Tracker Mortgages; How Much Equity?

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"There also seem (on the basis of such limited survey evidence as exists)[1] to be many other households who could continue to pay their mortgages but, for the moment, are not doing so."

Address by Governor Patrick Honohan to the Society of Actuaries in Ireland, 7 October 2013

Introduction

Mortgage Arrears are a serious problem. At end December, 2013 14.3 % of mortgages for the covered banks (AIB, Bank of Ireland and PTSB) were in arrears[2]. The arrears problem varies depending on the date the mortgage was taken out. For example, 21.5 per cent of mortgages taken out in 2007 were in arrears (the worst year). (Average balance €259,000). However, the problem is not confined to the period when house prices peaked. Surprisingly 8.3 per cent of existing mortgages taken out in 1997 are in arrears. (Average balance €39,000). Full data taken from the 2013 Forms 20 F of the three financial institutions are in Appendix 1.

The Public Interest

The public has a strong interest in minimising mortgage default. Loans written off are deducted from bank capital. The cost of this is fully borne by the taxpayer in the case of AIB and PTSB which are effectively state-owned. In addition large write-offs could result in further recapitalisation of banks with the cost potentially falling on the taxpayer.

The public interest is also not served by forbearance on loans particularly in the buy-to-let sector. This artificially reduces the number of properties coming on the market.

[1] "Examination of the Standard Financial Statement (SFS) returns of defaulting borrowers in Ireland has shown that, indeed, monthly amounts due on the original monthly schedule represent a remarkably small portion of current monthly income, for a relatively high fraction of borrowers". *(Address by Governor Patrick Honohan to the Society of Actuaries in Ireland, 7 October 2013)*

[2] Mortgages in arrears are those which are 90 days or more past due.

The Evidence

Tracker Mortgages

One of the puzzling aspects of the arrears problem is the relatively high default rate on tracker mortgages[3]. Since July 2010 the interest rate on tracker mortgages has fallen by 4 percentage points in line with the reduction in ECB interest rates. A typical tracker mortgage would now be paying an interest rate of 1.25 percent compared with 5.25 per cent 4 years ago. When the mortgage was issued it was stressed at a rate 2 per cent above the actual rate.

Central Bank data[4] shows that at end of June 2013 the default rates on residential mortgages were 19.1 per cent for those on a standard variable rate compared with 16.8 per cent for those on tracker mortgages. The corresponding rates for buy-to-let mortgages were 41.7 per cent for those on a standard variable rate compared with 34.2 per cent for those on tracker mortgages. (75 percent of mortgages on investment properties are trackers). One might expect a much lower rate of default on tracker mortgages given the decline in the burden of repayments.

The current interest cost of a €250,000 tracker mortgage is about €260 per month compared with a monthly rent of about €800 for a 1 bedroom property in Dublin 7 (the lowest of the Dublin postal districts).[5]

Lower Burden of Repayments

The current monthly repayments on a €250,000 mortgage over 25 years at a typical tracker rate of 1.25 % are €971. This compares with €1,498 in July 2010 – a reduction of 35 %. Monthly repayments of €971 would finance borrowings of just under €175,000 at a typical current standard variable rate of 4.5 % over 25 years. Clearly at current interest rates there is considerable equity in tracker mortgages which should be taken into account in any assessment of housing equity.

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[3] A tracker mortgage is a variable rate mortgage where the interest on the loan is linked to the European Central Bank rate by a fixed differential. Trackers began to be issued in Ireland around 2002 and virtually all mortgages issued in the period 2004 to 2007 were trackers.

[4] Macro Financial Review 2013.1 Pages 20-21. http://www.centralbank.ie/publications/Documents/Macro-Financial%20Review%202013.1.pdf

[5] https://c0.dmstatic.com/532/report/Daft-Rental-Report-Q4-2013.pdf

Increase in Arrears Cases in 2013

Table 1 shows that the net increase in the number of cases in arrears in 2013 was 14,953.

