REPOSSESSIONS TASKFORCE

INITIAL EVIDENCE PAPER: NEGATIVE EQUITY, ARREARS AND POSSESSIONS IN NORTHERN IRELAND

The Repossessions Taskforce

1. The Minister for Social Development established a Repossessions Taskforce, composed of people with knowledge and expertise from across a range of sectors to investigate the impact of negative equity, repayment arrears and possessions in Northern Ireland (NI).

2. The first phase of the Taskforce's work has made use of available data sources and the expertise of members to present the negative equity, arrears and possessions landscape in Northern Ireland. Outcomes from this research will inform the second phase of developing evidence-based recommendations for potential mitigating actions by the end of this year.

3. Throughout this process the Taskforce will seek to affirm the validity of its understanding and explore additional sources of information. Sector specific groups and members of the public are invited to actively and constructively participate in the testing and improvement of this evidence base.

The Northern Ireland Context

4. The scale of recent momentum in areas of England's housing market has not been replicated in NI. Rather, the NI landscape continues to be shaped by the legacy of the dramatic rise and fall in house prices. Understanding the makeup of the problem in NI and the extent to which this is distinct from the aggregate UK picture is of central importance to policy makers, particularly as interest rates and lenders' forbearance policies are expected to change.

5. While the cyclical characteristics of housing markets are familiar to many homeowners in Great Britain (GB), NI had not previously experienced these trends. There is a 'lack of consensus around the precise reasons why such volatility occurred, but essentially a series of processes and events coalesced

to produce a very different housing market to what had gone before' (Wallace, 2014).

6. In 2007 house prices in NI were surpassed only by London, the South East and the East regions of the UK. However, this rapid ascent of prices was not supported by regional wage growth. At their height house prices represented more than nine times the median salary and average mortgage repayments consumed 64 per cent of incomes (LPS/NISRA, 2014; Halifax House Price Index).

7. The artificially inflated and unsustainable nature of the market has led to a crash which is unprecedented in its severity. From a position at the higher echelons of UK house prices, NI is now the least expensive region of the UK and house prices remain 50 per cent below their 2007 peak (Nationwide, 2014).

8. The housing market is currently demonstrating signs of stabilising; however, the magnitude of the crash has entrenched a series of complex problems. The position of many borrowers, households and communities continues to be blighted by negative equity, repayment arrears and the risk of possession. The prevalence and significance of these issues position them as the core themes and central focus of this initial evidence paper.

9. These themes are multifaceted in nature and not mutually exclusive. Rather than operating in a linear process, the themes can undermine the position of borrowers and the market in an integrated fashion. This chaotic relationship often complicates understanding of the balance of individual influences between the themes. This complexity is magnified by the data limitations existing at a regional level.

Data Availability and Limitations

10. Building a picture of who is at risk, where they are and the reasons why they have found themselves in difficulty is complicated by the limited availability of data sets specifically relating to NI. Commentary and analysis produced by the Financial Services Authority (FSA), Financial Conduct Authority (FCA), the Bank of England and the Council of Mortgage Lenders (CML) provide a

comprehensive aggregate picture of the UK housing market, with a regional perspective only included on selected issues. Despite these limitations it is possible to build working assumptions from the aggregate UK data to supplement the body of evidence which exists for NI.

11. A similar exercise is also possible based on the experience of the Republic of Ireland (RoI). While the regulatory environment, currency and underlying structural problems are distinct in the RoI, the optimism bias of borrowers and lenders, supported by a perception that 'this time is different' were key drivers of behaviours and price inflation in both the RoI and NI. On the basis of this behavioural synergy it is also appropriate to utilise, where appropriate, the extensive analysis completed by the Central Bank of Ireland and Irish academics to support understanding of the NI landscape.

Borrower Profiles

12. 'In a distressed market situation, it is the distribution across the population of mortgage holders which is of interest, particularly the characteristics of those in the "tails" of the distribution' (Kennedy and McIndoe Calder, 2011). While data limitations for NI complicate this exercise, it is possible to construct an understanding of the high risk groups.

13. Those most likely to be in difficulties are at the lower end of the income range at which home ownership is possible, were 'credit hungry' during the period of relaxed underwriting standards, are financially overstretched investors, have been made redundant or had their income reduced, are in fragile employment, have experienced relationship breakdown, lack basic financial capability and/or have significant other debts (House of Commons Treasury Committee, 2009; McCarthy, 2014).

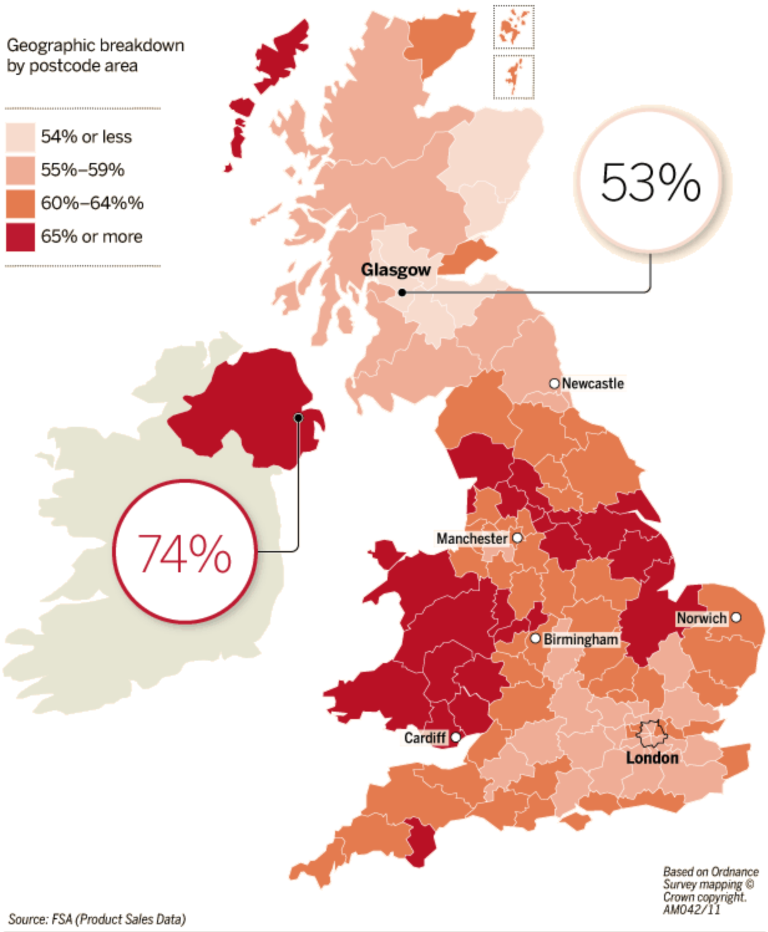
14. Many borrowers experiencing difficulties also have poor quality loans. As a result they exhibit higher mortgage costs as a proportion of their monthly income and have lower levels of monthly income (Gathergood, 2009). This is particularly relevant to NI, where a greater proportion of head of households are

homeowners in the lower supervisory and semi-routine social classes than across the UK (Wallace, 2014).

15. Affordability constraints in NI may have limited the number of first-time-buyers (FTBs) entering the housing market. However, these constraints presented a set of perceived investment opportunities for many people in NI. Possibly reflecting the popularity of buy-to-let (BTL) mortgages, interest only (IO) loans represented 41.7 per cent of all loans during the period of rising prices (Wallace, 2014).

16. 'Remortgaging activity in Northern Ireland has been consistently below [the level] across the UK' and has largely been amongst the region's middle and higher income homeowners (Wallace, 2014). Despite this overall regional comparison it is appropriate to recognise a proportion of borrowers in NI have become over-indebted and entered distress as a result of remortgaging. Of those borrowers who did remortgage at the height of the housing boom in 2007, three in four transactions were used to raise extra funds. Borrowers in the region 'took advantage of the availability of cheap credit to consolidate their debt or spend money on home improvements or other purposes such as to finance buy-to-let properties' (Cohen et al, 2011). This category of 'credit hungry' borrowers was disproportionately active in NI and is particularly at risk in the current market environment.

Remortgaging where borrowers withdrew equity as a percentage of all remortgaging in 2007 (Cohen et al, 2011)



17. A significant proportion of borrowers in NI, particularly lower income groups, have also become over-indebted through second charge and unsecured loans. The qualitative evidence suggests that over indebtedness through second charge and unsecured loans is a particular issue amongst homeowners who exercised their 'right-to-buy'.

18. The distinctions between the borrower categories reflect differences in how the housing market was viewed, which in turn can influence the financial resilience of borrowers. 'Seeing the house as a home, rather than a financial asset to be used, [has] offered a protective quality to homeowners in adverse economic circumstances. Those who had incorporated their housing equity into their financial plans or expectations, [are now], understandably, the most anguished by the housing market downturn' (Wallace, 2014). The buy-to-let and equity

release borrowers are overly represented within this latter group, who viewed property in terms of its 'asset-value' rather than its 'use-value'.

19. A more complete breakdown of the borrower categories, repayment terms and interest types is hindered by the availability of loan level data for the region. Similarly, the provision of a complete profile of borrower characteristics and, specifically within an NI context, an illustration of Section 75 groups, is difficult due to the limited availability of borrower level data. However, building an understanding of those affected will be a key pillar of the Taskforce's continued review, testing and improvement of its understanding of the regional landscape.

20. While a profile of risk is informative, distressed borrowers are not a homogenous group. Borrowers may simultaneously present a number of these characteristics which reflect their individual circumstances. This multifaceted and individualistic nature of circumstances is an important feature of the housing market crash. A key theme which does often unite borrowers in distress is the presence of negative equity.

