Mortgage Arrears: Level and Resolution

No. 4 of 2014 (Revised 03 October 2014)

Contents

Editorial

Mortgage arrears in Ireland have risen to historically high levels – though there is evidence that the situation is stabilising.

The issue of mortgage arrears impacts on numerous social and economic policy areas including, amongst others, banking, fiscal, housing, poverty and the labour market.

This *Spotlight* provides a snapshot of the level and extent of mortgage arrears in Ireland today and the main mechanisms used to remedy the situation by both banks and the Government. It also examines some resolution mechanisms proposed by others. It does not purport to cover all the possible issues that the mortgage arrears crisis gives rise to.

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Library & Research Service
Central Enquiry Desk: 618 4701

This version of the *Spotlight on Mortgage Arrears* replaces a previous edition released in April 2014.

After initial publication in April 2014 it was brought to the Library & Research Service's attention that the publication included a small number of factual errors. These have been corrected. The opportunity that these corrections provided also allowed a revision and update of the *Spotlight* in light of a number of relevant developments in the intervening period. Please see p.21 for more details.

Summary

The level of mortgage arrears in Ireland is currently very high in the context of recent Irish history.

Level of arrears

According to Central Bank of Ireland data at the end of Q2 2014 there were 90,343 mortgages on principal dwelling houses (PDH) in arrears over 90 days. There were also 31,749 mortgages on buy-to-let (BTL) residential properties in arrears over 90 days. This represents 11.8% and 22.0% of all such mortgages respectively.

In terms of value, the PDH mortgages in arrears over 90 days represent 16.5% of PDH mortgage balances whereas the value of the BTL mortgages in arrears over 90 days represents 30.7% of BTL mortgage balances (see p.8).

These rates compare unfavourably to the level of mortgage arrears in other EU countries (see p.9) – though data issues make accurate cross-country comparisons difficult.

Tackling arrears

Lenders in Ireland have been cautious in addressing the rise in mortgage arrears. The ultimate option of repossession has been little used compared to the number of mortgages in difficulty – there were 1,028 (most voluntary) repossessions in 2013 (see p.17). There were over 120,000 mortgages in arrears in 2013.

The Central Bank of Ireland in 2013 set targets for the six main banks (ACC, Allied Irish Bank (including EBS), Bank of Ireland (including ICS Building Society), KBC, Permanent TSB and Ulster Bank) to come to "sustainable solutions" with their customers in arrears. It appears these targets, combined with a revised mortgage arrears resolution process (MARP), have had an effect. The number of mortgages undergoing "permanent" restructuring has increased in the latter part of 2013 and in 2014.

As stated by the Minister for Finance "[t]he Central Bank's Code of Conduct on Mortgage Arrears (CCMA) places an onus on the banks, in respect of a co-operating borrower, to explore all the options for an alternative repayment arrangement offered by the lender to address a primary dwelling mortgage difficulty before any legal action is considered."[1] However, it also means that customers must provide information and agree a solution to their mortgage arrears with their banks within a defined timetable and show that their new solution is working in order to avoid losing their home.

According to information provided to the Joint Oireachtas Committee on Finance, Public Expenditure and Reform in April 2014 banks have begun or considered legal processes in over 22,000 mortgage arrears cases. However, there is some dispute over what is considered a legal process.[2]

The most frequent resolutions banks are agreeing with their customers include: moving to interest-only for a set period; short-term reduced payments; term extensions; and arrears capitalisation. In the past year split mortgages are becoming more common. Little used restructuring options include: the deferred interest scheme; permanent interest rate reductions; trade-down mortgages; and mortgage-to-rent. The number of rent receivers appointed to BTL properties has increased from 2,397 at end September 2013 to 4,648 at end July 2014 according to Department of Finance statistics (see p.16).

State response

The State has responded in various ways to try to resolve the mortgage arrears crisis. These include:

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[1] See Reply to Parliamentary Question No. 24 of 20 Feb 2014 [8439/14]

[2] See transcripts of Joint Committee on Finance, Public Expenditure and Reform meetings 8-10 April 2014 – AIB and PTSB, Bank of Ireland, and Ulster Bank.

- Increasing mortgage interest relief to buyers who purchased between from 2004 to 2008 (who are most affected by mortgage arrears);
- Expanding schemes such as mortgage interest supplement (now ceased for new entrants) to help homeowners on social assistance to maintain their mortgage payments;
- Introducing a *Mortgage-to-Rent* scheme;
- Introducing the *Mortgage Arrears Information and Advice Service* to give independent guidance on mortgage arrears issues to those who experience difficulty.

However, the current main mechanism for resolving arrears is through the Central Bank of Ireland's *Code of Conduct on Mortgage Arrears* (CCMA) and the linked but separate Mortgage Arrears Resolution Targets (MART) set for six banks. These aim to regulate the relationship between lenders and borrowers and speed up the resolution process.

Additional resolution alternatives

There are a number of alternative resolutions, proposed by commentators or introduced by the Government, to those offered by banks to assist mortgage holders in arrears to stay in their properties. These include:

- A personal insolvency arrangement (PIA) i.e. a formal process with legal protections that could involve writing down debt while allowing (in some cases) a person to keep their principal residence. PIAs are an alternative to bankruptcy.
- Debt-for-equity – where a lender swaps part of its debt for a share of the property.
- Mortgage-to-rent/lease – where a lender repossesses a property and rents it back to the former owner or sells/leases it to a third party who rents it to the former owner.
- Debt-forgiveness – where a lender writes down the loan to a value that is affordable to the borrower.

These options have not been used widely in resolving the mortgage crisis in Ireland. The PIA is a relatively new arrangement which may take time to have an impact. Some write-downs have occurred. The *Mortgage-to-Rent* scheme has encountered practical difficulties and take up is low, and a proposed *Mortgage-to-Lease* scheme has yet to be launched.

Introduction

The causes of the current problems with mortgage arrears at Irish banks are many and varied. The economic downturn has meant that a significant number of individuals no longer have sufficient income to meet their mortgage payments and are as a consequence in arrears.

This, combined with other factors including, the drop in house prices, cautious remediation processes with the banks and stringent bankruptcy laws until 2013, contributed to the mortgage arrears situation.

The extent of the mortgage arrears crisis has broad implications for a wide spectrum of Irish society and policy. It affects housing policy, banking policy, labour market policy, and perhaps, ultimately the State's finances.

This *Spotlight* examines a variety of aspects of the mortgage arrears crisis. It does not cover all aspects of the subject.

It includes a brief context section highlighting some of the reasons for the increase in mortgage arrears and some of the consequences of this situation.

It then details the rise, level and extent of mortgage arrears in Ireland.

Next is a brief summary of the initiatives that the State has taken since 2009 to help home-owners in arrears.

It then details the current mortgage arrears resolution mechanisms (restructurings and repossessions), the extent to which they are used, and the Mortgage Arrears Resolution Targets (MART) that have been issued to certain Irish credit institutions by the Central Bank of Ireland in order to address the situation.

In addition, there is a description of some of the other alternatives to repossession which are not currently used widely in Ireland.

Context and consequences

High levels of mortgage arrears are a new phenomenon in Ireland. Although comprehensive historical arrears data for Ireland is not available, researchers in the Central Bank of Ireland have published data[3] which suggests that in 2004/2005 the mortgage arrears rate in Ireland was essentially zero.

This research has shown that buyers with properties in regions with higher unemployment, high loan to value ratios, buy-to-let properties, and/or high repayment burdens (mortgage payments as a share of income) are more likely to be in mortgage arrears.

Unemployment

Unemployment rose from 5% in Q1 2008 to a peak of 15.1% in Q1 2012 but had fallen back to 11.5% by Q2 2014. For those with large mortgage payments spells of unemployment make meeting payments difficult as their income has fallen. For many of those in work, incomes have fallen due to pay cuts and/or reduced working hours.

