessed at a mortgage rate 3.0 percentage points higher than the loan product rate, as has been the case since October 2021 when APRA lifted the serviceability buffer from 2.5 percentage points.

Most borrowers who took out a home loan between late 2019 and mid 2022 would have seen their mortgage rate rise more than three percentage points, reflecting a combination of very low interest rates leading into and during the pandemic, but also the 3.5 percentage point rise in outstanding variable mortgage rates since May 2022. With mortgage rates rising more than the assessment buffer, alongside cost of living pressures and a record level of household income being consumed by taxes, household balance sheets are being tested, especially for those who may have had more leverage or seen a change in their financial circumstances.

We've also seen a tightening of lending policies for what APRA might describe as riskier types of lending: interest only loans, and loans with high debt to income ratios, high loan to income ratios or high loan to valuation ratios.

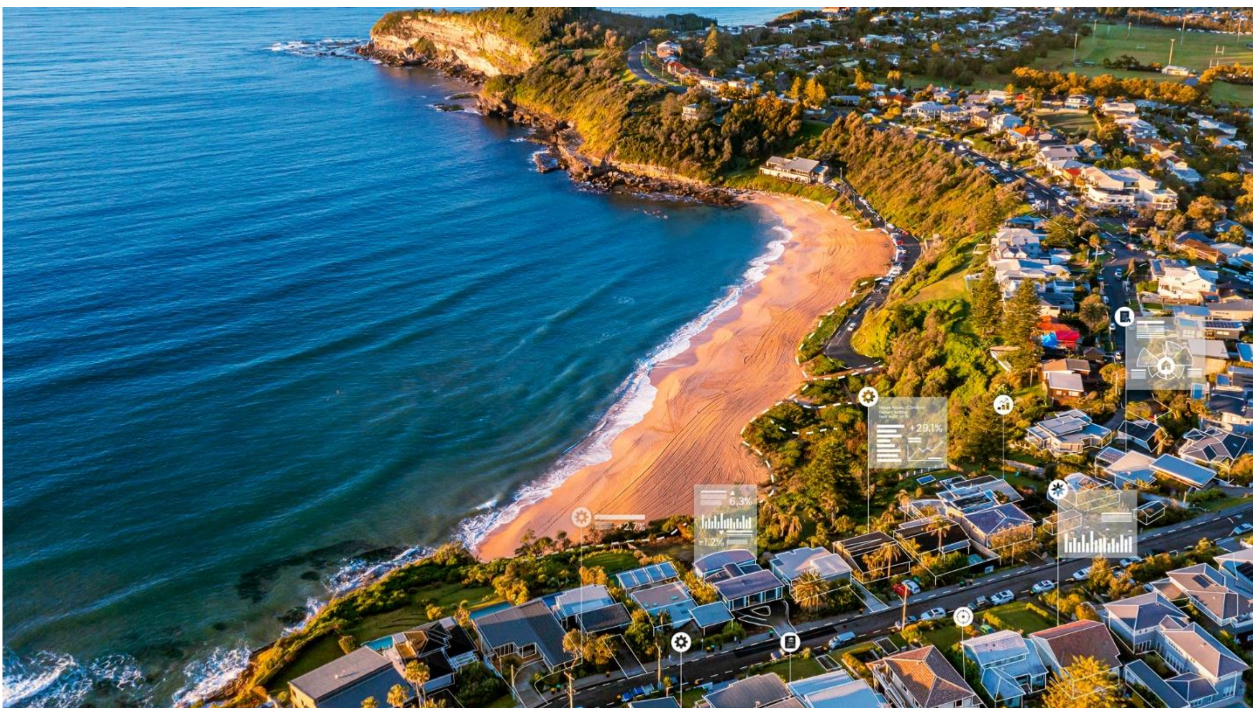
Interest only lending is where the borrower takes out a loan without the immediate obligation to reduce the principal (i.e. they only pay the interest component of the debt). This type of lending is generally skewed towards investors and would generally convert to a principal *and* interest repayment schedule after a period of time. Interest only loan originations have mostly held below 20% of mortgage originations since late 2017. Prior to that, interest only lending was as high as 45% of all loan originations, prompting APRA to introduce a temporary macroprudential constraint limiting interest only loans to 30% of originations. That policy was removed in 2018, but lenders have kept originations well below the historical cap since that time. The recent rise in interest only lending activity aligns with a substantial pick up in investor activity, where the value of new lending is up 36% over the past year.

High loan to income ratio lending has shown a subtle rise from the series low in mid-2023 but remains very low by historical standards. APRA data shows only 3.1% of loans originated in the March quarter had a credit limit greater than or equal to six times the annual income of the borrower, down from 11.1% of originations in the final quarter of 2021.

High debt to income ratio lending was at a series low in the March quarter, comprising just 5.2% of home loan originations, down from the final quarter of 2021 when 24.3% of new lending was to borrowers with an overall debt level at least six times higher than their gross annual income.

The portion of home loans originating with a deposit of 10% or less have risen a little but still comprise less than 8% of originations for owner occupiers and just 3.2% of originations for investors. Analysis from the RBA shows high LVR loans have recorded higher mortgage arrears than other categories of lending.