Negative Equity

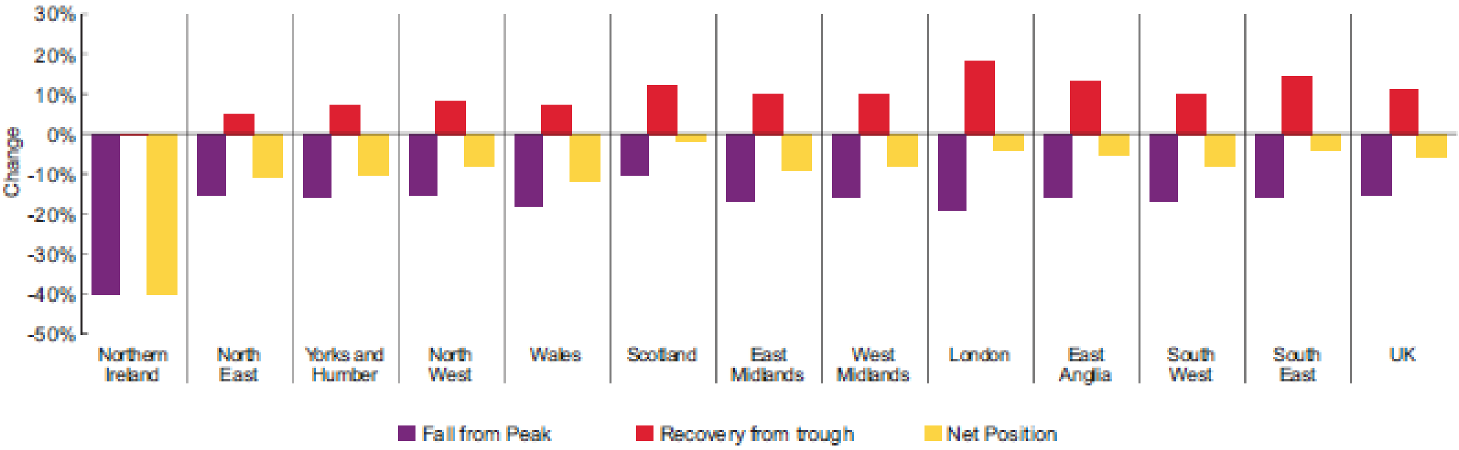
21. High house prices within an environment of relaxed credit conditions and weak regulatory oversight will inevitably influence loan-to-value (LTV) ratios. In 2000 two per cent of Irish mortgages had LTV ratios over 0.94, by 2006 this had increased to 15 per cent. Similarly, across the UK, 15 per cent of gross mortgage lending in the middle of 2007 was advanced to borrowers with a 90 per cent LTV ratio or higher (Whittaker, 2014).

22. During the boom, the high house price to earnings ratio demonstrates NI borrowers' need for large scale loans, access to which was facilitated by relaxed credit conditions and encouraged by the behaviours of peers. Consequently, a similar LTV trend to that experienced in the RoI and the UK is likely to have occurred at a regional level in NI.

23. High LTV ratios during periods of high house prices leaves borrowers with low equity buffers should prices begin to fall, which proceeded to happen with

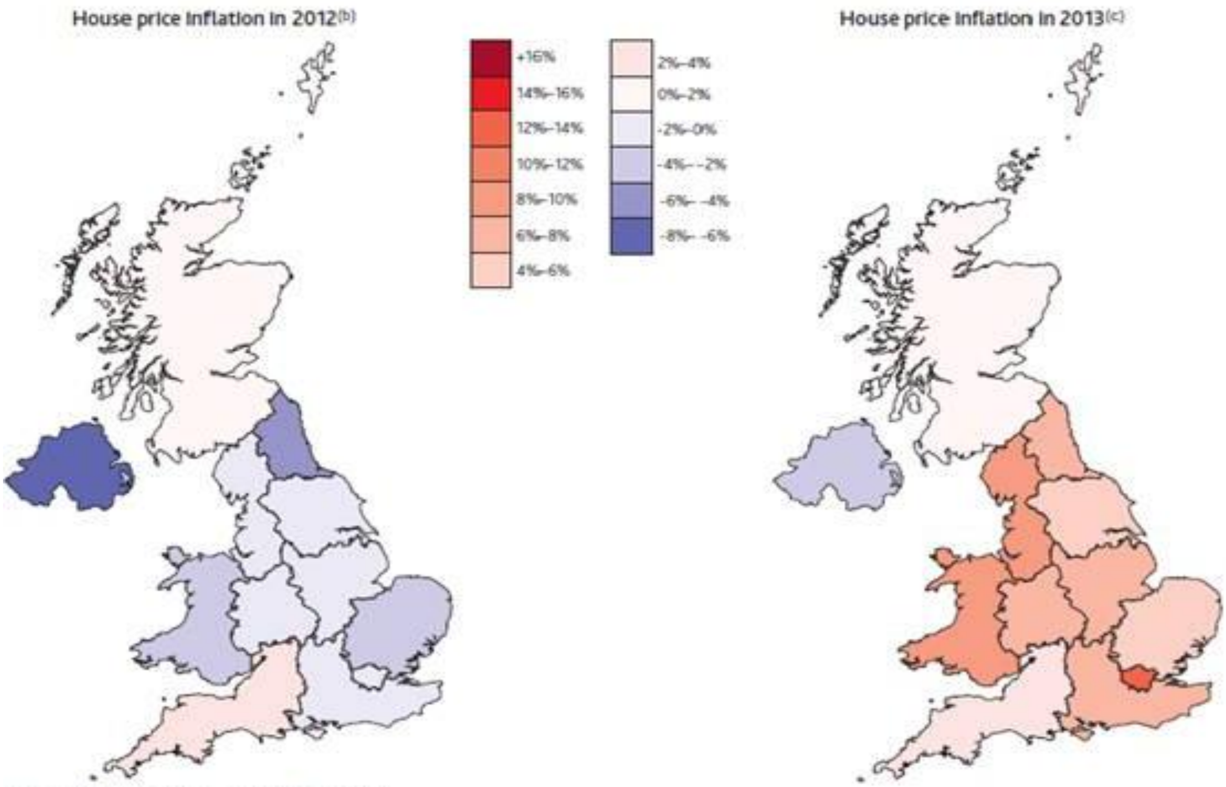
emphatic force. The graphics below aptly illustrate how the severity of the house price decline and sluggish recovery in NI distinguishes it from all other regions of the UK.

Regional House Price Falls from peak and Recovery from Trough (FSA, 2011)



Source: Department for Communities and Local Government, FSA calculations
Note: Calculations based on December 2010 data. Recovery from trough not included for Northern Ireland as house prices are still falling.

Annual House Price Inflation in 2012 and 2013 across the UK (Bank of England, 2013)

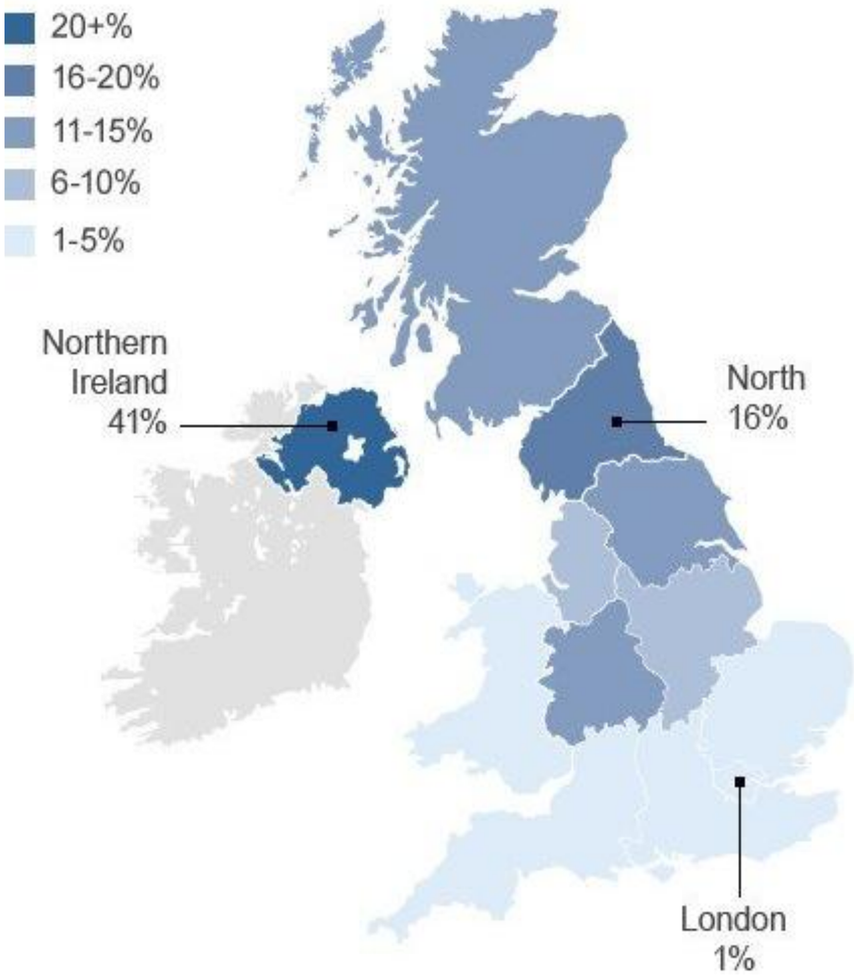


Sources: Halifax, Nationwide and Bank calculations.

(a) The stylised maps show the average of the Nationwide and Halifax regional house price series.
(b) The 2012 map shows house price inflation between 2011 Q4 and 2012 Q4.
(c) The 2013 map shows house price inflation between 2012 Q4 and 2013 Q3, scaled to an annual rate.