Table 1 Increase in Number of Arrears Cases 2013

	Total	All cases	%	Av Balance €K
Pre 1997	18	17746	0.1	32.8
1997	56	7148	0.8	39.0
1998	107	9158	1.2	50.5
1999	150	14321	1.0	69.0
2000	270	17827	1.5	80.0
2001	324	19475	1.7	89.8
2002	416	28263	1.5	116.3
2003	762	39782	1.9	139.3
2004	1225	54930	2.2	168.2
2005	1922	74191	2.6	200.5
2006	3085	95638	3.2	247.0
2007	3100	85633	3.6	259.3
2008	2294	68753	3.3	246.7
2009	875	38849	2.3	192.0
2010	281	25148	1.1	182.3
2011	40	12718	0.3	198.6
2012	28	13563	0.2	178.6
	14953	623143	2.4	

Of these 378 cases were from Bank of Ireland, 5,989 were from AIB and 8,586 were from PTSB.

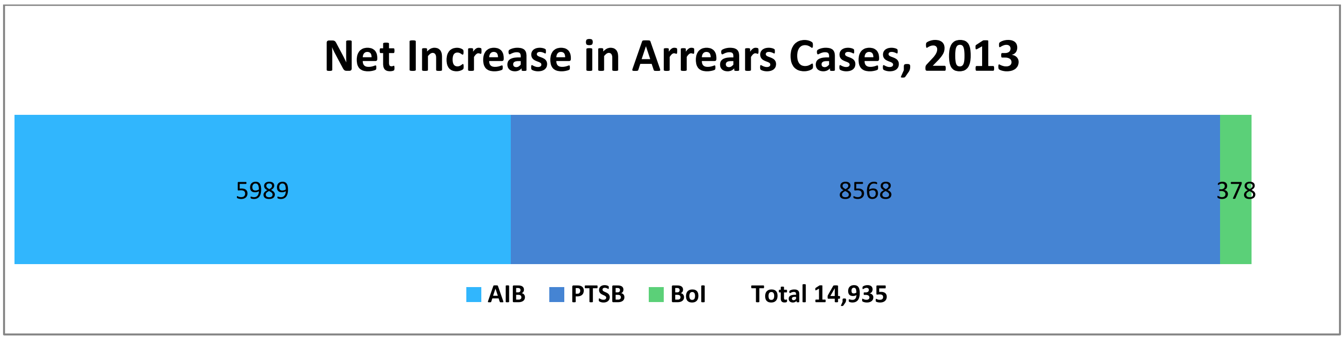
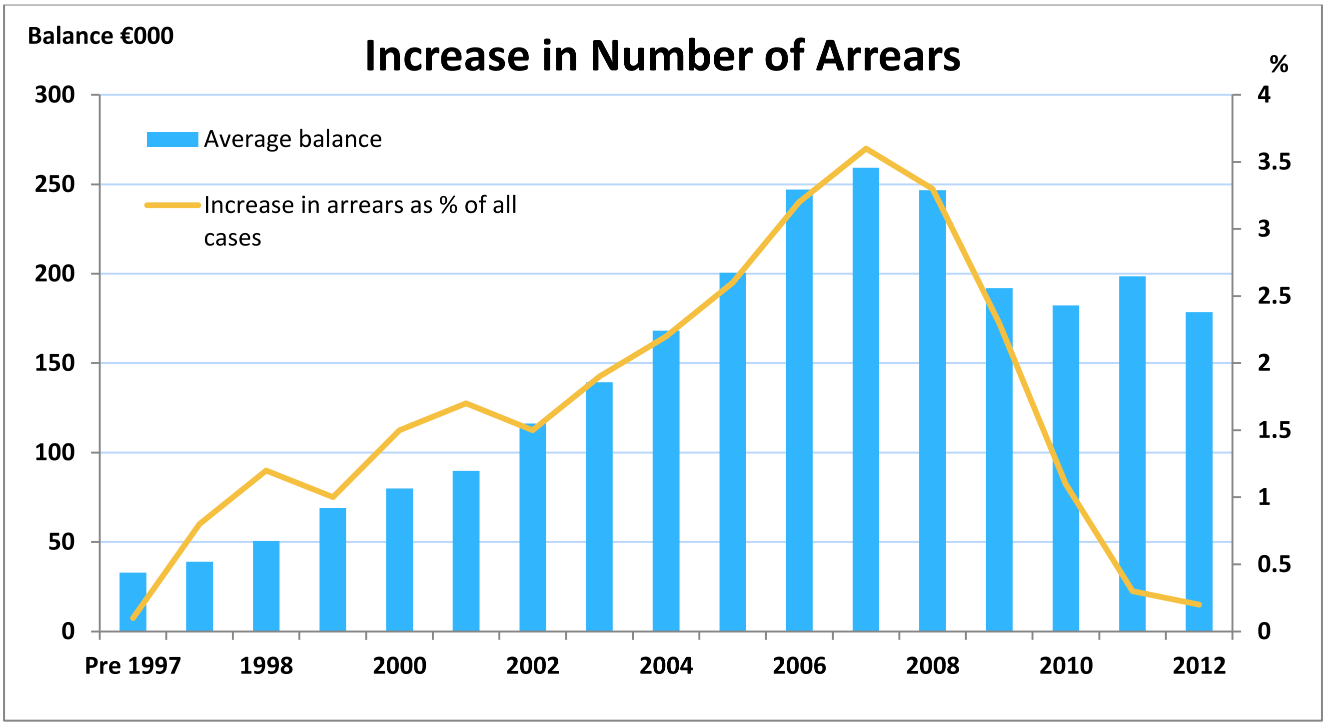


