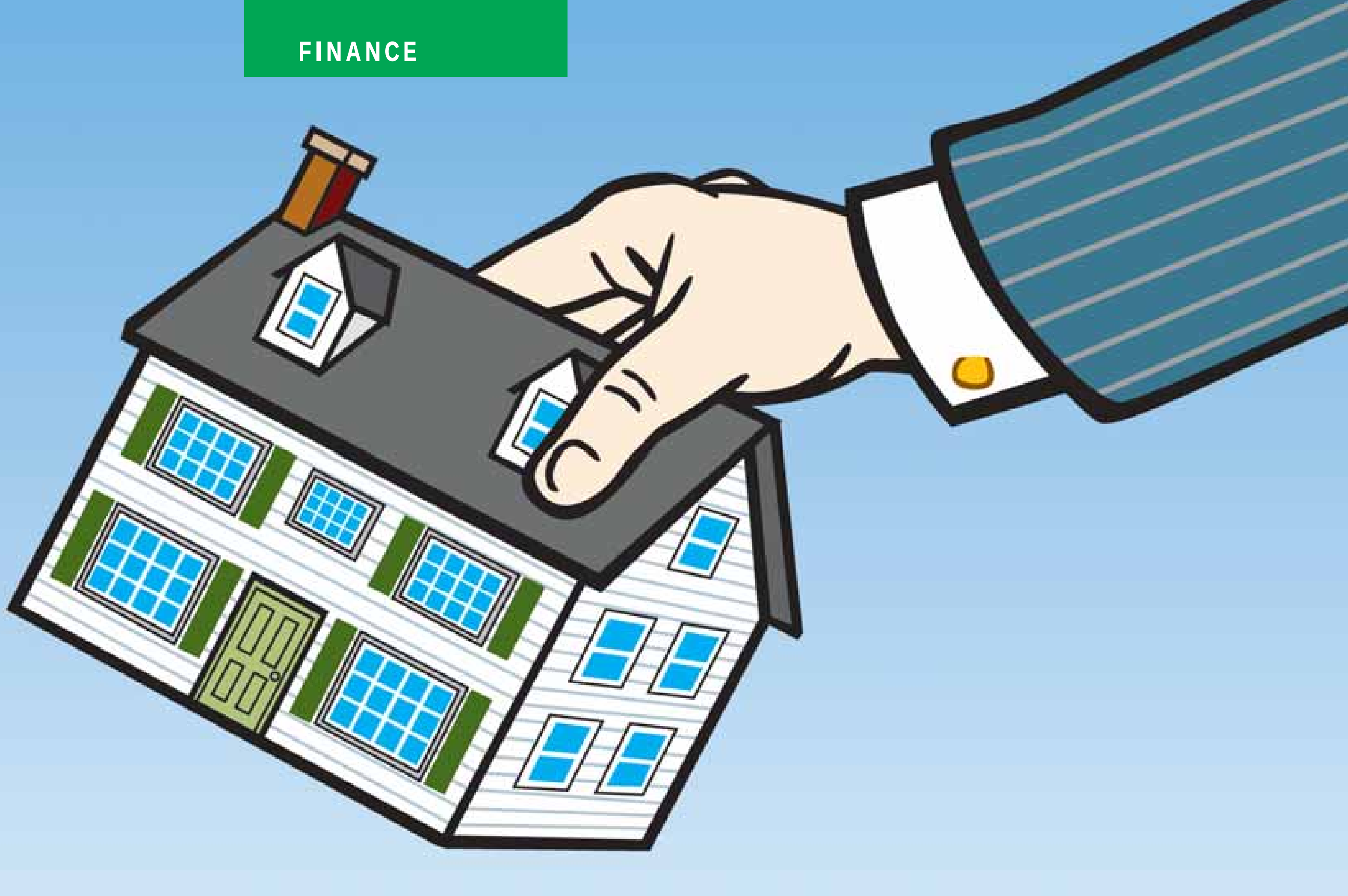

Mortgage arrears

As part of the Government's banking recapitalisation programme, the Financial Regulator has issued lenders with the new Code of Conduct on Mortgage Arrears. The mandatory code came into force earlier this year, but what does it mean for mortgage holders, and does it go far enough?

AT A GLANCE

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Criticisms.

Avoiding arrears.

Figures from the Financial Regulator show that, as of June 2008, 14,000 people, or 1.4% of all residential mortgages, were more than three months in arrears. With sharp rises in unemployment continuing, that number is be bound to be higher when the Regulator compiles figures for the remainder of 2008 and so far 2009 offers little cause for optimism.

Rightly or wrongly, this means that Ireland is likely to see an increase in the future number of house repossessions as mortgage holders fail to meet repayments and slip into arrears. In fact, Irish Life and Permanent, the country's largest residential mortgage provider, reported that in December 2008, 7,900 of 192,000 IL&P mortgages were a month in arrears – an increase of almost 40% over the same period a year earlier.

The new code

Up to now, banks have followed the Irish Banking Federation's (IBF) voluntary Code of Practice on Mortgage Arrears. However, the Regulator's code, which came into force in February of this year is mandatory for the mortgage lending activities of all regulated entities including sub-prime lenders.

The new code specifies how a lender should deal with a mortgage arrears problem, and outlines the procedure to follow on foot of the first missed payment. As soon as this occurs, the lender must communicate promptly and clearly with the borrower to establish the reasons why and also ascertain how the arrears situation can be rectified. All viable options must be examined with consideration to the borrower's repayment capacity, previous payment history as well as any outstanding equity in the property.