24. The presence of high LTV ratios and low equity buffers, followed by a dramatic decline in prices has entrenched many borrowers in negative equity. Research completed by HML on behalf of the BBC, which highlights that 41 per cent of borrowers with mortgages advanced since 2005 are burdened with low or negative equity, demonstrates the extent to which NI is distinct from the rest of the UK.

Percentage of Borrowers in Negative Equity (Milligan, 2014)

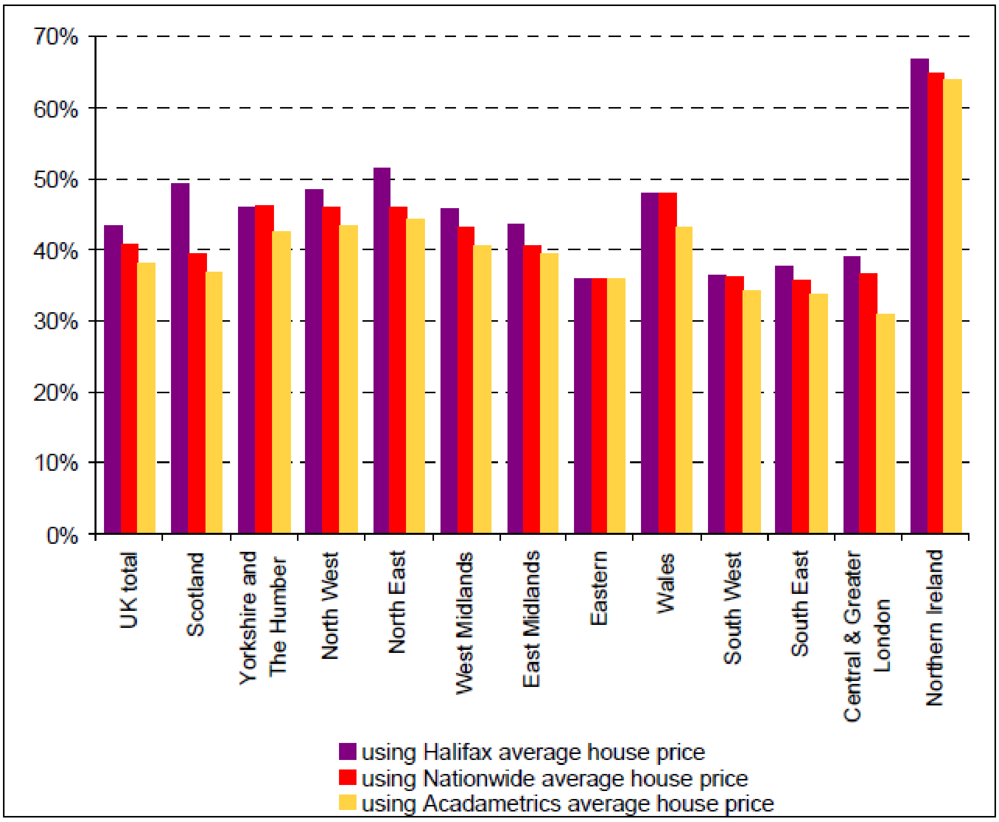


25. Negative equity within the region is concentrated in a particular profile of borrowers. Single people, couples with no children, borrowers with one or two bedroom properties, those who purchased after 2005, borrowers who remortgaged and those in intermediate or professional occupations have been found to be most affected (Wallace, 2014).

26. Borrowers in negative equity are often unable to improve their position by remortgaging for a better deal or moving house. The FSA's Mortgage Market

Review estimated that over 60 per cent of NI borrowers who had taken out a mortgage since 2005 could be 'mortgage prisoners' (FSA, 2012). These estimates were echoed in research completed by the Resolution Foundation, which found 57 per cent of NI borrowers are unable to access market based options for re-structuring (Whittaker, 2014). In both of these assessments NI is significantly more affected than other regions of the UK.

Mortgage Prisoners by Region (FCA, 2012)



27. Further to the prevalence of negative equity being greater in NI, the value is also significantly higher. At £35,162, the mean negative equity held by homeowners in NI is twice that of UK homeowners (Wallace, 2014). Within the region, 'the greatest incidence and value of negative equity was found among homeowners in the bottom income quintile' (Wallace, 2014).

28. The incidence and value of negative equity in NI has undermined market mobility as 'mortgage prisoners' are unable to 'move-up' the property ladder. While the fall in prices has allowed many first-time-buyers (FTBs) to access the market and subsequently driven the rate of mortgage lending in the region, the

low levels of upward mobility continue to define NI as a dysfunctional market environment.

29. Beyond inhibiting mobility, research completed by the Central Bank of Ireland has found that 'housing equity has a positive and significant impact on the probability of experiencing mortgage arrears' (McCarthy, 2014). Within the RoI context, moving from a current LTV of below 50 per cent to between 100-120 per cent increases the probability of default by eight per cent. A worsening of position to a LTV of over 120 per cent increases the probability by 11 per cent (Lyndon and McCarthy, 2010). The Central Bank of Ireland's analysis demonstrates that negative equity not only limits borrowers' ability to improve their position, it also deteriorates (either directly or indirectly) their ability-to-pay.

Ability-to-pay

30. For many borrowers who do not need to move and can afford their monthly repayments negative equity will progressively become less of an issue. However, this attritional approach can be undermined by pressures on homeowners' ability-to-pay. The Central Bank of Ireland has illustrated the potential impact of negative equity; however, within this financial crisis over indebtedness has been found to be the most significant negative influence on borrowers' ability to meet their monthly repayments.

31. The scale of over indebtedness for a number of borrowers is heightened due to second charge and other unsecured loans. In many cases these tiers of debt exposure and vulnerability are not mutually exclusive. The Bank of England's Financial Stability Report highlights that highly geared households also tend to hold higher levels of unsecured debt, thus further increasing the likelihood of arrears and possession (Bank of England, 2013).

32. The continued binding relationship many borrowers have with credit is supported by the Consumer Council's finding that 'credit and borrowing was a major aspect of the way [NI consumers] live at the moment' (Consumer

Council, 2012). This relationship is confirmed by 56 per cent of NI consumers using some form of credit within the past year (DETI, 2013).

33. Despite a reliance on credit, borrowers often lack basic financial literacy skills. Within NI, 17 per cent of borrowers do not understand the terms and conditions of their current mortgage; this proportion increases to 28 per cent for lower income households and 29 per cent for 61 to 70 year olds (Ipsos Mori, 2012). The absence of financial capability is also illustrated by many customers of Housing Rights Service's Mortgage Debt Advice Service (MDAS) failing to appropriately prioritise their debt. This failure to recognise, engage and prioritise frequently leads to a worsening of the borrower's position.

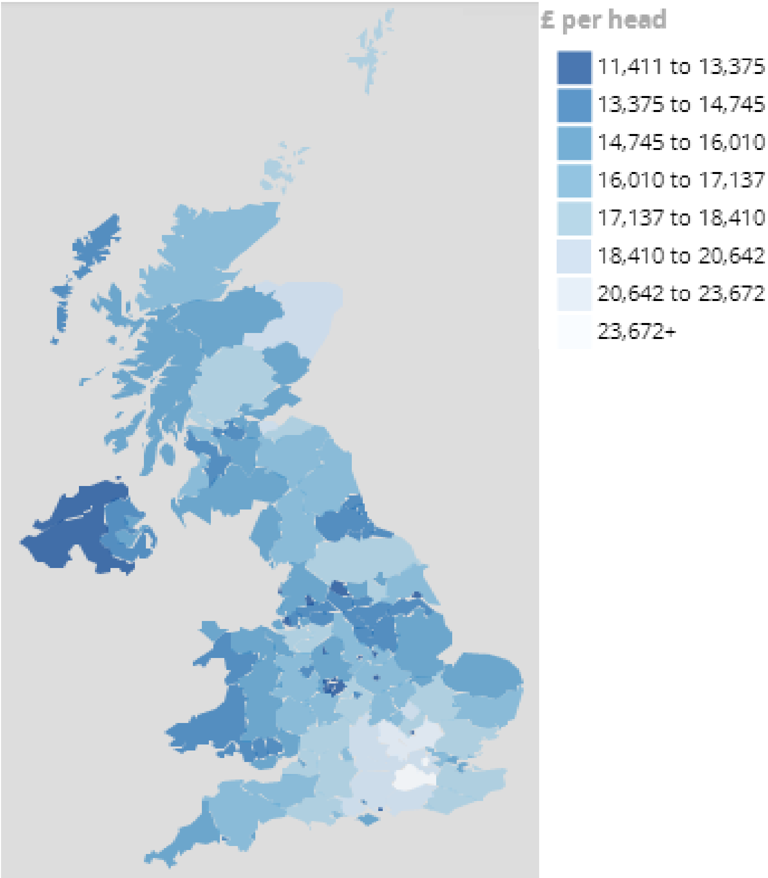
34. Consumers are also being challenged by the impact of inflation on their spending power and continue to feel the squeeze of rising living costs. Poorer households have been particularly impacted as a result of rising food and energy prices. PwC analysis outlines that 'consumer prices facing the poorest 10 [per cent] of households have risen by around 40 [per cent] since 2003, as compared to a 32 [per cent] cumulative rise in prices of the households with the highest income levels'. This 'inflation gap' equates to an extra cost of around £20 per week for the poorest households (PwC, 2014). The impact of inflation on borrowers, especially those in the lower income deciles, is increased by the level of regional earnings.