Level and extent of mortgage debt

The level of mortgages issued during the boom period were predicated on high incomes, high house prices and an expectation of continued rising house prices. During this period loan-to-value ratios increased as did the average length of mortgage loans.

Houses prices have fallen approximately 50% since their peak in 2006/7, meaning a significant proportion of mortgage holders are in negative equity (where the value of their property is less than the principal outstanding). While negative equity does not affect an individual's ability to make mortgage payments, it does affect their ability to terminate their mortgage if their circumstances change and they can no longer afford repayments i.e. sell the property and repay the outstanding principal. It may also affect their willingness to pay the mortgage.[4]

The amount of mortgage debt Irish banks issued in the run up to 2008 also has a significant effect on the mortgage arrears issue. Irish households had borrowed approximately €68 billion in 2002, but this had risen to just over €203 billion by the end of 2008[5] – approximately 80% of this debt was mortgage debt.[6] Thus, the level of lending has made the increase in mortgage arrears a major issue for banks as the potential losses are significant.

Interest rates

The low interest rate environment after Ireland joined the euro and post 2001 was also a factor. After the terrorist attacks on New York and Washington in September 2001 the ECB and other Central Banks reduced interest rates and kept them low for an extended period to help avoid major negative economic consequences resulting from the uncertainty the attacks caused. These interest rates were arguably too low for Ireland at that point in its economic cycle

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[3] Lydon, R.and MCCarthy, Y. (2013) What Lies Beneath? Understanding Recent Trends in Irish Mortgage Arrears.

[4] See Bank of England (2009) The economics and estimation of negative equity for a discussion of the effects of negative equity.

[5] Loans to household sector from Central Bank of Ireland's Quarterly Financial Accounts data. 2002 figure is an average.

[6] Estimate based on Central Bank of Ireland's Loans to Irish Residents data (2003 to 2008).

and allowed its construction boom to continue.[7]

Consequences

The consequences of the high level of household debt and mortgage arrears are many and varied. These include:

- Bank losses, in part due to provisions for mortgage defaults and arrears, which led to the recapitalisation of a number of Irish banks.
- The impact such recapitalisations have had on Ireland's Government finances.
- The change in households' expenditure behaviour including increased savings and reduced spending.[8]
- The impact on the labour market of the lack of mobility that mortgage arrears (and negative equity) engender.
- The social consequences arising due to individuals being unable to move to accommodation more suitable to their needs e.g. couples who originally purchased "starter" homes which are unsuitable for families.
- The impact on poverty levels, the health of individuals and the subsequent effects on the State of having to address such social and economic problems.[9]

This *Spotlight* does not address these wider issues but focuses on the level of arrears and the attempts to address them.

The following section details the level and extent of mortgage arrears.

Mortgage Arrears data

Mortgage arrears arise if a:

> *"borrower fails to make a mortgage repayment by the due date".*[10]

The mortgage arrears data reported by the Central Bank by length of time denotes the amount due in terms of their contracted payment and not necessarily the time they are in arrears for, i.e. a person who has been making half payments for three months would be classified as being in arrears of one and a half months. A person who stopped paying their mortgage for six months and then begun paying again without addressing their arrears would be considered six month in arrears even though they are once again making full mortgage repayments.

According to Census 2011 35.4% of households were owner occupied with a mortgage. In addition, 18.5% of households rented from private landlords, many of whom would have mortgages. While it is difficult to be definitive, it is likely that less than half the occupied housing stock in Ireland is mortgaged. Those in mortgage arrears are a sub-set of this group.

In 2004/2005 the greater than 90 days mortgage arrears rate was essentially zero for both principal dwelling houses (PDH) and buy-to-lets (BTL).[11] The rate rose in 2006/2007 but the greater than 90 days arrears rate was less than 1%. It was only in 2008 that arrears began their steady rise for both types of property.

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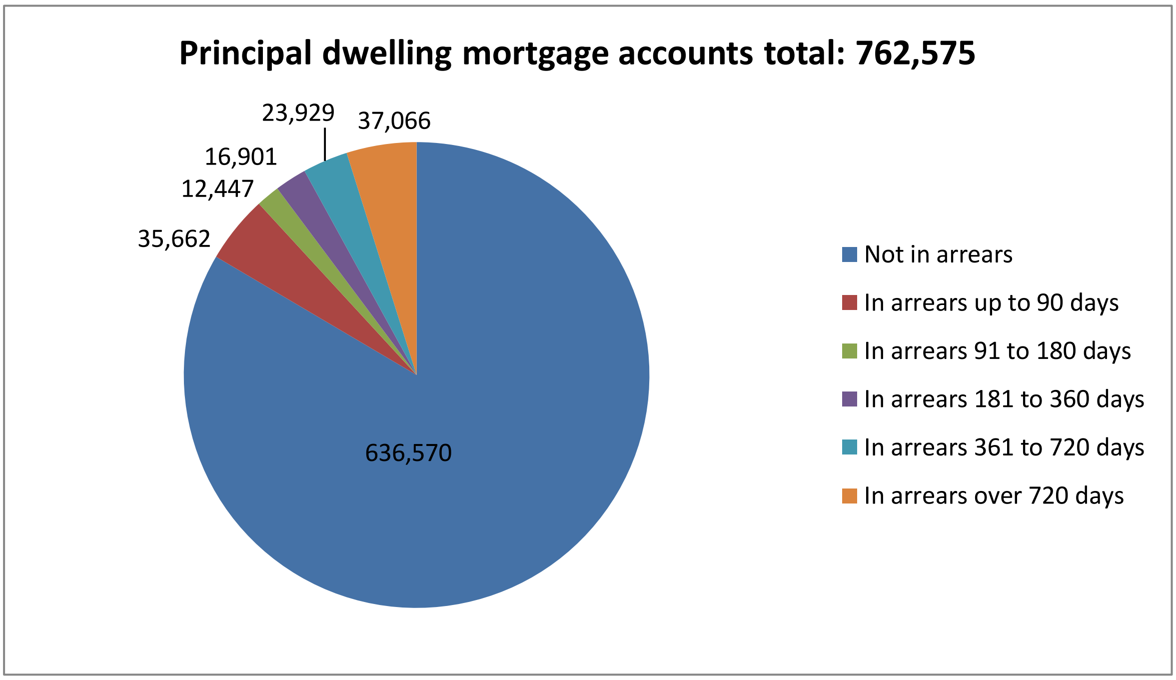
[7] See Honohan, P. (2009) What went wrong in Ireland for a broader discussion of the crisis in Ireland.
[8] See Lydon, R (2013) Do households with debt problems spend less?
[9] See the Oireachtas Library & Research Service (2010) Spotlight on Debt: Personal debt and consequences for an overview of the social effects of high debt levels.

[10] Central Bank (undated) Residential mortgage arrears and repossession statistics – explanatory notes.
[11] Lydon, R.and MCCarthy, Y. (2013) What Lies Beneath? Understanding Recent Trends in Irish Mortgage Arrears.

Figure 1: Number of principal dwelling house mortgage accounts and those in arrears end Q2 2014 (Source: Central Bank of Ireland)



The Central Bank has produced detailed end-quarter statistics on mortgage arrears going back to 2009.[12] Care should be taken in interpreting the figures (see below). The data shows that:

- The trend over the period had, until the end of 2013, been upwards.
- In Q3 2009 the share of mortgages for PDH in arrears over 90 days was 3.3%.
- This rose to 12.9% by end Q3 2013 but has fallen since. At end Q2 2014 it was 11.8%.
- Overall, 126,005 or 16.5% of PDH mortgages were in arrears (both up to 90 days and over 90 days) at the end of Q2 2014.

Figure 1 above shows the number of mortgages and the number of mortgages in arrears at end Q2 2014. The number of mortgages in arrears over 90 days is 90,343 or 11.8% of all PDH mortgage accounts.

In addition, there were 35,662 PDH accounts in early arrears (up to 90 days). This figure has declined from 45,018 or by 20.8% since end Q2 2013.