Figure 1.



While most arrears cases date from the boom period, a number do not, and the balances outstanding in these are relatively modest suggesting that some at least are in substantial positive equity. The question also arises whether there is a difference in the approaches of different financial institutions to the mortgage arrears issue and whether or not this explains the significant differences in the growth of the arrears problem between institutions. For example, does what appears to be a more uncompromising approach by Bank of Ireland explain their relatively low increase in arrears cases. If not what is the reason for their markedly different experience.

Conclusion

There is a strong public interest in minimising mortgage default. The costs of writing off large amounts of mortgage debt could fall largely on taxpayers some of whom are trying to cope with their own debt.

While clearly some mortgage holders are in severe distress, the data suggest that some who could afford to do so have decided not to prioritise their mortgage debt. These cases may be concentrated among those with buy to let tracker mortgages, others on tracker mortgages and also in a small number of cases where the mortgage was taken out over 10 years ago.

More aggressive actions by financial institutions particularly in the buy-to let sector could in addition to reducing mortgage default could increase the supply of properties for sale through repossessions. This would be of benefit to first time buyers.

Mortgage Book as at 31/12/13					
Year	All Mortgages		Arrears cases		% in
	No	Bal €m	No	Bal €m	Arrears
Pre 1997	17746	330	1493	49	8.4
1997	7148	176	590	23	8.3
1998	9158	300	852	43	9.3
1999	14321	537	1203	83	8.4
2000	17827	873	1638	131	9.2
2001	19475	1201	1916	172	9.8
2002	28263	2242	2958	344	10.5
2003	39782	3824	5005	697	12.6
2004	54930	6508	7455	1254	13.6
2005	74191	10722	11961	2398	16.1
2006	95638	17335	19039	4702	19.9
2007	85633	16651	18438	4781	21.5
2008	68753	12602	12960	3197	18.9
2009	38849	5791	3891	747	10.0
2010	25148	3758	1015	185	4.0
2011	12718	1839	141	28	1.1
2012	13563	2096	28	5	0.2
2013	12441	1967	1	0	0.0
	635584	88752	90584	18839	14.3
Source : 2013 Annual Reports of Bank of Ireland, AIB and PTSB					

Figure 2.