35. Median gross weekly earnings in NI continue to lag behind the UK average. Across all NI households the 2013 Annual Survey of Hours and Earnings (ASHE) showed a slight increase in the median gross weekly earnings to £367; however, this only represents 88.1 per cent of the UK average. The median gross weekly earnings for full-time employees in NI was the lowest of all of the UK regions in 2013, leading to a widening of the full-time pay gap to 88.9 per cent of the average UK figure. These income levels undermine many households' ability to meet the rising cost of living. As a result, 'less than half of NI consumers are keeping up with bills and financial commitments without difficulty' (Consumer Council, 2014).

36. The impact of inflation and the performance of regional earnings has shaped the disposable income available to borrowers. At a UK level 16 per cent of mortgage debt is owned by households with less than £200 remaining per month after housing costs and essential expenditure, and a third is owned by households with less than £300 remaining (Bank of England, 2013).

37. Similar pressures on disposable incomes are also evident in NI. In 2012 the average person in NI experienced the lowest growth in Gross Disposable Household Income (GDHI). This low growth has maintained the position of NI's households as having the smallest amount of money to save or spend in the UK. At a sub-regional level all of NI's NUTS3 regions were below the UK average, with the West & South and North regions particularly disadvantaged compared to the rest of the UK (ONS, 2014).

NUTS3 regions' GDHI per head (ONS, 2014)



38. Over-indebtedness, inflation and limited disposable incomes are impacting on borrowers' savings, which have historically been a central tenet of households' response to income shocks. The reduction of the UK saving ratio from 7.2 per

cent to 5.0 per cent in 2012 reflects the pressures households are facing (OBR, 2014). The pressure on borrowers' savings is further demonstrated in Shelter's recent poll which found that a quarter of UK workers 'had no savings at all and would immediately find themselves struggling to keep up with housing costs if they lost their job. Four in ten could cover less than one month's rent or mortgage payment, rising to six in ten after three months'. This has led to Shelter highlighting the 'financial knife-edge' on which many families' are currently living (Webb, 2014). .

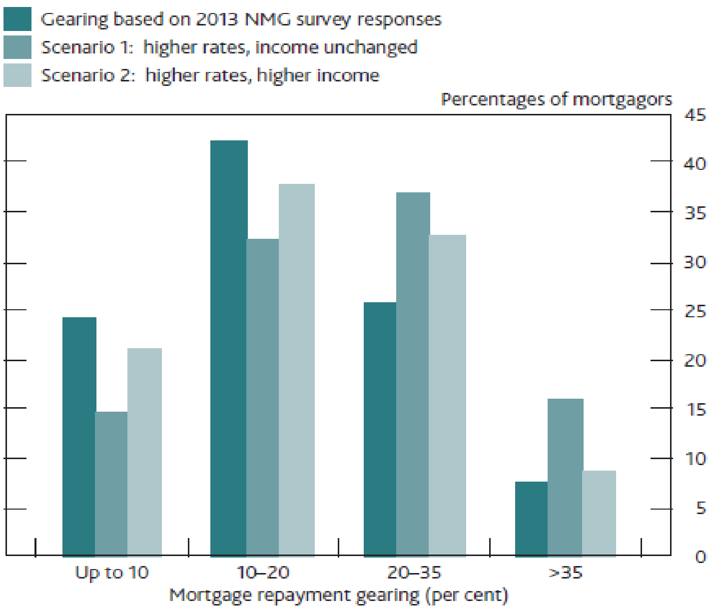
39. In November 2013, it was estimated that within 27 days of losing their usual source of income the average NI household would become reliant upon state benefits or family support; this resilience has decreased from 34 days in June 2013 (Legal & General, 2014). While these average figures are informative, a small proportion of borrowers with large savings can distort the picture and mask a large number of borrowers with little or no savings.

40. The proportion of borrowers at the fragile end of the savings spectrum is a particular issue in NI, where 52 per cent of households reported having no savings compared to 32 per cent across the UK (DETI, 2013). This trend illustrates that NI homeowners have not adjusted their saving behaviours to compensate for the loss of housing wealth. Consequently, a significant cohort is 'vulnerable to future shocks as they have little or no savings or pensions' (Wallace, 2014).

41. Over-indebted groups unsupported by wage growth, pressurised by inflation and holding little or no savings are highly exposed to interest rate increases, income and expenditure shocks and changes to credit conditions which could further reduce their ability-to-pay. Frequently borrowers in the region do not appreciate their exposure to the risk, with 31 per cent of borrowers not considering how losing a job, a change in interest rates, illness or a change in family circumstances would affect their ability to repay a loan or mortgage before applying (Ipos Mori, 2012).

42. The sensitivity of borrowers to future income shocks, in particular interest rate rises, would be much less severe if incomes also rose significantly. Analysis by the Bank of England indicates that 8 per cent of UK borrowers currently make mortgage repayments above 35 per cent of pre-tax income. Should interest rates rise by 2.5 percentage points and incomes remain unchanged, this figure is expected to rise to 16 per cent. However, should an interest rate rise be accompanied by incomes increasing by 20 per cent the proportion of highly geared borrowers would fall to 9 per cent.

Sensitivity of the Distribution of Mortgage Repayment Gearing to High Interest Rates[(a)] (Bunn, 2013)



Sources: NMG Consulting survey and Bank calculations.

(a) 'Scenario 1' denotes the distribution under an assumed 2.5 percentage point increase in interest rates with income unchanged from its current level.
'Scenario 2' denotes the distribution under both an assumed 2.5 percentage point interest rate increase and a 20% income rise. The two scenarios assume full pass-through of higher interest rates to all mortgagors. The assumptions listed in footnote (2) also apply.

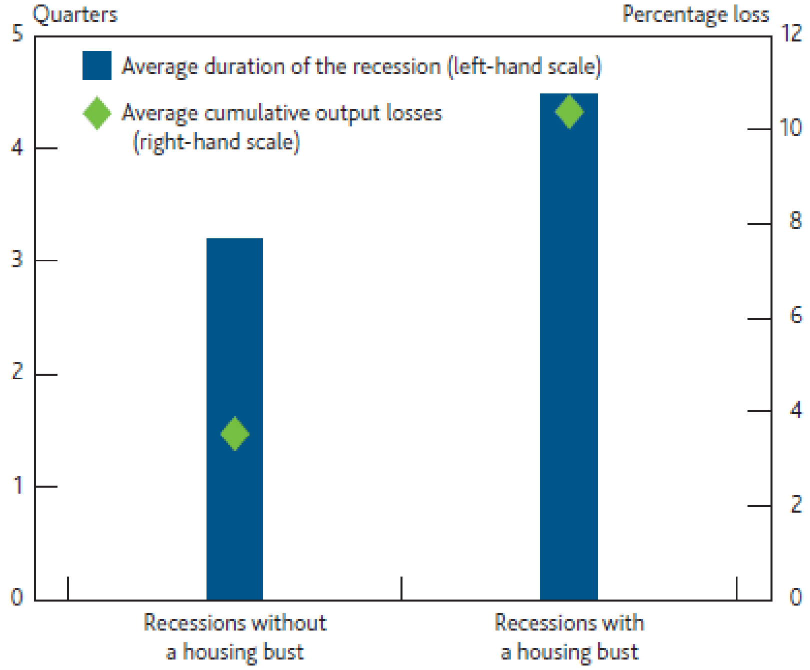
43. Recent economic trends in NI indicate that a rise in interest rates is more likely to 'occur against a backdrop of subdued economic activity and weak income growth' (Bank of England, 2013). Between 2006/07 and 2011/12 median household incomes in NI fell by just under 10 per cent, compared to seven percent in the UK as a whole. For those within the lower income brackets these falls and the gap with the UK were even more pronounced. The incomes of the bottom fifth in NI experienced a 16 per cent fall, compared with around 5 per cent in the UK; for the bottom third, the declines are 13 per cent and seven

per cent respectively (JRF, 2014). As NI homeowners are more likely to be on lower incomes and in more routine occupations, they have been particularly affected by the impacts to the lower income deciles.

44. During this period the NI labour market has also experienced a greater increase in underemployment, a larger proportion of people unemployed for more than two years and a sharper rise in the number of families where the main earner was self employed than in the UK. These trends 'point to a decrease in the number of families on higher incomes in NI and an increase in the number on low incomes. This happened across the UK, but was most pronounced in NI' (JRF, 2014).

45. As housing busts are associated with more persistent and severe output losses (IMF cited in Bank of England, 2013; Reinhart and Rogoff, 2009), the speed at which the NI economy will reverse these trends and transform the position of borrowers is likely to be incremental.

Duration of Output Losses of OECD Recessions, 1960-2007 (Bank of England, 2013)



Sources: IMF *Global Financial Stability Report* (April 2011) and Claessens, S, Ayhan Kose, M and Terrones, M E (2009), 'What happens during recessions, crunches and busts?', *Economic Policy*, Vol. 24, pages 653–700.

46. The ability of the economy to reduce the sensitivity of borrowers to future income shocks is further undermined by the levels of inactivity, real wage

growth and productivity growth. In this light the NI economy remains some distance away from reaching Governor Carney's 'escape velocity'. Despite NI borrowers being poorly equipped to absorb future income shocks, households should expect a certain but gradual increase of interest rates.

47. The extent to which NI borrowers are exposed to future income shocks is illustrated by the proportion of highly geared mortgages in the region. Around 15 per cent of borrowers currently spend a third or more of their after-tax income on mortgage repayments. Should interest rates rise in line with the Office for Budget Responsibility's (OBR) projections the proportion of highly geared borrowers in the region is expected to rise to 26 per cent by 2018 (Whittaker, 2014). While the proportion affected will continue to be largest in the lowest income deciles, the range of borrowers affected by high repayment gearing is expected to climb the income scales.