The number of PDH accounts in longer-term arrears (over 180 days) fell by 2,366 or 2.9% between end Q2 2013 and end Q2 2014. The equivalent figure between end Q4 2012 and end Q4 2013 was +7,366 or a 10% increase. This suggests that the rate of increase of longer term arrears fell substantially in the latter part of 2013 and first half of 2014.

However, at the end of Q2 2014, 37,066 PDH mortgage accounts were in arrears of almost 2 years or more (over 720 days). This was the only group in the Q2 2014 data where the number of accounts increased over the quarter. The number of mortgages in this group has risen by 8,206 or 28.4% between end Q2 2013 and end Q2 2014.

The mortgage arrears data above needs to be interpreted with care for a number of reasons.

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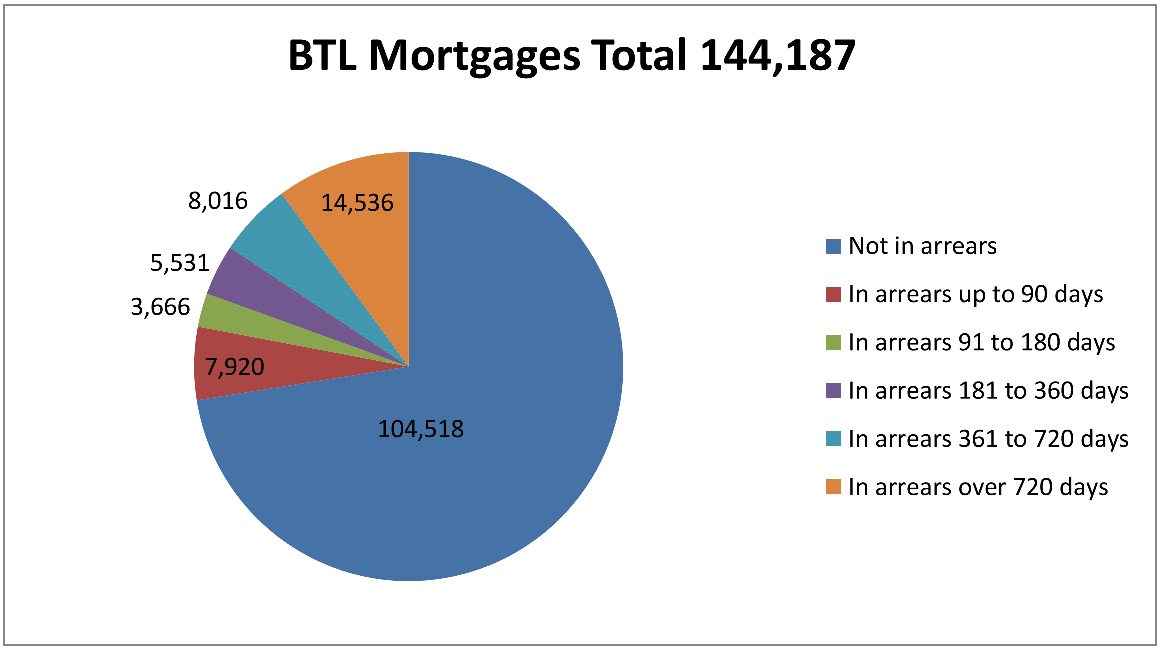
[12] Available from http://www.centralbank.ie/polstats/stats/mortgagearrears/Pages/releases.aspx. It should be noted that the data presented is regularly revised.

Figure 2: Number of Buy-to-let mortgage accounts and those in arrears end Q2 2014 (Source: Central Bank of Ireland)



Firstly, the number of PDH mortgages exceeds the number of properties on which the mortgages are secured. This is due to second or more mortgages on such properties. Central Bank research based on data from 2010[13] from Allied Irish Bank, Bank of Ireland, Permanent TSB and the Irish Bank Resolution Corporation showed that 21% of the properties in their cleaned dataset[14] had at least two mortgages on them. Indeed, 622 properties had six or more loans against them.

This suggests that the actual number of households in mortgage arrears of any length (on their principal residence) is lower than the 126,005 PDH mortgage accounts in arrears. Using the 21% share from the above research would mean 104,136 PDHs are in arrears.

Secondly, there were 1.65 million households counted in Census 2011 – only 583,148 or 35.4% were owner occupied with a mortgage (again suggesting that the number of mortgage accounts (currently 762,575) overstates the number of households with mortgages). Approximately 1/3 of households were in owner occupied homes without mortgages and another 1/3 in rented accommodation (which may or may not have mortgages on them).

Thus mortgage arrears affect perhaps 100,000 or so owner occupied households – this represents about 6% of all households in the State (approximately 1 in 16 households).

In terms of the balance of the mortgages in arrears, the 90,343 mortgages in arrears over 90 days totalled €17.5 billion at end Q2 2014. This represented 16.5% of PDH mortgage balances. The arrears themselves for these mortgages were €2.44 billion at the end of Q2 2014. The vast majority of arrears owed is concentrated in the over 720 days (€1.75 billion) and the 361 to 720 day (€464 million) categories.

Buy-to-lets

At the end of Q2 2014 there were 144,187 buy-to-let (BTL) mortgages with an outstanding balance of €29.2 billion.

[13] Kennedy, G and McIndoe-Calder, T. (2012) The Irish Mortgage Market: Stylised Facts, Negative Equity and Arrears.

[14] The researchers had to remove a number of mortgages from their analysis due to missing data.

A total of 31,749 of these mortgages were in arrears over 90 days with 22,552 in arrears for almost a year or more (over 361 days).

The balance owed on the BTL mortgages in arrears over 361 days was €6.67 billion, including €1.45 billion of arrears.

The number of BTL mortgages in any arrears at end Q2 2014 was 39,669 compared to 39,948 at end Q2 2013. However, the number in arrears over 720 day (i.e. 2 years) increased by 4,303 or 42.1% over the same period, with the number with shorter term arrears falling. This is probably due to fewer BTLs entering arrears but more of those in arrears falling further behind.

Other data on arrears

Department of Finance

The Department of Finance has begun to publish monthly mortgage arrears data for six banks. These banks represent approximately 90% of the mortgage market.

The latest data is for end July 2014.[15] For PDH it shows the continuing trend of reducing arrears; 8% fewer mortgages were in arrears at the end of July when compared to the end of March 2014. The number in arrears of greater than 90 days fell by 7,135 or 9.1% in this period.

For BTL properties there was a small decrease in the number of total mortgages in arrears (2.1%) from end March to end July 2014.

The data shows that the trends of the later part of 2013 and early 2014 shown in the Central Bank of Ireland data are continuing. These trends may reflect the targets the Central Bank of Ireland has placed on certain banks to restructure or otherwise resolve their mortgage arrears. The smaller numbers in the early arrears group (i.e. less than 90 days) could also reflect a stronger economy and increased employment.

Box 1: Data on Pre-arrears

The Code of Conduct on Mortgage Arrears states "A pre-arrears case arises where the borrower contacts the lender to inform them that he/she is in danger of going into financial difficulties and/or is concerned about going into mortgage arrears".

However, the return that banks must complete in order to create the mortgage arrears data does not include any question on pre-arrears. The L&RS could find no reference to the number of those in pre-arrears.

Some of the restructurings of mortgages (discussed later) would include those who approached their banks before going into arrears and restructured their mortgage in order to prevent an arrears situation arising.

Other Central Bank research

Researchers in the Central Bank have recently produced a short report that uses a different dataset from the quarterly mortgage arrears dataset to give more detail on what types of mortgage are in arrears. This dataset covers fewer banks but has a large amount of additional information on mortgages.

The paper by Frost, Goggin and Lyons shows that:[16]

- Mortgages which originated between 2004 and 2008 are more likely to be in longer term arrears (greater than 360 days).
- The Border and Midlands regions have the highest level of long-term arrears over 8% for PDH and over 14% for BTLs. This compared to under 6% for PDH's in the South West and under 11% for BTLs in the Mid-West.
- The median loan-to-value ratio on long-term arrears cases for PDH

[15] Department of Finance: Mortgage Restructure data.