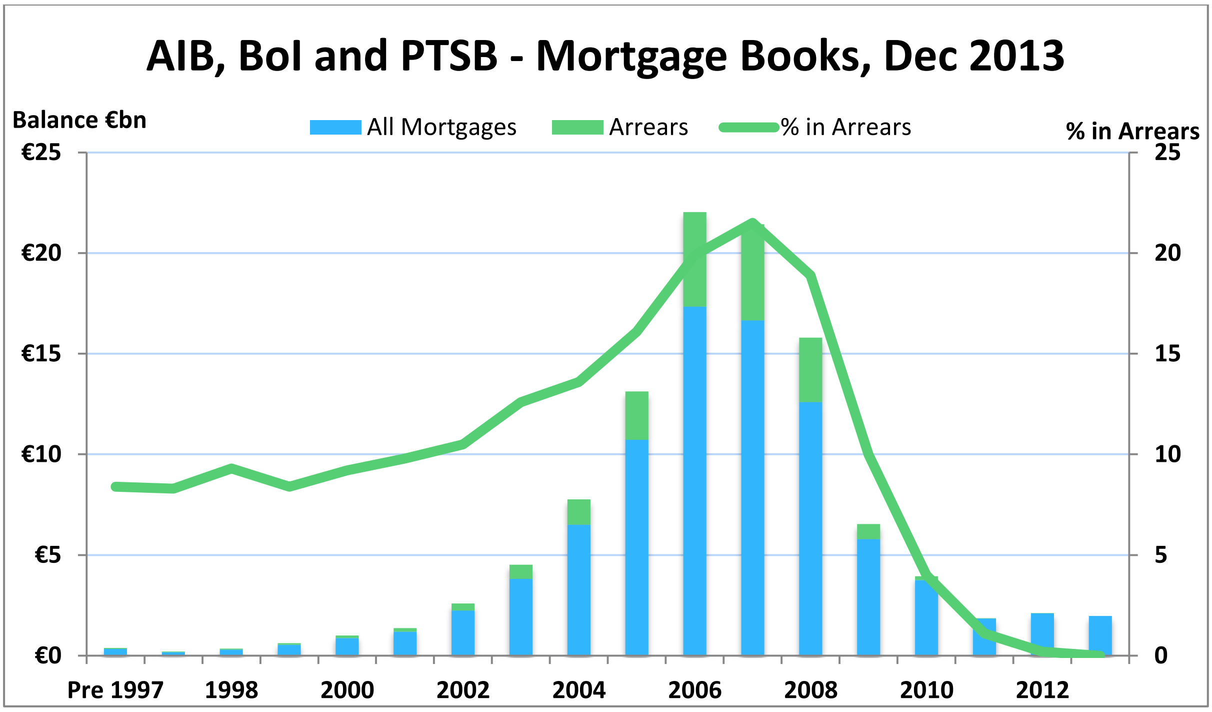


Figure 3. Source: CBI, Residential Mortgage Arrears and Repossessions Statistics: Q3 2013