Affordability Among UK Households, by Income Deciles: 2014 & 2018 (Whittaker, 2014)

		Decile 1	Decile 2	Decile 3	Decile 4	Decile 5	Decile 6	Decile 7	Decile 8	Decile 9	Decile 10
Affordability	Highly geared households in 2014 (base rate at 0.5%)	290,000 61%	110,000 27%	90,000 18%	110,000 18%	100,000 14%	100,000 11%	100,000 9%	110,000 9%	70,000 5%	70,000 5%
	Highly geared households in 2018 (base rate at 2.9%)	370,000 77%	170,000 41%	170,000 34%	210,000 34%	210,000 28%	260,000 28%	230,000 22%	280,000 24%	250,000 18%	180,000 12%

Notes: All figures are shown as a proportion of the total population of households with mortgages within the specified income decile, with the ten groups being defined on the basis of equivalised net household income. 'Highly geared' covers those spending 33% or more of their income on repayments. Modelling is based on the assumption that the Bank of England base rate rises in line with current market expectations (reaching 2.9% by 2018) and that household incomes rise in line with OBR projections, but with variation across the income

Source: Resolution Foundation modelling using DWP, *Family Resources Survey* and OBR, *Economic and Fiscal Outlook March 2014*

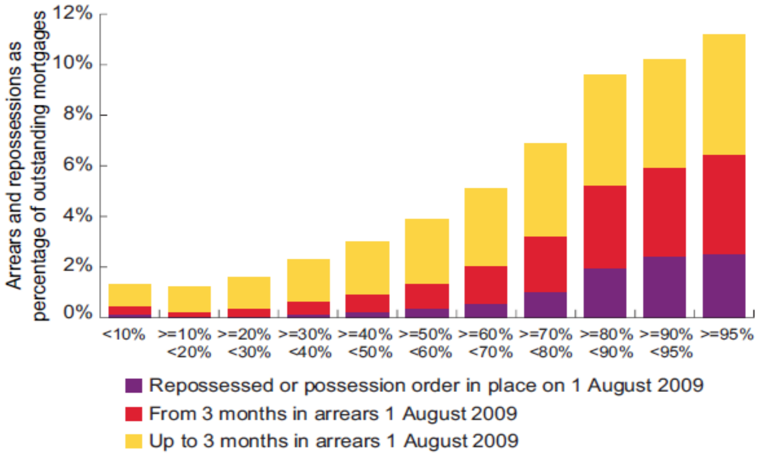
48. 'Despite an extended period of low bank base rates, household debt-to-income ratios remain high and unsustainable levels of debt remain a key driver of financial distress for UK borrowers' (FCA, 2014). In NI these unsustainable levels are underpinned by subdued economic activity and weak income growth. These dual impacts have profoundly influenced borrowers' ability-to-pay, resulting in many households being burdened with sizeable arrears.

Arrears

49. Arrears rates in the UK are higher for borrowers with high LTV ratios, buy-to-let loans, where income was self certified and where loans were made to customers with impaired credit histories (FSA, 2011). Borrowers in regions that have suffered more severe economic shocks are also more likely to be in arrears (Lyndon and McCarthy, 2011).

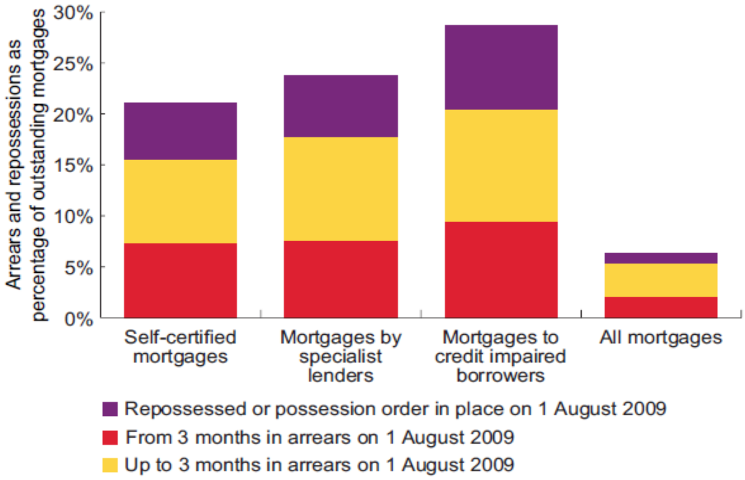
Performance of Mortgages Sold by LTV and Type (FCA, 2012)

Performance of mortgages sold by loan-to-value band between April 2005 and March 2009



Source: FSA (Product Sales Database and Arrears Dataset). The sample contains around 70% of all regulated mortgages sold between 1 April 2005 and 31 March 2009. We measured performance of these loans on 1 August 2009. See CP10/16, Annex 3, Section 7 for the 'Notes on data and methodology' www.fsa.gov.uk/pubs/cp/cp10_16.pdf

Performance of mortgages sold by type between April 2005 and March 2009



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50. The profile of arrears also indicates that sub-prime borrowers are four times more likely to experience default than borrowers in the mainstream market (Stephens & Quilgars cited in Wallace, 2014). While some borrowers will have been exposed to subprime lending, NI's overall exposure is considered to be less severe than other areas of the UK (Keasy and Veronesi, 2012).

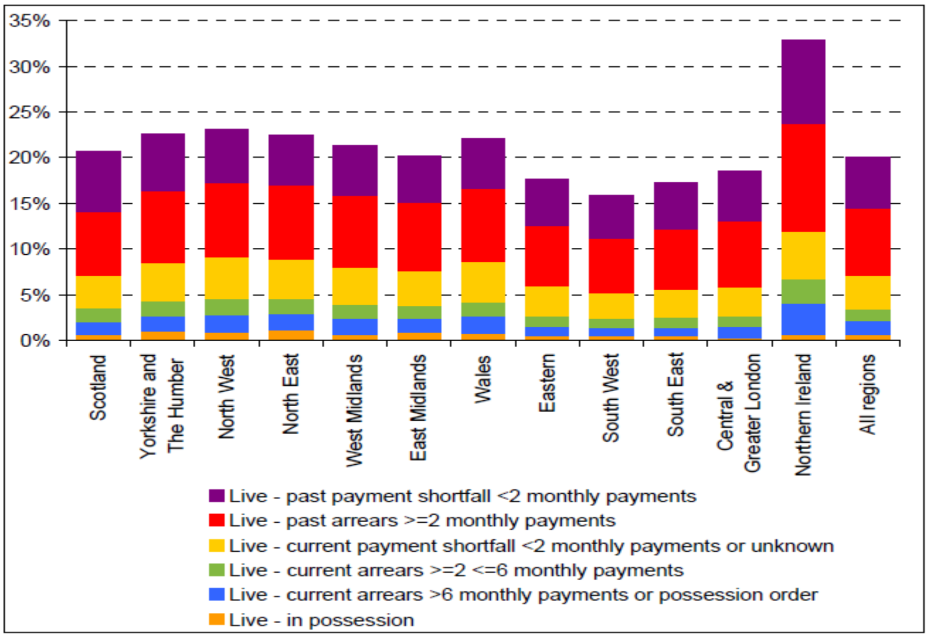
51. From this profile of UK arrears the prevalence of BTL arrears is particularly relevant to NI. Soaring prices in the region excluded many FTBs from entering the housing market. The subsequent increased demand in the private rental sector spurred the market's appetite for BTL loans. NI now has the highest rate of BTL arrears in the UK (Wallace and Rugg cited in Wallace, 2014), which is likely to be linked to the surging popularity of investment opportunities during the period of rising house prices.

52. Borrowers with IO loans are also a group at risk of encountering arrears when their mortgage matures. Across the UK the FCA estimates that 90 per cent of borrowers have a repayment strategy for their IO loan. However, just under half of all IO borrowers are likely to encounter a shortfall, of which one-third are expected to be over £50,000. Mortgages opened from 2005 to 2008 are particularly affected as there are concentrations of highly indebted individuals with low or negative equity within this tranche of borrowers (Experian, 2013; FCA, 2013).

53. 'While NI's homeowners, lower income homeowners in particular, made less frequent use of interest only terms than in the UK..., as the housing market fell more affluent homeowners have been able to convert to repayment loans at a greater rate than lower income ones, who are more frequently left on interest only terms and the incumbent risk of non-payment' (Wallace, 2014).

54. Across the range of arrears profiles there has been a tangible rise in the number of customers with long-term arrears. 'The sizeable income shocks Irish [and NI] borrowers have faced in recent years means that there is likely to be a large group of borrowers amongst those in deep arrears that are in a long-term unsustainable debt position' (Lydon and McCarthy, 2011). Grasping the level of arrears and, in particular, the 'deep arrears' at a regional level of critical importance. A comparative view of regional arrears is provided in the FCA's Mortgage Market Review, which lucidly illustrates the scale of the problem in NI.

Regional Mortgage Performance (FCA, 2012)



Note: This Exhibit shows performance of mortgages sold in April 2005 - December 2011 that were outstanding as at March 2012 when performance was measured.

Source: PSD Performance data 2012

55. While the data specifically relates to mortgages sold between April 2005 and December 2011, research based on the British Household Panel Survey (BHPS) has shown that 70 per cent of repayment problems occur within five years of purchase and 90 per cent are within eight years (Gathergood, 2009). Therefore, the FCA's exercise is likely to be an accurate representation of arrears across the NI market. From this snapshot it is possible to build working assumptions on the future sustainability of the market.

56. Each month a mortgage is in default the likelihood of it returning to a performing status is progressively decreased (McCann, 2014). The prevalence of arrears and, more significantly, long-term arrears indicates that this 'scarring effect' is particularly damaging in NI. The proportion of long-term distressed borrowers in the region presents a serious concern for the future sustainability of the housing market. The current dysfunctional nature of the housing market also has much wider ramifications for NI.