[16] Sarah Frost, Jean Goggin and Paul Lyons (2014) *'Analysing Mortgage Arrears with Aggregated and Granular Data'*.

was 111% compared to 73% when the mortgages were initially issued. The median loan-to-value ratio of loans less than 90 days in arrears was 70%. Thus, on average those in longer term arrears are in negative equity. Their arrears would push up the loan-to-value ratio as well.

- The median loan-to-value ratio in long-term arrears cases for BTLs was 134% compared to 122% for BTL mortgages in arrears 90 to 360 days.

European and other countries

Mortgage arrears data across countries is not always available or comparable. What data is available, however, suggests that Ireland has a high level of mortgage arrears and that it rose faster in recent years than a range of other European countries.

The data available is for the mortgages that underlie Residential Mortgage Backed Securities (RMBS) i.e. mortgages which were grouped together and sold as bonds. The market for such securities in different countries varies widely and as such it may not give a full picture of a country's mortgage arrears situation.

In Spain, the greater than 90 days RMBS arrears rate (by outstanding balance) was 7.5% at end-2013, this compared to 19.6% of the total outstanding balance in the Irish RMBS, 5% for Greece, 4% for Portugal and 2% for Italy. These figures were reported in a recent paper by Central Bank of Ireland researchers.[17]

In the UK the greater than 90 days RMBS arrears rate was 1.8% at end-2012, 1.5% in Germany 0.7% in Belgium and 0.5% in France with the Dutch rate of greater than 60 days arrears rates at around 0.7%.[18]

[17] Sarah Frost, Jean Goggin and Paul Lyons (2014) *'Analysing Mortgage Arrears with Aggregated and Granular Data'*.

[18] Moody's Global Structured Finance Collateral Performance Review March 2013.

It should be noted that the share of mortgages in mortgage arrears as a proportion of all mortgages is not just a function of how many individuals default on their mortgages but also how and how quickly the arrears situation is resolved. In countries where repossession is used frequently and speedily it is be expected that mortgage arrears are not at a high level – the situation is resolved and the mortgage no longer appears in the arrears statistics.

State response to the increase in mortgage arrears

This section covers some of the various actions/initiatives that the State and its bodies have used to address the mortgage arrears issue. The reforms regarding personal insolvency are discussed later.

In 2010 the Expert Group on Mortgage Arrears and Personal Debt was set up. Its interim report[19] focused on improvements to the Central Bank of Ireland's Code of Conduct on Mortgage Arrears (CCMA) and the Mortgage Arrears Resolution Process (MARP) (see below). Its final report[20] made recommendations, amongst others, on the creation of the Deferred Interest Scheme (see restructurings section p.13), reforms to bankruptcy and a non-judicial debt settlement system (i.e. personal insolvency).

In 2011 an Inter-Departmental Mortgage Arrears Working Group was set up by the Government's Economic Management Council [21] to address 15 specific matters in relation to mortgage arrears. Many of these were following up on areas identified by the Expert Group on

[19] Mortgage Arrears and personal Debt Group (2010) Interim report.

[20] Mortgage Arrears and personal Debt Group (2010) Final report.

[21] The Economic Management Council is a cabinet sub-committee made up of the Taoiseach, Tánaiste and Ministers for Finance and Public Expenditure and Reform.

Mortgage Arrears and Personal Debt. The Working Group's recommendations[22] included setting up mortgage-to-rent schemes, continued forbearance in some cases, split mortgages, trade-down mortgages and sale by agreement. It also recommended that homeowners in mortgage difficulties should get independent advice but forego some of the protections under the Code of Conduct on Mortgage Arrears if they failed to co-operate with their lender.

In March 2013 the Government policy on mortgage arrears was set out in the *Government Statement – Resolving the Mortgage Arrears Crisis*[23] which was accompanied by Central Bank of Ireland proposals to reform the CCMA and the initial set of Mortgage Arrears Resolution Targets for six banks (see pages 13-14 below).

Some of the main actions that have been taken are discussed below.

Mortgage interest relief

The most extensive and most fiscally significant support for mortgage holders is mortgage interest relief which is provided at source and is paid for the first seven years of the mortgage. It was available to all eligible mortgage holders, but was of greatest benefit to first time buyers. The Commission on Taxation estimated that it cost the State approximately €700 million in reduced taxes each year. It was ended for new applicants from the beginning of 2013. In Budget 2012 the amount of the relief was increased for those first-time buyers who purchased between 2004 and 2008. They were targeted as part of the Programme for Government commitments to homeowners with distressed mortgages. All mortgage interest relief is due to cease by end 2017.

Mortgage Interest Supplement

Mortgage interest supplement (MIS) was one component of supplementary welfare allowances. It was a payment made to those households where there was no earned income due to unemployment, or where there was a significant reduction in salary or wages. MIS paid the costs of mortgage interest repayments. It only supported the interest component of the loan and not loan capital repayments.

A 2010 review of MIS by the Department of Social Protection[24] shows that there was a significant expansion in both the numbers of households availing of MIS and the total expenditure under it:

- Expenditure on the scheme had increased from €12.2 million at the end of 2007 to €27.7 million at the end of 2008. Expenditure continued to rise and was €67.9 million in 2011 before falling to €55.1 million in 2012.
- The number of recipients of mortgage interest supplement increased from 4,111 at the end of 2007 to over 8,000 at the end of 2008, an increase of 97%. The number of recipients increased to 18,703 in 2011 before falling to 14,437 in 2012.

MIS was to be only available for up to one year in most circumstances. By 2011 approximately 12,000 households were on MIS over a year according to the Inter-Departmental Mortgage Arrears Working Group[25] which (in line with the 2010 Department of Social Protection review) recommended the introduction of a time limit on MIS.

In Budget 2014 MIS was ceased for new entrants and MIS will be wound down over four years for existing recipients. The Department of Social Protection states that the "most appropriate way in which customers experiencing short-term mortgage difficulties can be supported is through engagement with their lender

[22] See http://www.finance.gov.ie/sites/default/files/mortgagearr2_0.pdf.

[23] See http://www.merrionstreet.ie/index.php/2013/03/government-statement-resolving-the-mortgage-arrears-crisis/.

[24] Review-of-the-Mortgage-Interest-Supplement-Scheme.pdf.

[25] Inter-Department Mortgage Arrears Working Group p19.

under the Mortgage Arrears Resolution Process."[26]

Mortgage-to-Rent scheme

The *Mortgage-to-Rent* scheme, administered by the Housing Agency, allows for certain individuals in mortgage arrears to have their lender repossess their home, which is then bought by a recognised social housing association and rented back to the original owner.

The numbers who have availed of the scheme is quite low (38 up to April 2014).[27] However, 2,337 cases have been identified by lenders to be considered for the scheme, including 464 cases under negotiation and 988 at the initial stages of the process. The others have not progressed.

The scheme is limited in terms of the value of the properties involved. Only properties valued up to €180,000 outside Dublin and up to €220,000 in the greater Dublin area are included. Lenders must agree to it and it can take up to 18 months to complete.[28]

A similar scheme has been recently introduced for those in arrears who are purchasing their homes from a local authority.[29] It will have a budget of €20 million in 2014.