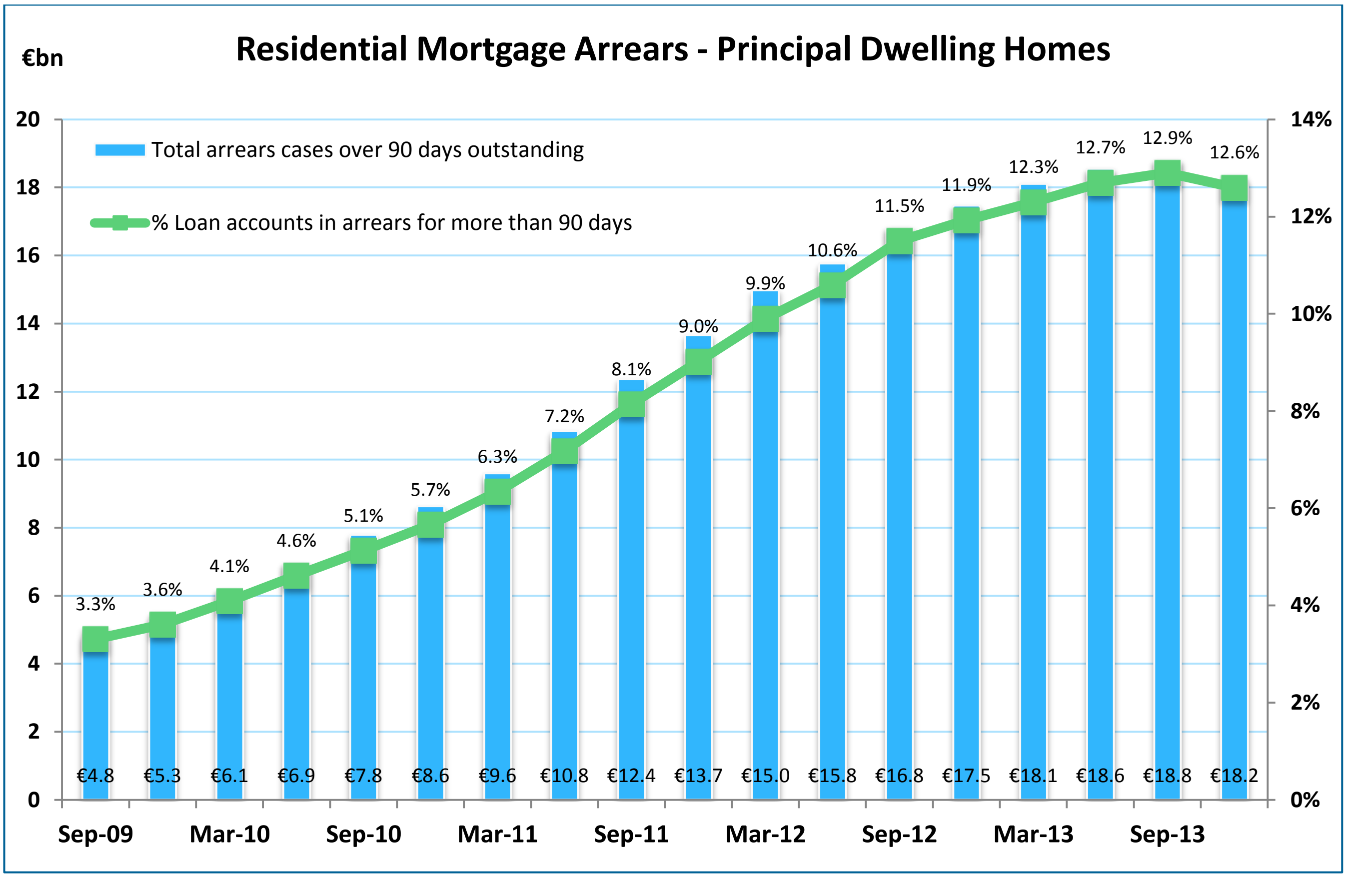