57. At a UK level there has been considerable coverage of the risks the housing market poses to the durability of economic expansion. While some of the

concerns are not immediately relevant to NI, the relationship between the housing market and strong, sustained and balanced expansion is pertinent. In this context the level of arrears in the region is a specific concern. The prevalence of arrears, particularly the tranche of long terms arrears, indicates a significant debt overhang in NI. These high levels of debt can inhibit the ability of consumers to support growth and undermine the sustainability of the economic recovery.

58. The large level of arrears and debt overhang in NI poses a risk to the sustainability of households' financial position, the functionality of the housing market and the durability of economic expansion. The accumulation of this large body of debt can, in part, be attributed to high levels of lender forbearance.

Forbearance

59. Lenders' forbearance policies have been a distinguishing feature of this financial crisis. In cases where borrowers have entered arrears, a more flexible approach from lenders has led to increased use of forbearance options. Consequently, high levels of arrears have been tolerated and the UK rate of possessions, to date, is lower than in the 1990s. An exception to this trend has been the approach of second charge lenders, many of whom have demonstrated a more tenacious approach to arrears management. For borrowers dealing with these lenders this has presented an additional layer of challenges.

60. Conversion to interest only (IO) contracts has been a key feature of lenders' initial response. Within NI this migration has been particularly prevalent and the region has the highest rates of conversion to IO terms in the UK (Experian, 2013). However, due to concerns over the sustainability of this option, IO forbearance is becoming harder to secure.

61. The long-term sustainability and appropriateness of all forbearance options is becoming increasingly scrutinised. At the onset of crisis the FSA's guidance directed lenders towards forbearance; however, this position has now evolved.

The FCA's Risk Outlook queries whether given the profile of possessions to date, which suggests distress is driven by over-indebtedness and longstanding affordability issues, that forbearance may only be delaying and prolonging the pain (FCA, 2013).

62. In light of the FCA's position and given the scale of repayment arrears in the region a balanced, mature and informed consideration of the long-term sustainability of all forbearance options must take place. Where forbearance cannot provide a sustainable outcome, exiting homeownership may be in the borrower's best interests.

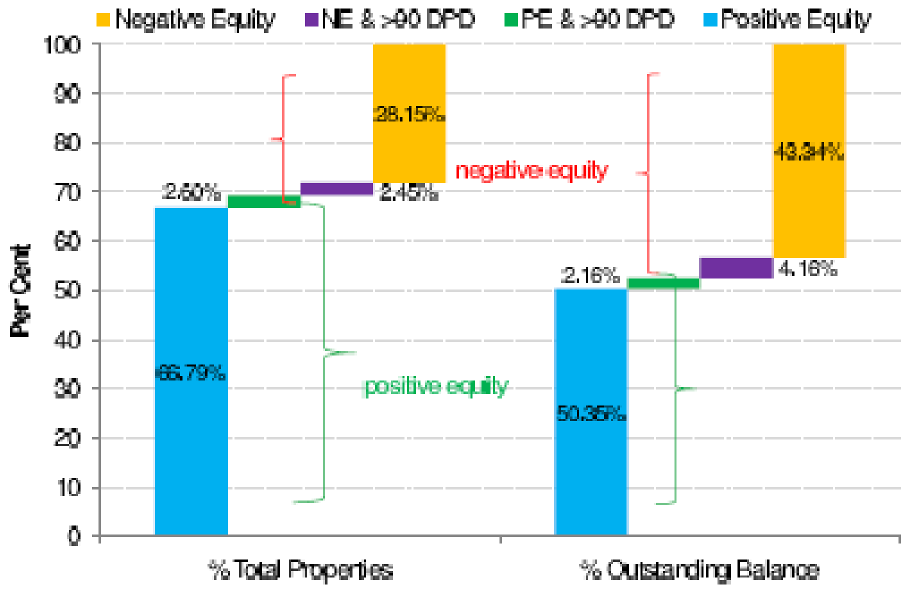
Possessions

63. The 'double trigger' approach places equity and affordability at the heart of understanding how mortgage holders move to a position where possession is sought. For the vast majority of cases, borrowers must have little or no equity *and* experience negative shocks to their ability to make payments to be at risk of possession.

64. If a household is in negative equity but is able to manage its payments it will not be in their interests to have their house possessed, as they will still be responsible for the balance not covered by the sale of the property. Where a household has affordability problems but has significant equity, a sale or change of tenure can improve their circumstances. Therefore, both the equity and affordability elements must be satisfied for a property to be possessed (Muellbauer, 2010).

65. The wealth of data held by the Central Bank of Ireland enables the identification of mortgage holders most at risk, i.e. both in negative equity and repayment arrears. The purple band in the below graphic represents 11,600 mortgagors who were simultaneously at least three months in arrears and in negative equity. In addition, the data allows analysts to track the transition of borrowers between positive and negative equity, and the non-arrears and three month arrears categories.

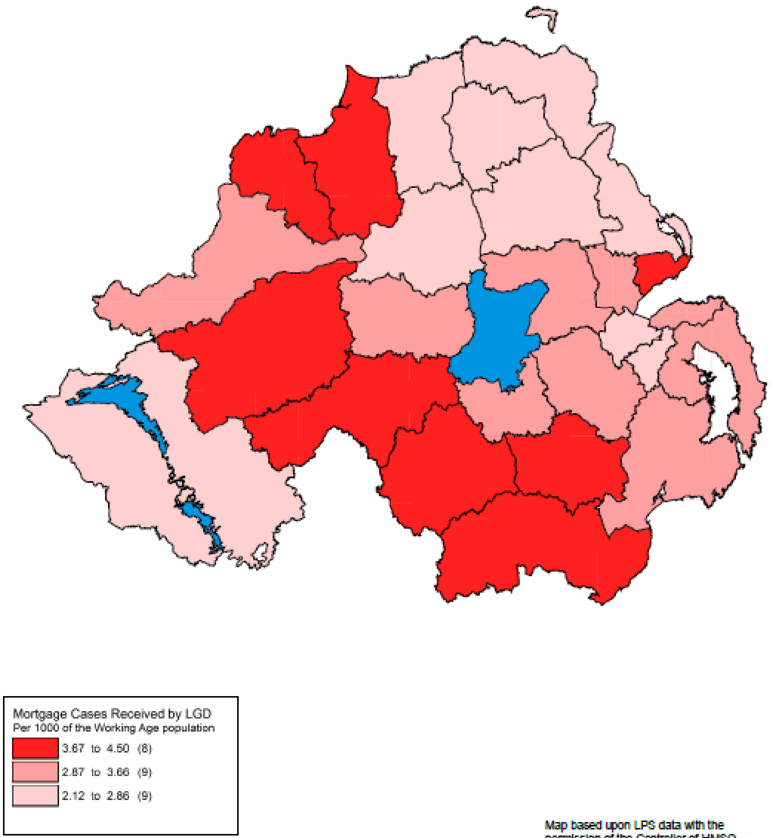
Negative Equity and Arrears in the RoI at December 2010 (Kennedy et al 2011)



66. While this level of detail is not available for NI, the prevalence of negative equity and the proportion of arrears suggest that a concerning proportion of borrowers are likely to be within the high risk ‘double trigger’ bracket. Moreover, the sluggish recovery in house prices and the pressures on their ability-to-pay will sustain or possibly increase the levels negative equity and arrears within NI. These factors indicate that the proportion of borrowers within this high risk category is likely to increase.

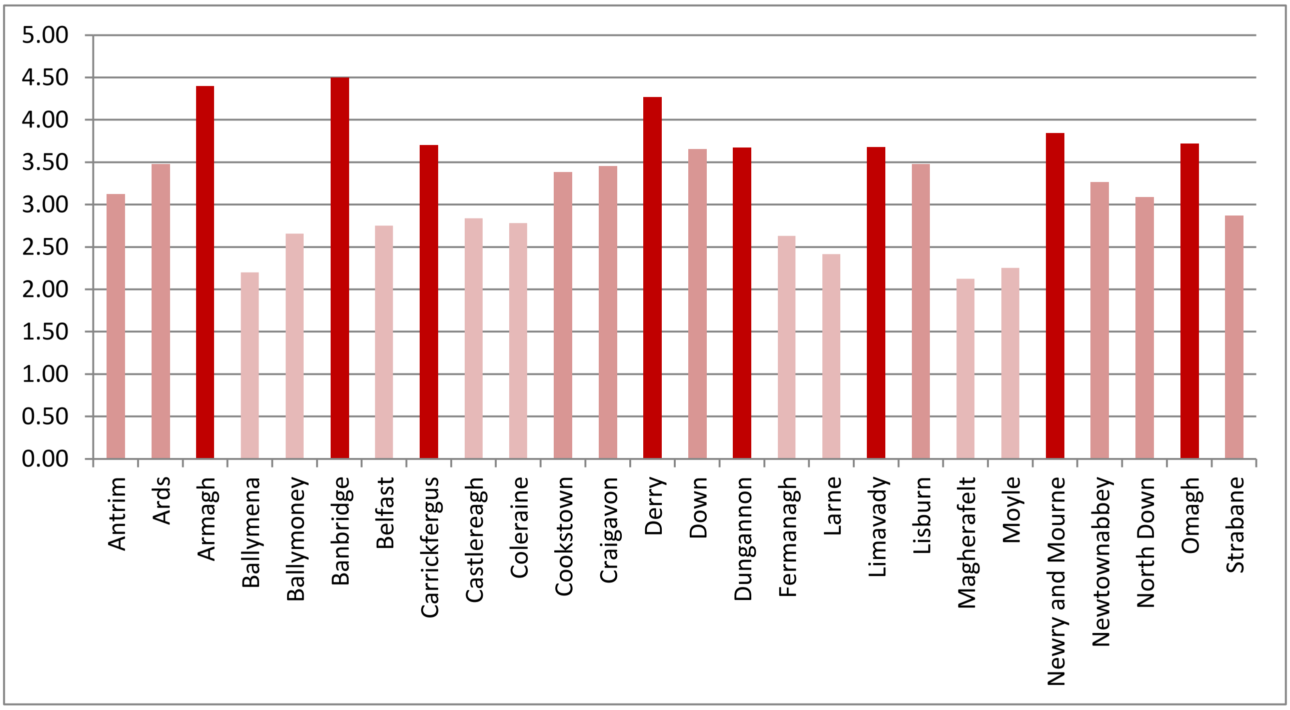
67. Quantifying the actual level of regional possessions is particularly challenging. The Northern Ireland Courts Service publishes statistics for the number of possession cases received and disposed, and provides a breakdown of the final orders made (NISRA, 2014). While these figures are not a complete representation, they are informative as a proxy of people at risk of possession. The below map identifies Limavady, Londonderry, Omagh, Dunagannon, Armagh, Banbridge, Newry and Carrickfergus as ‘hotspots’ of possessions in 2012.