Code of Conduct on Mortgage Arrears (CCMA)

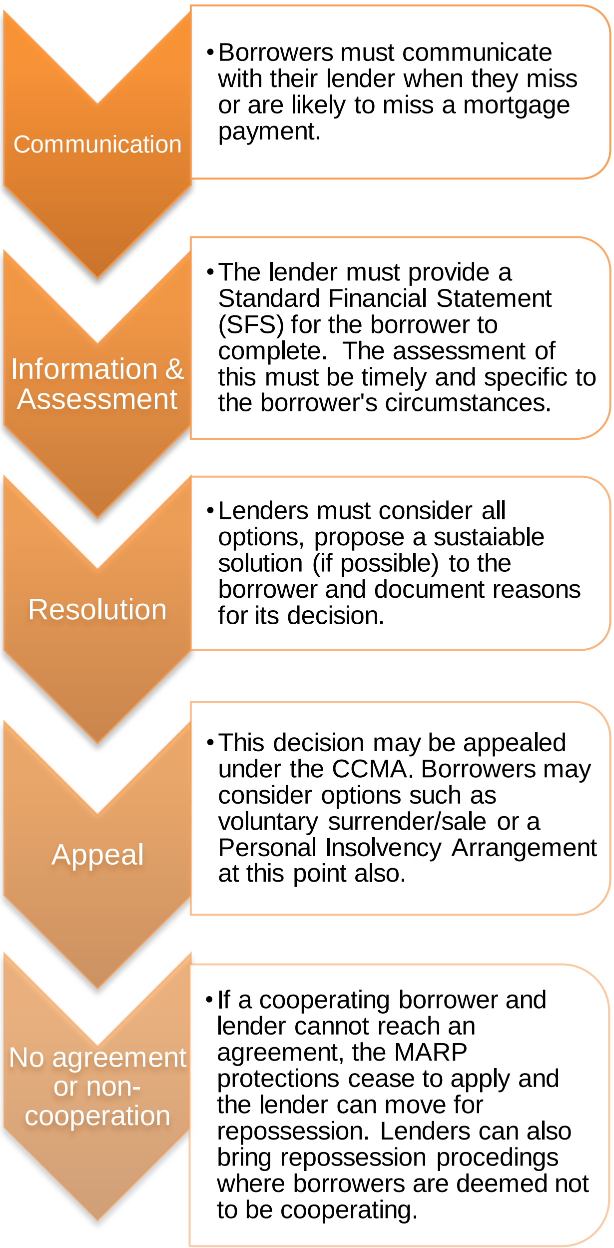
The current financial crisis led to the adoption by the Financial Regulator of the Code of Conduct on Mortgage Arrears in February 2009. The Code was based very closely on an older Irish Banking Federation Code. However, because it was issued by the Regulator under Section 117 of the *Central Bank Act 1989*, it is mandatory. Further, it applies to all regulated mortgage lending institutions, not just the deposit-taking ones (banks and building societies), except credit unions. Thus, the so-called 'sub-prime' lenders, which specialised in loans to low-income or otherwise high-risk customers, are also bound by its terms. However, non-regulated entities which purchase loan books are not bound by it. In a number of recent cases, the purchasers of such loan books have stated that they will apply the Code. The Government has announced legislation to bring such non-regulated entities under the Code.[30]

The Code regulates the conduct of a bank and its processes when dealing with a customer who falls into arrears with their mortgage. It has been revised a number of times, with the latest revision applicable from July 2013. The revised code sets out the new Mortgage Arrears Resolution Process (MARP).

According to the Minister for Finance the Central Bank's CCMA "places an onus on the banks, in respect of a co-operating borrower, to explore all the options for an alternative repayment arrangement offered by the lender to address a primary dwelling mortgage difficulty before any legal action is considered."[31] While the code does not set out the exact resolution mechanisms a mortgage lender must use, it does state that the resolution proposed (if any) should be sustainable.

[26] See http://www.welfare.ie/en/Pages/Mortgage-Interest-Supplement---Qualifying-Conditions.aspx.
[27] See reply to PQ nos. 393, 413 to 418, and 431, 15 April 2014.
[28] Mortgage-to-rent scheme all but unworkable – Irish Examiner 14/04/2014.
[29] Press release 11/02/2014 New €20m Fund to Assist Local Authority Mortgage Holders in Distress.
[30] See http://www.finance.gov.ie/news-centre/press-releases/public-consultation-consumer-protection-sale-loan-books.
[31] Parliamentary Question reply No.24 of 20 February 2014 [8349/14].

Figure 3: The Mortgage Arrears Resolution Process



Source: Oireachtas Library & Research Service based on [Code of Conduct Mortgage Arrears July 2013.]

Mortgage Arrears Resolution Process (MARP)

The Mortgage Arrears Resolution Process (MARP) was introduced in the 2010 revision of the CCMA based on the recommendations of the Expert Group on Mortgage Arrears and Personal Debt. It has been revised a number of times since.

Each mortgage lender must have its own Mortgage Arrears Resolution Process which applies the standards set out in the CCMA. [32]

A mortgage lender must set up an Arrears Support Unit (ASU) within the bank. The CCMA sets the standard of how banks are to deal with customers in mortgage arrears. The basic MARP is set out in Figure 3.

There are various protections for borrowers including restrictions on how soon a mortgage lender can begin repossession proceedings after a borrower goes into arrears. These time restrictions depend on if a sustainable solution is possible and whether the borrower is cooperating with the lender.

Mortgage Arrears Resolution Targets

In March 2013 the Central Bank set out Mortgage Arrears Resolution Targets (MART) for six banks with the aim of speeding up the resolution of the mortgage arrears crisis. These are discussed in the next section.

Advice to borrowers in mortgage difficulties

The various official reports on the mortgage arrears problem have also emphasised the need for borrowers in difficulty to receive independent advice on their financial situation. The Government has set up the *Mortgage Arrears Information and Advice Service* "to provide a comprehensive and coordinated approach to assist people in mortgage arrears or pre-arrears in assessing their options." [33]

The service, which differentiates between mortgage information and mortgage advice, has three elements:

- The website www.keepyourhome.ie. This is an online portal for general mortgage and debt information and advice.

[32] This section is based on the Code of Conduct Mortgage Arrears July 2013.
[33] Parliament Question Reply No. 113 of 17 April 2014 [18485/14].

It was launched in June 2012 and is provided by the Citizens Information Board and the Money Advice and Budgeting Service (MABS). It also includes information for tenants who have problems paying their rent.

- The Mortgage Arrears Information Helpline (phone 0761 074050). This was established in August 2012 and provides general mortgage arrears information, information on the Code of Conduct on Mortgage Arrears and other supports available for those in mortgage difficulties.
- The Mortgage Arrears Information and Advice Service panel of accountants. This is a panel of accountants that mortgage lenders can refer borrowers in difficulty to. The accountants give the borrowers independent financial advice when presented with a long-term resolution proposal. There are over 2,000 accountants on the panel and borrowers are free to choose their own advisor. The lender pays €250 to the accountant for the service.

According to the Minister for Social Protection, between August 2012 and 4 April 2014, 10,945 calls were made to the helpline. A total of 222,267 visits were made to the website between June 2012 and 4th April 2014. In addition, mortgage lenders were invoiced by 297 accountants during 2013.[34]

A review of the independent financial advice element of the Mortgage Arrears Information and Advice Service was undertaken in 2013 to ensure that the service was meeting its objectives. The key recommendations of the review[35] relate to increasing awareness among borrowers through the provision of clear and unambiguous information about the service and to increase the scope of the advice to include advice on the other mortgage debt resolution options that are available for borrowers. The review also recommended that consideration be given to increasing the funding for the financial advice from €250 to €500. These recommendations are in the process of being implemented.

Restructurings

The Mortgage Arrears Resolution Process and the Mortgage Arrears Resolution Targets set by the Central Bank of Ireland as stated above are now the main mechanisms through which the mortgage arrears crisis is being addressed. This section examines the data on mortgage restructures in the context of the resolution targets set by the Central Bank.

Targets

In March 2013 the Central Bank of Ireland published its Mortgage Arrears Resolution Targets (MARTs) for six banks.[36] The initial target for these banks was that they would have proposed a sustainable solution to at least 50% of those in mortgage arrears (greater than 90 days) by the end of 2013 (with quarterly targets in between). In addition, by end Q1 2014 the terms of 75% of the agreed solutions were to have been met.