If a third mortgage payment is missed, the lender may issue a formal demand for the full arrears amount due or for possession of the property. However, before any demand is made, lenders must ensure that the borrower has been advised in writing of the total arrears payable (plus interest) and give advice regarding failure to pay i.e. the potential for legal proceedings and the loss of his/her property.

If repossession is to be sought, the lender must wait at least six months from the time payment arrears first arise before applying to the courts to commence repossession proceedings. In the cases of Bank of Ireland and AIB Group, institutions which are part of the Government's bank recapitalisation plan, it has been agreed to go beyond the terms of the code and that repossession orders cannot be served on borrowers before 12 months.

Addressing an arrears problem

The new code outlines how lenders should address an arrears problem, taking into account that borrowers have different levels of indebtedness and different abilities to repay their arrears,

AVOIDING ARREARS

- **Overpay when you can** One of the best ways to head off an arrears problem is to overpay your mortgage when you can afford to. The benefits of overpaying are clear. Firstly, if you never experience repayment problems you will pay less in interest and be mortgage-free sooner. Paying an extra €50 a month on a €250,000 mortgage at a rate of 3.8% over 25 years will save over €9,000 in interest and clear the mortgage 18 months earlier. However, if at some stage you find yourself unable to make your monthly payment, by overpaying in the past you have given yourself some flexibility to get back on track. With the ECB currently cutting rates, now is a good time to divert those savings into your mortgage. There is one crucial caveat, though; speak to your bank first as sometimes overpaying can incur a penalty.

- **Pay fortnightly** Making mortgage payments every two weeks as opposed to once a month is the equivalent of making one extra monthly payment a year. As with overpaying your mortgage, this can help you build up a buffer against arrears and clear your debt sooner. However, not all lenders provider this facility, so being able to pay fortnightly depends on your mortgage provider.

- **Switch lenders** If you are having, or think you will have trouble meeting your mortgage payments, then it is wise to compare the market and see if you can get a better interest rate from another lender. Unfortunately, in the current climate there are fewer switching opportunities out there, as many banks have withdrawn their switching products. However some, such as Halifax, will still pay for the costs of switching. For a €250,000 mortgage over 25 years, switching from a 4.2% rate to 3.6% saves €82 a month.

- **Rent a room** Did you know that you can earn up to €10,000 per annum, tax free, by renting out a room in your home? While you should declare the income to the tax authorities, income from the 'rent a room' scheme is not counted for tax purposes and the agreement is not covered by landlord/tenant legislation in Ireland. Of course, sharing your home is not ideal but if you are facing the prospect of mortgage arrears it can be a useful source of income to bridge a difficult financial gap.

- **Go interest only** Provided your lender agrees, paying only the interest portion of your mortgage can result in a much lower monthly payment and stave off the threat of falling into arrears. A mortgage of €250,000 at a rate of 4.2% over 25 years costs €1,347 a month to repay both interest and the capital sum. However, the interest-only repayment is €875. Similarly, renegotiating with your lender and extending the mortgage repayment term should also be considered if you feel you may fall behind in your payments.

making each case unique. However, lenders must explore the following alternative repayment measures:

- Changing the monthly repayment amount to an affordable amount for the lender
- Deferring payment of all or part of the monthly payment where there is a temporary shortfall in income
- Extending the term of the mortgage and reducing the monthly payment.
- Changing the type of mortgage that the borrower has (e.g. interest only) if this results in a lower, affordable, monthly repayment amount
- Rolling over the unpaid arrears and interest into the outstanding capital sum owed on the mortgage. This should be considered where a pattern of payment has been established and where sufficient equity exists

Lenders must not seek repossession of a property until every reasonable effort has been made to agree an alternative repayment schedule and borrowers must be made aware of other options such as refinancing through another lender or downsizing. Where repossession does occur, the lender remains liable for the outstanding debt plus costs and charges, irrespective of how the property is disposed of.

Criticisms of the code

The Free Legal Rights Centre (FLAC), has criticised the new code saying it is "deeply disappointing and represents even less protection for consumers than the draft code". FLAC also criticised the code for being vague, ambiguous and difficult to enforce, saying "The code gives guidance to lenders, urging them to deal sympathetically with borrowers in difficulty, but allows a number of escape routes for lenders who wish to short circuit the code." It was also pointed out that the code allows lenders to start repossession proceedings six months after a single missed payment – not after six full months of mortgage arrears.

The housing charity Focus Ireland has also criticised the new code, warning that a 6-month delay in legal action by banks would not effectively protect borrowers who fall into mortgage arrears due to the recession. Focus Ireland had called for an automatic two-year moratorium on home repossessions and has said that, "the fundamental position must be that no one should become homeless because of the recession, no matter what type of accommodation they are living in - be it rented or as a mortgage holder."

When contacted, a spokesperson for the IBF pointed out to *Consumer Choice* that too long a moratorium on home repossessions can in fact result in mortgage loans being rated excessively negatively by the international credit market. This is turn can lead to "higher rates for the customer or a reduced availability of mortgage credit in an increasingly risk averse market."

Report by Mark Channing CC

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Useful websites

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choice comment

Recent data published by the IBF shows that house repossession levels remain very low level in Ireland with the total number of repossessions only 0.01% of the total number of mortgages in issue. That said, arrears statistics are increasing and it may be 2010 or later before the full extent of any repossession problem becomes clear. That is why the Regulator's new code of practice is welcome as it provides a mandatory set of principals that lenders must follow in arrears cases. However, the code has attracted criticisms from both FLAC and Focus Ireland as being vague and not going far enough to prevent a property from being repossessed. Therefore it is important that the Regulator monitors market developments closely and quickly introduces amendments to the code if necessary.