Mortgages Cases Received by LGD per 1000 of the Working Age Population



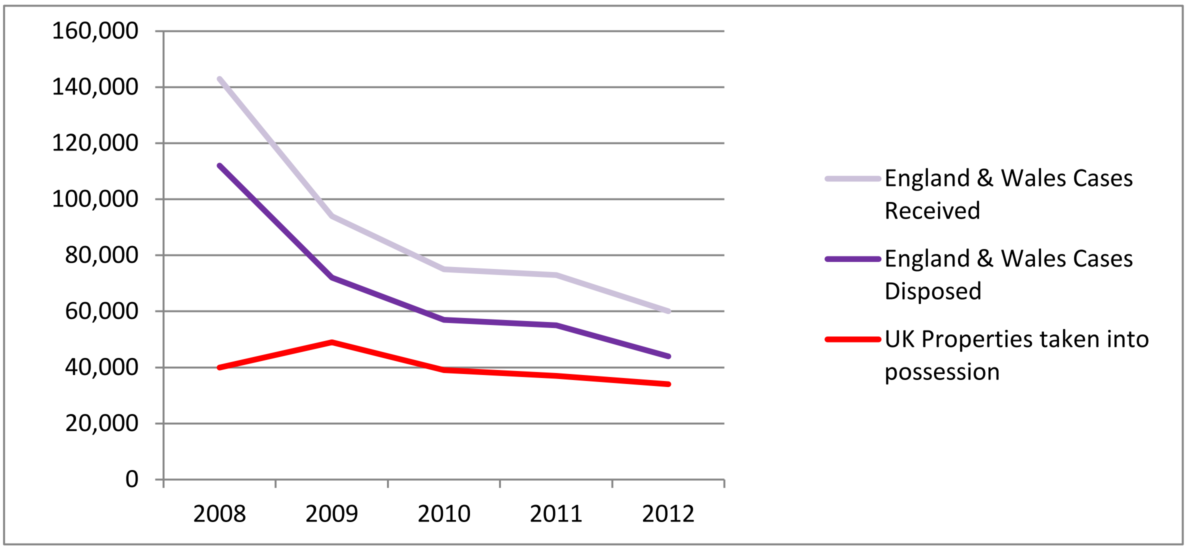
Map based on NI Court Service data for Mortgage Cases Received in 2012
Map developed by Analytical Services Unit, DSD

68. While particular areas may appear as 'hotspots', the data across all regions illustrates that the margins between the Local Government Districts (LGDs) is not significant. Consequently, the consideration of possessions and potential mitigating actions must be done at a regional level.

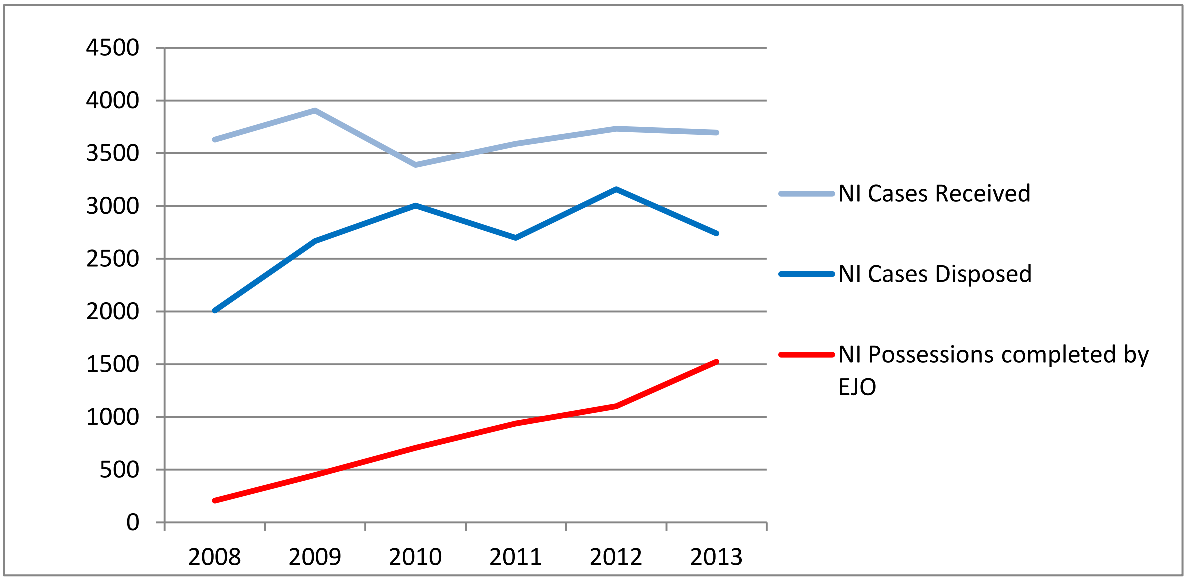


69. A comparison of the NI possession figures with England and Wales demonstrates a disparity in recent trends. CML's figures for the UK highlight that the level of possessions is falling at this aggregate level, which is aligned with the falling number of cases received and disposed in England and Wales. However, NI's statistics do not share this progressive decline.

England and Wales Possession Cases Received & Disposed and UK Possessions (DCLG)



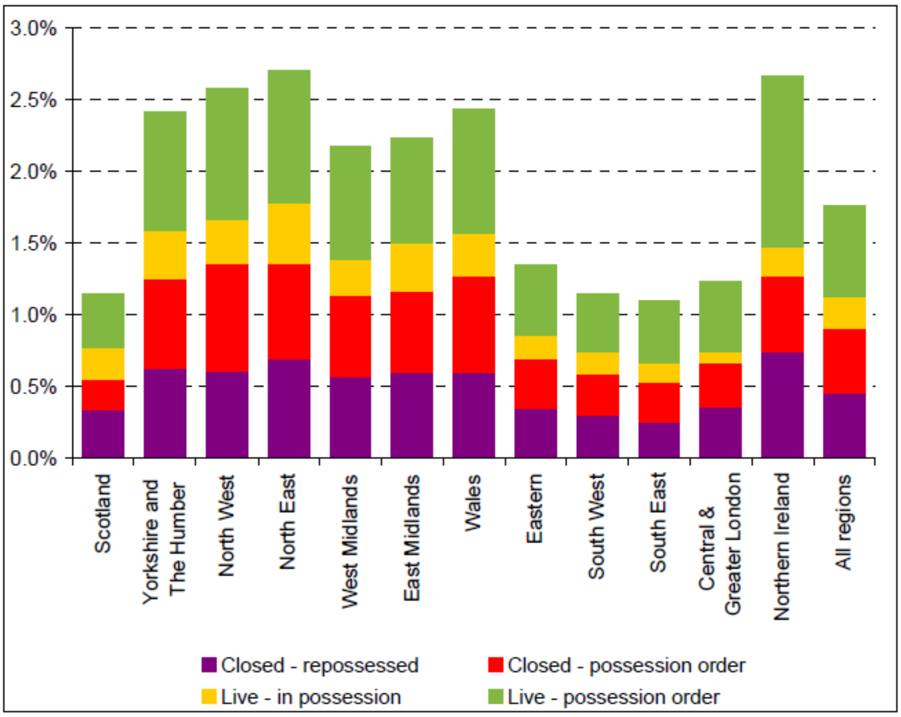
NI Possession Cases Received, Disposed and Enforced (NI Courts and Tribunals Service)



70. The levels of negative equity, repayment arrears and wider economic performance have been the key drivers of the above figures and have created the conditions for a 'perfect storm' within the NI housing market (see the FSA's

financial and economic indicators table at Annex A). However, the data underpinning the FCA's Mortgage Market Review demonstrates that the level of possessions in NI is lower than might be expected.

Regional Mortgage Possessions (FCA, 2012)



Note: This Exhibit shows repossessions and possession orders on mortgages sold in April 2005 - December 2011 as at March 2012 when performance was measured.

Source: PSD Performance data 2012

71. This anomaly may be explained by the presence of different cultural attitudes to evictions, the efficiencies of the court systems or access to good quality representation. In addition, the level of negative equity in NI may be deterring lenders from realising the value of their losses. Determining the exact causes of this anomaly is empirically challenging; however, from the above graphic it is clear that the level of possessions in NI does not reflect the scale of arrears in the region.

72. Anticipating the future levels of possessions is an equally complex and challenging exercise. HML has made attempts to forecast possessions at a regional level within the UK. Within this forecast NI is expected to have the highest rate of possessions at 0.82 per cent, which represents 2,606 possessions (HML, 2014).