In November 2013, the Central Bank published the outcome of the MART for Quarter 2 and Quarter 3 of 2013 for banks offering sustainable long-term solutions for mortgage arrears customers. The Central Bank stated that the banks had exceeded their targets for these periods. [37]

[34] All figures from this paragraph are from Parliament Question Reply No. 113 of 17 April 2014 [18485/14].
[35] Department of Social Protection (2013) Review of the Independent Financial Service.
[36] The banks covered are ACC, Allied Irish Bank (including EBS), Bank of Ireland (including ICS Building Society), KBC, Permanent TSB and Ulster Bank. See Mortgage Arrears Resolution Targets March 2013.
[37] Press release - Central Bank publishes outcome of Mortgage Arrears Resolution Targets.

In December 2013 the Central Bank set revised targets for end-June 2014[38] and in June 2014 it set new expectations for end 2014.[39]

The quarterly targets for solutions proposed, concluded and being met for 2014 are set out in Table 1 below. By the end of 2014, the six banks must propose sustainable solutions to 85% of customers over 90 days in arrears and for concluded solutions to reach 45%. The terms of 75% of the agreed solutions must be being met.

Table 1: Central Bank of Ireland Mortgage Arrears Resolution Targets

Sustainable Solutions	Q1	Q2	Q3	Q4
Proposed [Target 1]	70%	75%	80%	85%
Concluded [Target 2]	25%	35%	40%	45%
Terms being met [Target 3]	75%	75%	75%	75%

Source: Central Bank of Ireland.

Sustainable solutions

The MART document[40] defines sustainable solutions as one of the following:

"(a) An arrangement concluded under a bank's Mortgage Arrears Resolution Process (MARP), …, where the borrower is cooperating under the MARP and the bank has satisfied itself that the arrangement provides a sustainable solution which is likely to enable the customer to meet the original or, as appropriate, the amended terms of the mortgage over the full remaining life of the mortgage, including repayment of the original or an agreed revised principal sum where offered. This may include an interest-only or other temporary solution for a period if it is likely that full repayment of the original or revised principal will be achieved over time, or where there is a payment plan to return the account to sustainability through the clearance of arrears;

(b) A personal insolvency arrangement effected under the *Personal Insolvency Act 2012;* or

(c) If an arrangement could not be reached or is not appropriate, that the PDH or BTL property securing the loan has been voluntarily sold or, failing that, any situation where a [lender] takes possession of the property including by way of voluntary agreement with the borrower or by Court Order or otherwise."

The European Commission in its Country Specific Recommendations for Ireland under the European semester has recommended that Ireland:

> "Announce ambitious targets for the third and fourth quarters of 2014 for the principal mortgage banks to propose and conclude restructuring solutions for mortgage loans in arrears of more than 90 days, with a view to substantially resolving mortgage arrears by the end of 2014. [41]

Types of restructuring

The following types of restructuring can be used by banks and are recorded by the Central Bank in its quarterly data. Some arrangements are more frequently used than others.

Interest-only – the mortgage holder reduces their payment to the interest proportion of the loan and ceases capital payments for a time. This option is most useful for those with temporary financial difficulties (for example a short period of unemployment). After an agreed period of time the mortgage holder must begin repaying the capital proportion of their mortgage. Moving to an interest-only arrangement would tend not to be a long-

[38] Central Bank statement on Mortgage Arrears Resolution Targets 05 Dec 2013.
[39] Central Bank statement on Mortgage Arrears Resolution Targets 04 June 2014.
[40] Mortgage Arrears Resolution Targets March 2013.

[41] See recommendation 6 of Recommendation for a COUNCIL RECOMMENDATION on Ireland's 2014 national reform programme and delivering a Council opinion on Ireland's 2014 stability programme COM(2014) 408 final.

term solution. As the capital on their mortgage has not been repaid for a period they must increase their payments to maintain the term of the loan.

Reduced payments (greater or less than interest-only) – this is similar to the interest-only option but the payment depends on how much an individual can afford. If they can afford a higher than interest-only payment they pay part of their capital repayment. If they pay less than the interest, they will probably accrue arrears that will need to be repaid in the future. Again, these are short-term options and likely to work for those in short-term financial difficulty.

Term extension – this increases the term of a mortgage (e.g. from 20 to 25 years). This has the effect of reducing the capital portion of the monthly payment due on a loan and thus reducing the overall amount of the monthly mortgage payment. However, it also means that the loan becomes more expensive (the borrower is paying interest on a higher amount for longer). Extending the term of a loan can be a sustainable solution if the new payments can be met.

Arrears Capitalisation – this is where the built up arrears become part of the loan i.e. the amount owed increases by the arrears. Once this happens the loan is no longer in arrears but a higher level of payments must be made as the loan is now higher and interest must be paid on this higher amount.

Payment Moratorium – this is where mortgage payments are ceased for a period of time. This is likely to be a short-term measure in cases of severe, unexpected financial difficulty.

Deferred Interest Scheme – this is a scheme that allows borrowers, under certain circumstances, to pay two-thirds of the interest due on their mortgage for up to 5 years. Essentially it is a formalised reduced payment scheme. The deferred interest would have to be repaid. The mortgage holder has to resume full repayments as soon as they are able. If the amount of deferred interest reaches 18 months interest payments or the mortgage holder is still in the scheme after five years, the mortgage is to be considered unsustainable and repossession can take place. The mortgage holder has to go through the MARP process and have their income and expenditure evaluated. The take up of this scheme has been very low (see Table 2).

Temporary/permanent interest rate reduction – this is where the bank reduces the interest rate payable on the loan, either temporarily or permanently. Overall mortgage payments will be lower for the length of the reduction. This option is favourable to the mortgage holder as it reduces their payments but also means they do not accrue other debts that must be capitalised later.

Split mortgage – this is where part of the mortgage is split off ('parked') from the rest of the mortgage. The non-parked part of the mortgage is repaid as normal. Its level is chosen to reflect the borrower's ability-to-pay. The parked part of the mortgage remains a charge on the property (i.e. it must be repaid if a property is sold). Some banks charge interest on this portion, others do not. In the future, when the non-parked part of the mortgage is paid off and the mortgage holder wants to own their home outright, they would have to pay off the parked part of the mortgage. Split mortgage offers must give options to the borrowers on what will happen to the parked portion of their mortgage at the end of the term. This could be a new mortgage, a trade-down option or the recovery of the debt from the person's estate.

Trade-down mortgage – this is a little used restructuring solution where a person sells their home and purchases a new, less expensive home. Their mortgage is essentially transferred from the old home to the new home, perhaps with some paid off (the difference between the sale price of the old home and the cost of the new home). This can allow individuals to trade-down and pay off part of their mortgage and thus reduce payments.

Combinations of the above arrangements are also possible, for example combining term extensions with arrears capitalisation.

Use of restructuring arrangements

The restructuring arrangements most used include interest-only, reduced payments, arrears capitalisation and terms extensions (see Table 2). Split mortgages have become more frequent in 2013 and 2014 (at the end of 2012 there were only 52 split mortgages).

Table 2: Restructurings data Q2 2014

	PDH	BTL
All restructurings	101,973	23,790
Of which not in arrears	62,500	14,401
Restructuring by type		
Interest-only	11,600	5,943
Reduced payment (greater than interest-only)	13,785	5,013
Reduced payment (less than interest-only)	3,638	438
Term Extension	15,830	3,111
Arrears Capitalisation	25,677	5,585
Payment moratorium	1,773	257
Deferred Interest Scheme	91	2
Permanent interest rate reduction	18	-
Split mortgage	12,882	494
Trade-down mortgage	25	-
Temporary interest rate reduction	3,359	63
Other	13,295	2,884

Source: Central Bank of Ireland (2014) Residential Mortgage Arrears and Repossession Statistics: Q2 2014. Note: Other include accounts offered a permanent solution pending six months successful payments.

The Department of Finance's monthly mortgage restructures data[42] for the six main lenders shows that 71% of PDH mortgages in arrears over 90 days had not been restructured by the end of July 2014, with 76% of BTLs in arrears over 90 days also not restructured.