Overall, lending policies across Australia remain relatively conservative, with close to 70% of borrowers obtaining housing credit with at least a 20% deposit and where their loan amount or overall debt profile is less than six times their gross annual income. It's likely lending policies will remain fairly cautious as the economy navigates a period of weakness punctuated by high interest rates and stubborn cost of living pressures.



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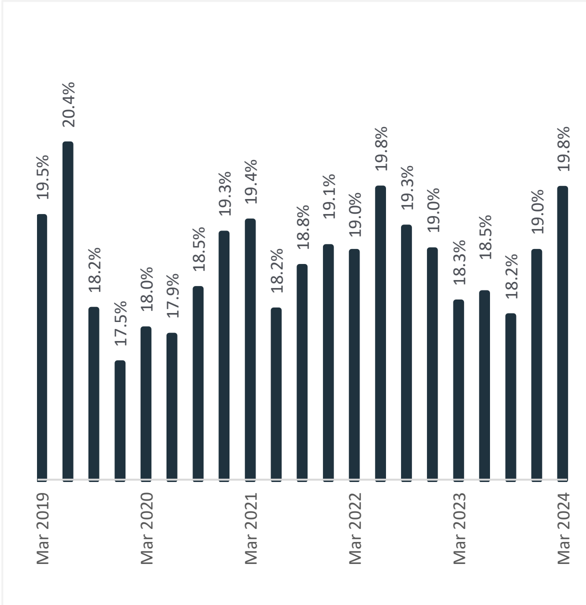
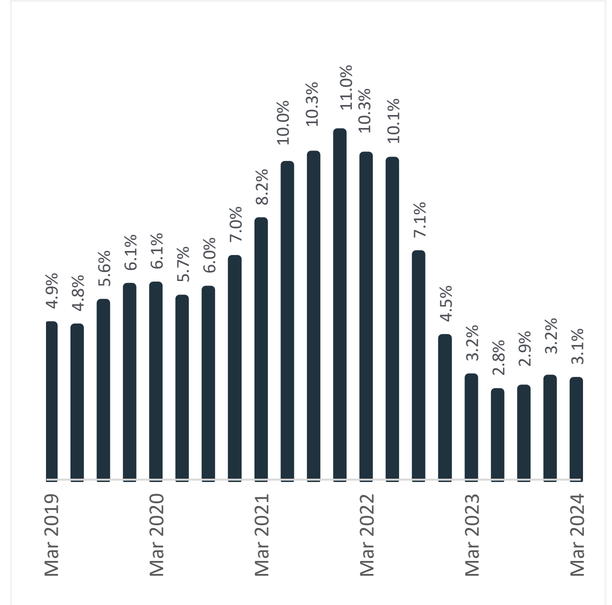
Mortgage originations for 'riskier' types of lending

% of loans on interest only terms



Source: CoreLogic, APRA

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



Source: CoreLogic, APRA

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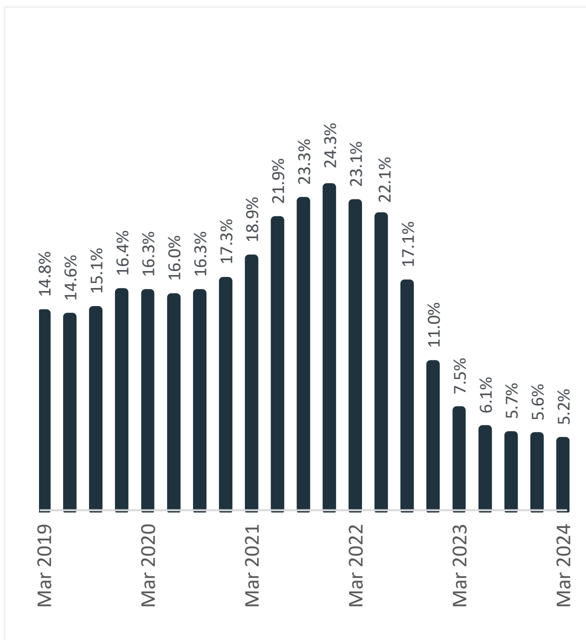
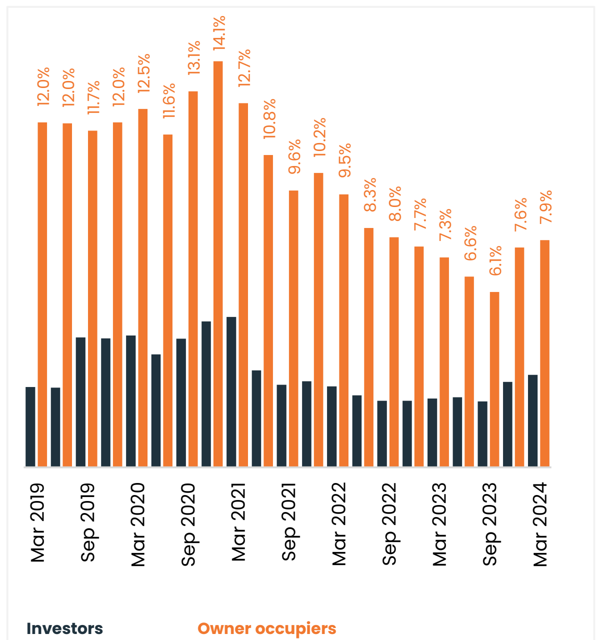


Source: CoreLogic, APRA

% of loans originated with an LVR >=90%



Source: CoreLogic, APRA

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