Regional Possession Forecast (HML, 2014)

Region	Possession Rate Forecast 2014 (%)	UK Forecast By Volume
East of England	0.21	1,892
East Midlands	0.20	1,604
Greater London	0.33	2,993
North	0.28	1,117
North West	0.22	2,345
Northern Ireland	0.82	2,606
Scotland	0.23	2,399
South East	0.23	2,961
South West	0.18	1,425
Wales	0.29	1,466
West Midlands	0.29	2,299
Yorkshire and Humber	0.22	1,950
Total	0.24	25,057

73. HML's forecasts represent a significant increase in the rate of possessions for the region. In 2013 3,696 possession cases were received and 2,741 were disposed, of those disposed 1,718 possession orders were made. In the same period the Enforcement of Judgments Office (EJO) enforced 1,522 orders. Therefore, for HML's forecast to be fulfilled NI would require a significant increase in the number of cases being brought before the Courts and enforced by the EJO.

74. The level of arrears in NI is the principal driver of HML's forecast. Additional factors potentially leading to an increase in the level of possessions expected by HML include interest rate rises, increases in unemployment, a lack of mortgage availability and the time-limited nature of government schemes. To date these factors have largely been controlled, leading to possessions rates being reduced by least 23 per cent across the UK (Muellbauer, 2012). However, should the impact of these drivers be amplified the scale of increase suggested by HML may be realised.

75. Borrowers can also influence the rate of possessions at an individual level. The Chartered Institute for Housing has found many households are in denial or

believe that possession was a foregone conclusion. Consequently, only half of borrowers attend their court hearings. This delay in engaging with the reality of the situation is reflected in the point at which customers engage with Housing Rights Service's Mortgage Debt Advice Service (MDAS). In 2013 45 per cent of MDAS service users sought advice after legal action had commenced and 24 per cent engaged after their possession hearing. Early intervention significantly increases a borrower's ability to positively influence the outcome of proceedings.

76. Where possession orders are granted by the Court or voluntary arrangements are agreed, the presence of shortfall balances may prolong the distress experienced by borrowers. Given the prevalence of negative equity in NI it is likely that a significant number of borrowers are likely to incur high shortfall debts (Wallace, 2014), which lenders can pursue for up to six years. A rise in possessions may lead to a delayed increase in lenders pursuing these unsecured loans and initiate a potential rise in bankruptcies.

77. A rise in possessions may also impact upon demand for social and private rental housing. In 2012/13 mortgage default accounted for 509 individuals presenting as homeless, of which 252 were accepted as a Full Duty Applicant (FDA). These figures suggest that for the majority of households evicted as a result of a Court possession order alternative housing was independently arranged.

Next Steps and Key Questions

78. Negative equity, arrears and possessions are complex and evolving issues. The Taskforce has made use of available data sources and the expertise of members to present the composition of these issues in NI.

79. The next stage of the Taskforce's work will be the consideration and development of potential mitigating actions that will improve the existing comprehensive provision of advice and support that is currently available for distressed borrowers. This process must be completed in conjunction with a constant review of the landscape in NI. Therefore, it is necessary for the

Taskforce to present its understanding of these issues to affirm the validity of this evidence base.

80. The Taskforce welcomes perspectives from members of the public and sector specific groups which may improve and enhance its understanding of these complex issues. To facilitate and support this engagement a series of key questions are provided below:

1. **There are gaps in the data on the distribution of distress across the population. Is further data available which illustrates the characteristics of those adversely affected by negative equity, arrears and possession in NI?**

2. **Is data available to specifically outline the impact of the housing crash on Section 75 groups[1]?**

3. **The proportion of first-time buyer, buy-to-let, mover and equity release borrowers in distress and the terms of their loans will be key to the Taskforce's future consideration of mitigating actions. Is it possible to construct a more complete breakdown of the borrower categories, repayment terms and interest types of distressed homeowners in NI?**

4. **The sensitivity of borrowers to future income shocks is a core issue for the Taskforce. Can the representation of borrowers' ability-to-pay and households in arrears be improved?**

5. **Quantifying the actual level of possessions and anticipating how this may change is a challenging and complex exercise. Are sources available which can enhance the Taskforce's understanding of the current and future possession rate in NI?**

81. The insight, perspectives and experience of the public and sector specific groups will be of tremendous value to the Taskforce. Should you feel that you

[1] See http://www.nidirect.gov.uk/section-75 for more information in Section 75.

can contribute to this process please visit https://www.surveymonkey.com/s/Repossessions-Taskforce or submit your views and recommendations to repossessionstaskforce@dsdni.gov.uk.

Annex A

UK Regions – Financial and Economic Indicators (FSA, 2011)

Region	Residential mortgage arrears and repossession			House prices		Housing equity		Unemployment			Vulnerability to fiscal tightening				
	Repossessed or possession order in place on 1 August 2009	In arrears greater than or equal to 3 months on 1 August 2009	Cure rate*	House price growth over the last year as at December 2010	House price difference from peak as at December 2010	Median loan-to-value at origination (residential mortgage sales 2005 – 2010)	Negative equity by region (Q4 2010)	Unemployment rate (October – December 2010)	Average unemployment rate (Q4 2009 – Q4 2010)	Change in unemployment rate on year (October – December 2010)	Public sector share of total employment (Q3 2010)	Per capita welfare spending relative to national average (100, 2008/2009)	Capital spending on housing as share of regional gross value added, relative to national average (100, 2008/09)	Capital spending on education as share of regional gross value added, relative to national average (100, 2008/09)	Current spending on public order as share of regional gross value added relative to national average (100, 2008/09)
North East	1.8%	2.4%	26%	-4%	-11%	65.8	6.5%	10.2%	9.4%	1.0%	25%	112	133	182	141
N. Ireland	0.8%	3.7%	78%	-15%	-40%	60.3	11.2%	8.0%	6.9%	2.0%	30%	118	290	123	181
Wales	1.5%	2.5%	40%	0%	-12%	66.9	5.2%	8.4%	8.7%	-0.2%	26%	116	119	88	130
North West	1.5%	2.6%	42%	0%	-8%	67.7	7.1%	7.5%	8.2%	-1.0%	22%	107	129	105	127
Yorkshire and Humber	1.5%	2.4%	39%	-1%	-10%	67.4	6.2%	9.3%	9.2%	0.1%	22%	98	102	126	111
Scotland	0.6%	1.8%	65%	5%	-2%	68.8	2.7%	8.0%	8.1%	0.3%	24%	108	164	94	90
West Midlands	1.4%	2.3%	41%	4%	-8%	67.8	6.0%	9.8%	9.1%	0.5%	21%	103	89	107	109
East Midlands	1.4%	2.2%	38%	5%	-9%	68.5	6.7%	8.0%	7.6%	0.8%	19%	94	61	116	96
East England	0.8%	1.6%	51%	6%	-5%	65.1	3.8%	6.6%	6.6%	0.1%	17%	90	53	99	79
London	0.9%	1.8%	52%	6%	-4%	68.2	2.4%	9.0%	9.1%	-0.2%	18%	99	116	72	97
South East	0.6%	1.5%	59%	7%	-4%	65.6	2.9%	6.1%	6.2%	-0.1%	17%	87	50	94	75
South West	0.7%	1.4%	51%	3%	-8%	63.3	3.2%	6.1%	6.1%	-0.3%	20%	98	57	110	83
UK	1.1%	2%	47%	4%	-6%	66.7	5.3%	7.9%	7.8%	0.1%	21%	100	100	100	100
Source:	FSA (PSD and arrears dataset)			DCLG, FSA calculation		FSA (PSD)	FSA PSD, Hometrack, DCLG, FSA calculation	ONS				HMT, FSA calculation	ONS, HMT, FSA calculation		

Note: Regions performing equal to or better than the UK average have been colour-coded green, the worst three regions have been colour-coded red, and the remaining regions have been colour-coded amber. Thus, the colour-coding is a comparative ranking and does not illustrate the degree of divergence from the national average. The latter can be inferred directly from the numbers but not the colour-coding.
*Cure rate is defined as the percentage of arrears cases, greater than or equal to 3 months, where repossession is avoided.

1. The FSA's financial and economic indicators show NI to be second only to the North East as the UK's most at risk region (FSA, 2011). While this positioning is in itself concerning, this outlook may present NI in an overly positive light as a number of indicators may be incorrectly classified as Green.

2. Different attitudes to evictions, efficiencies of the court systems and an unwillingness of lenders to realise the value of their losses creates an artificially low possessions figure for the region. In addition, the FSA's unemployment rate does not reflect high levels of economic inactivity and poor regional economic productivity.

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GLOSSARY OF ACRONYMS

ASHE	Annual Survey of Hours and Earnings
BBC	British Broadcasting Corporation
BHPS	British Household Panel Survey
BTL	Buy-To-Let
CML	Council of Mortgage Lenders
DCLG	Department for Communities and Local Government
DETI	Department of Enterprise, Trade and Investment
DPD	Days Past Due
EJO	Enforcement of Judgements Office
FCA	Financial Conduct Authority
FDA	Full Duty Applicant
FSA	Financial Services Authority
FTBs	First-Time-Buyers
GDHI	Gross Disposable Household Income
HML	Homeloan Management Limited
HMT	HM Treasury
HRS	Housing Rights Service
IO	Interest Only
IMF	International Monetary Fund
JRF	Joseph Rowntree Foundation
LGD	Local Government Districts
LPS	Land and Property Service
LTV	Loan-To-Value
MDAS	Mortgage Debt Advice Service
NE	Negative Equity
NISRA	Northern Ireland Statistics and Research Agency
OBR	Office for Budget Responsibility
ONS	Office for National Statistics

PE	Positive Equity
PwC	PricewaterhouseCoopers