The numbers not restructured can include, for example, borrowers who have completed a temporary restructure and are now considering a permanent restructure, borrowers who are in discussions with their lenders, borrowers who have not submitted an SFS to their lender, and borrowers who are in the legal process.

The Department of Finance data also shows that 4,648 rent receivers have been appointed to BTL properties at the end of July 2014. This has increased from 3,179 at the end of 2013, and from 2,397 at the end of September 2013.

The data also shows that there has been an increase in permanent restructures with a fall of temporary restructures over the period end September 2013 to end July 2014. This suggests that the Central Bank's Mortgage Arrears Resolution Targets are beginning to have an effect.

Repossessions

Mortgages are a legal contract between a lender and a borrower with a property used as collateral for the loan. If a borrower does not meet their payments, the option to repossess the property in order to resolve the loan and any arrears becomes available. However, Irish banks have, historically, been cautious with regards to the repossession of family homes. There are a number of possible reasons for this, including the cost of repossession, the length of time it takes, legal issues with repossession law (since resolved) and bad publicity.

In addition, when a property is repossessed the bank must fully realise any loss on it. While the customer is responsible for repossession costs and any shortfall if the amount realised from the sale of repossessed property does not cover the mortgage, it can be difficult for the bank to pursue the customer or come to agreement on the outstanding amount owed. As part of the Mortgage Arrears Resolution Process banks should only pursue legal options if the customer

[42] Department of Finance: Mortgage Restructure data.

is not cooperating, has failed to sustain the agreed solution or no agreed sustainable solution could be made.

In 2013, according to Central Bank data (and ignoring the effects of reclassifications), the banks collectively repossessed 766 principal residential properties, most (515 or 67%) through voluntary repossession (See Table 3). At the end of 2013 they had 1,014 repossessed/voluntarily surrendered/abandoned formerly principal resident properties on their books. In the first half of 2014 a total of 580 PDH properties were taken into possession by banks (143 through a court order).

Table 3: Repossessions of principal dwelling houses 2010 to H1 2014

	Court ordered	Voluntarily surrendered
2010	102	261
2011	196	412
2012	194	412
2013	251	515
2014 H1	143	437
	886	**2,037**

Source: Central Bank of Ireland various Residential Mortgage Arrears and Repossessions Statistics releases. Quarterly data was summed to calculate annual figures – there are minor discrepancies in the data quarter on quarter due to reclassifications and revisions.

With BTLs the number repossessed in 2013 was 262 with 183 through voluntary repossession. At the end of 2013 there were 502 repossessed BTL properties held by credit institutions. In the first half of 2014 a further 170 were repossessed/voluntarily surrendered.

in some circumstances repossession may be in the best interest of the customer, especially if it is likely that the mortgage payments owed will never become affordable. It may be better for the customer to surrender their home voluntarily or have a sale facilitated rather than continuing to build up arrears and more debt.

According to information provided to the Joint Committee on Finance, Public Expenditure and Reform, four banks (AIB, PTSB, BOI and Ulster Bank) between them by the end of 2013 had considered bringing 15,782 legal processes against those in arrears on the principal dwelling, the vast majority being letters advising legal action or the initiation of court proceedings. A further 6,372 legal processes were considered against those with BTLs in arrears. It should be noted that the definition of what constitutes a legal process is ambiguous and debatable – some consider letters advising potential legal action as part of the legal process, others do not.

It seems unlikely that all such processes will lead to repossession or even court proceedings. Evidence given to the Committee suggests that many individuals re-engage with their lenders after receiving letters advising potential legal action.[43]

Voluntary sale

A voluntary sale is where the borrower and lender agree for the property to be sold and new terms are agreed for any outstanding debt. A voluntary sale avoids a formal repossession and the transfer of ownership to the bank. This option can be cheaper for both parties than legal repossession or even voluntary surrender.

There does not seem to be statistics available on voluntary sales. However, according to data provided to the Joint Oireachtas Committee on Finance, Public Expenditure and Reform from three banks (AIB, BOI and PTSB), by the end of 2013 this solution was offered to almost 5,600 borrowers (approximately 4,000 PDH and 1,600 BTLs) as part of the Mortgage Arrears Resolution Targets.

[43] David Duffy of AIB at Joint Committee on Finance, Public Expenditure and Reform meeting 09/04/2014.

Additional alternatives to repossession

The restructuring and repossession options listed above are solutions that currently are or can be used by the banks to help resolve mortgage arrears. There are a number of alternative resolutions, proposed by commentators or introduced by the Government, to those offered by the banks to assist mortgage holders in arrears to stay in their homes. These are discussed below.

Personal insolvency

Personal insolvency and bankruptcy legislation in Ireland was reformed in 2012 and implemented in late 2013. For an individual in financial difficulties there are a number of options in entering personal insolvency. The personal insolvency arrangements include Debt Relief Notices (DRN), Debt Settlement Arrangements (DSA) and Personal Insolvency Arrangements (PIA). Bankruptcy is also an option for those in financial difficulty.

The *Debt Relief Notice (DRN)* is for unsecured debt up to €20,000 and thus is unlikely to be of use to mortgage holders in arrears.

A *Debt Settlement Arrangement (DSA)* is an agreed settlement on unsecured debt, with no limit involved, normally over 5 years. As mortgages are secured debt this option could be used if a person in financial difficulties could afford their mortgage payments but not repayments on their other debt. Alternatively if their home was repossessed and there was a shortfall due to negative equity they could then try to enter a DSA to resolve the outstanding debt.

A *Personal Insolvency Arrangement (PIA)* is for an agreed settlement on secured debt up to €3 million (though this cap can be increased) and unsecured debt with no limit involved, normally over 6 years. This is the option most likely to be of use to mortgage holders in arrears.

The DSA/PIA processes involve a Personal Insolvency Practitioner (PIP) being appointed and working out the income, assets and liabilities of an individual or couple. The insolvent person(s) is/are allowed a certain amount of income to cover basic expenses[44] and the rest of their income is used in settlement of part of their debt. The PIP negotiates with the creditors of the person and the creditors representing a qualified majority of the total debt[45] must agree the arrangement. If a person's circumstances change (i.e. they receive additional income) they must inform the PIP. After the 5 years for the DSA or 6 years for the PIA the rest of the outstanding unsecured debt is written off. These are the usual maximum periods for the arrangements but they can be extended for one year in certain circumstances. The periods can also be reduced if creditors agree.

The treatment of secured debt (i.e. mortgages) under a PIA depends on the negotiations between the creditors and the PIP. In general it is expected that, with the exception of normal principal residences, secured assets would be sold to meet the secured debts with any shortfall resolved as part of the settlement. There is an onus on the PIP "insofar as reasonably practicable, … to formulate the proposal on terms that will not require the debtor dispose of an interest in, or cease to occupy all or a part of his or her principal private residence and the personal insolvency practitioner shall consider any appropriate alternatives" (Section 104 of the *Personal Insolvency Act 2012*).

Thus principal residences have a measure of protection under a PIA i.e. the PIP must consider all options that would allow a person to retain their primary residence. It is likely that after the PIA is completed the residence would still

[44] For the Insolvency Service's guidelines on reasonable living expenses see Guidelines on a reasonable standard of living and reasonable living expenses.

[45] This is at least 65% of the debt but is complicated in the PIA as creditors representing half of both secured and unsecured debt by value must also agree.

have a (possibly reduced) mortgage on it. One possible scenario is that the mortgage would be written down to the value of the home – though this would have to be agreed. Family homes that are considered too big or are very expensive may have to be given up and the insolvent person be expected to trade-down. The circumstances of the individual will determine the outcome of the PIA.

The number of PIAs which have been agreed since the Irish Insolvency Service became operational is low. Up to the end of March 2014 there were 320 applications for a PIA and 41 protective certificates issued but only 5 PIAs agreed. By the end of June 2014 there had been 533 applications, 147 protective certificates issued and 32 PIAs agreed.[46]

Part of the aim of the new personal insolvency arrangements is to encourage banks and other creditors to come to arrangements with those who can no longer service their loans outside the formal process. Such agreements may be mutually beneficial to both parties rather than going down the legal personal insolvency route.