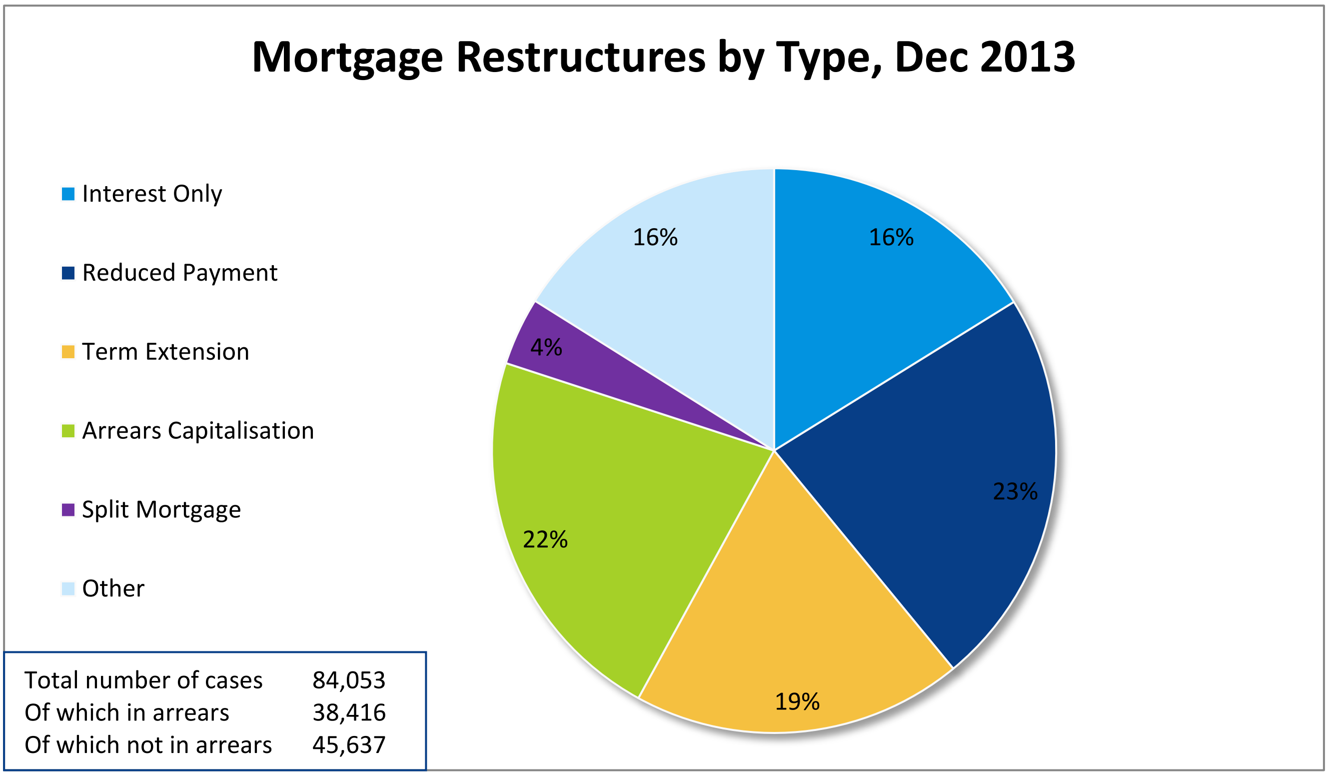