An alternative to the PIA is bankruptcy; in this case all assets are included for disposal, including the family home. The automatic discharge term for a bankruptcy (three years) can be less than for a PIA or DSA. However, bankruptcy is more expensive (as it involves the High Court) and comes with other restrictions and requirements (such as not being allowed to be a director of a company).

There are media reports[47] that suggest some banks have engaged with individuals in severe mortgage arrears and have come to arrangements which involved write down of debts outside the personal insolvency framework. AIB has stated that it "will compromise on debt with co-operating customers only if there is no prospect of that debt being paid, where there is no affordability to pay it, or when considered against the economics of alternative options open to the bank and, of course, against our requirement to optimise our recovery."[48]

Debt-for-equity swap

Debt-for-equity is an alternative solution to resolve mortgage arrears that has been suggested by some commentators.[49] The Joint Committee on Finance, Public and Expenditure and Reform recently recommended that the Central Bank undertake an analysis of the potential of a debt-for-equity product.[50]

Debt-for-equity is where a bank (or perhaps a third party) takes equity stakes in the property of those in mortgage difficulty. Essentially the bank converts part of the loan to an equity stake in the property and thus shares the ownership. The mortgage has fallen and thus the homeowner pays less on the mortgage. When the home is sold the bank receives an amount commensurate to its share. If the home value rises the bank also shares in this rise.

Such schemes may work better for individuals whose properties have positive equity (see Box 2). However, such schemes may be viewed as complicated for banks to engage in. The bank will own a very illiquid asset which they may not be able to sell.

There are other complications with debt-for-equity. In reality rent should be paid on the share owned by the bank or third party. If rent is paid on the share owned by the bank or third party then it may not

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46 ISI Statistics Q2 2014.

47 For example Irish Times (20/03/2014) Sharp increase in debt write down deals.

48 Comments by David Duffy, CEO of AIB to Joint Committee on Finance, Public Expenditure and Reform, 9 April 2014.

49 Examples include former Bank of Ireland chief executive and current Central Bank Commission member Mike Soden, David Hall of the Irish Mortgage Holders Organisation in Sunday Business Post 8 September 2013, and David McWilliams.

50 Joint Committee on Finance, Public and Expenditure and Reform (2014) Report on Hearings on Matters Relating to Mortgage Arrears Resolution Processes. See recommendation 34.

be worthwhile for the homeowner who could be paying almost as much as before but now end up owning only part of their home.

Box 2: Debt-for-equity example

A couple are having financial difficulties. They can afford mortgage payments on a €200,000 loan. Their mortgage is €300,000, and the house is now worth €200,000. Under a debt-for-equity arrangement the bank would swap €100,000 of the debt for half the home.

The couple is still in €100,000 of negative equity (they owe €200,000 on the half of the home they own). They can now afford their mortgage payment.

However, they may also owe rent on the half of the home they do not own. Unless accompanied with a debt write down there is little incentive for the homeowner in this case. However, there is no incentive for the bank to give a debt write-down – if they repossess they gain €200,000 and are still owed €100,000, some of which they may recover.

Mortgage-to-rent

Mortgage-to-rent is a generic term for the situation where a bank or third party takes ownership of a home and rents it back to the former homeowners. The arrears and any shortfall would have to be dealt with under such an agreement.

Banks may be reluctant to enter such arrangements for various reasons including that they do not want to take on the responsibilities of landlords or directly own houses which they may not be able to easily dispose of.[51]

There is a Government backed *Mortgage-to-Rent* scheme (see p.11 above). This is where an approved housing association purchases the home and rents it back to the former owner.

The Inter-Departmental Mortgage Arrears Working Group proposed a form of mortgage-to-rent scheme known as *mortgage-to-lease*. The proposal is that the mortgage holder would surrender the property to their bank. The bank would then lease it on a long-term basis to a local authority, who in turn would allow the former mortgage holder to stay in residence as a social housing tenant. The mortgage-to-lease scheme is still being developed. Such a scheme avoids the bank becoming the direct landlord of the former mortgage holder.

Debt forgiveness

There have been calls for lenders to consider debt forgiveness for borrowers and allow the borrower to keep their home.[52] The media has highlighted some recent cases where a bank has written off significant portions of mortgages.[53] Debt forgiveness on a large scale, outside formal processes such as an insolvency agreement or bankruptcy gives rise to a number of issues.

One such issue is moral hazard. Wide scale debt forgiveness could encourage those who can afford to pay their mortgages to stop paying in the hope that they will also get debt forgiveness. This is especially true if there is little transparency in the process. Formal insolvency arrangements avoid this to an extent – there are guidelines on what constitutes a reasonable living standard and any write-down reflects this.

In addition, the amount of debt to be forgiven would vary considerably across individuals. Presumably those with higher debt and higher arrears would get the most forgiveness. However, the level of debt and arrears may be very different for individuals in similar circumstances who stopped paying their mortgages at different times.

In reality, insolvency arrangements and many voluntary arrangements between banks and mortgage holders involve debt forgiveness. Many banks are reluctant to contemplate debt forgiveness unless the home is sold. In addition, debt forgiveness is a loss to the banks.

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[51] See Mortgage Debt for Equity by Karl Deeter (mortgage broker).

[52] For example David McWilliams and a group of academic economists.

[53] See Irish Times, 20 March 2014.

The main advantage of debt or partial debt forgiveness is that it allows individuals who clearly cannot sustain their level of debt to get on with their lives with a more manageable level of debt.

In addition, such informal proposals may cost less to both creditors and debtors than formal insolvency or bankruptcy arrangements.

Future Interventions

The Mortgage Arrears Resolution Process and the separate Central Bank of Ireland Mortgage Arrears Resolution Targets are now the main mechanisms used by the State to tackle the mortgage arrears crisis.

For some this will mean an extension of their mortgage and may mean paying more in the long run. However, they will avoid repossession and ultimately will keep their home. In other cases the resolution mechanism will mean the loss of the home or property through repossession, or voluntary sale or surrender. The process may also lead to write-downs of debt in some cases especially where there is significant negative equity.

The Joint Committee on Finance, Public Expenditure and Reform recently released its *Report on Hearings on Matters Relating to Mortgage Arrears Resolution Processes* which includes 47 recommendations.[54]

These include that:

- Voluntary sales include a sustainable treatment of any residual debt;
- Commencing legal proceedings be the action of last resort;
- Appeals in the Mortgage Arrears Resolution Processes in individual banks should be adjudicated by an independent third body;
- The interest rate of the warehoused portion of split mortgages should be zero;
- Consideration should be given to a debt-for-equity solution; and,
- The *Mortgage-of-Rent* scheme should be reviewed.

In addition, the resolution process has also raised a number of other policy issues. These include:

- How to address the housing needs of those who lose their homes; and,
- How the tenants of buy-to-lets which are repossessed are dealt with.

Longer term issues with regard to split mortgages and how they are resolved at the end of the mortgage term may also need further consideration.

Corrections and Revisions September 2014

After the initial publication in April 2014 of the Spotlight on Mortgage Arrears it was brought to the Library & Research Service's attention that it included a small number of factual errors. These have been corrected.

The opportunity that these corrections provided also allowed a revision and update of the Spotlight in light of a number of relevant developments in the intervening period including:

- New mortgage arrears data for 2014;
- New Central Bank of Ireland Mortgage Arrears Resolution Targets (June 2014);
- A report on mortgage arrears from the Oireachtas's Joint Committee on Finance, Public Expenditure and Reform (July 2014).

In addition, some other post-publication suggestions aimed at improving the readability of this *Spotlight* were included.

[54] Joint Committee on Finance, Public and Expenditure and Reform (2014) Report on Hearings on Matters Relating to Mortgage Arrears Resolution Processes.