Figure 1 illustrates the increase in mortgage arrears on principal dwelling homes. In September 2009, accounts in arrears over 90 days were valued at €4.8bn, equivalent to 3.3% of total residential mortgage loan accounts. Arrears more than tripled to 12.9% (€18.8bn) in September 2013. December 2013 marked the first decrease in mortgage arrears since the start of the series to 12.6% (€18.2bn).

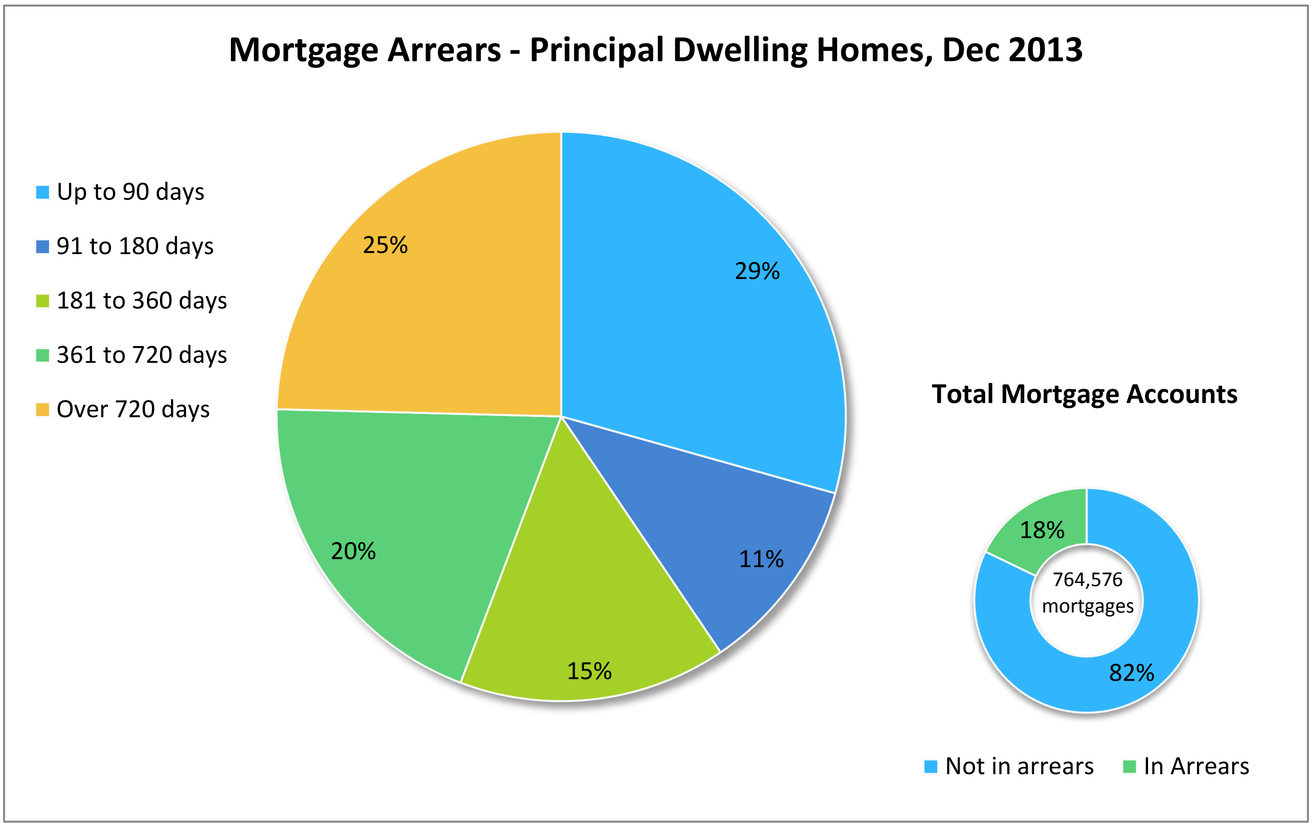
Figure 4. Source: CBI, Residential Mortgage Arrears and Repossessions Statistics: Q3 2013



The total number of restructures in Dec 2013 was 84,053 cases. Of these, 46% were in arrears and 54% were not. The most common type of restructure is a reduced payment, followed by arrears capitalization[6] and a term extension of payments.

[6] Arrears Capitalization is an agreement whereby the outstanding arrears are added to the remaining principal, to be repaid over the remaining life of the mortgage.

Figure 5. Source: CBI, Residential Mortgage Arrears and Repossessions Statistics: Q3 2013



Of a total 764,576 residential mortgages in December 2013, 18% were in arrears. Of the mortgages in arrears, the most common category is up to 90 days - 29% of all arrears were up to 90 days outstanding. This represents a 5.7% decline from September 2013. However, 25% are in arrears over 720 days - a 5.5% increase from September. There has also been a decline in the number of arrears between 91 -180 days and 180-360 days, but the number of arrears between 361-720 days has increased. Overall, arrears have shifted to longer outstanding period categories.

Figure 6. Source: CBI, Residential Mortgage Arrears and Repossessions Statistics: Q3 2013