

EMF

Study



2010 EMF Methodological note and survey on Non-Performing Loans in the EU



RATES
(simple)



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In 2004, the Federation established the European Covered Bond Council (ECBC), which represents covered bond stakeholders from Europe and around the world.

The Secretariat, a team of 12 people based in Brussels, co-ordinates the activities of the Federation and maintains contact with the European institutions.

European Mortgage Federation

Avenue de Cortenbergh, 71
B-1000 Brussels
Belgium

Phone: +32 2 285 40 30
Fax: +32 2 285 40 31
Email: emfinfo@hypo.org
Web: www.hypo.org



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Contact Details

Alessandro Sciamarelli

Statistical Adviser

European Mortgage Federation
Avenue de Cortenbergh, 71
B-1000 Brussels

Tel: +32 2 285 40 42

E-mail: asciamarelli@hypo.org

Susan Yavari

Head of Economic Affairs

European Mortgage Federation
Avenue de Cortenbergh, 71
B-1000 Brussels

Tel: +32 2 285 40 46

E-mail: syavari@hypo.org

List of Contributors

We are most grateful to the time effort and expertise which the following EMF delegates in the EMF's Statistics Committee have lent to the production of this study.

BELGIUM

Frans MEEL
Adviser
Union Professionnelle du Crédit (Febelfin)
E-mail: Frans.Meel@febelfin.be

DENMARK

Kaare CHRISTENSEN
Association of Danish Mortgage Banks
E-mail: kc@rkr.dk

FRANCE

Jean-Marie GAMBRELLE
Crédit Immobilier de France
E-mail: jean-marie.gambrelle@creditimmobilierdefrance.com

GERMANY

Thomas HOFER
Verband Deutscher Pfandbriefbanken
E-mail: hofer@pfandbrief.de

IRELAND

Tom O' CONNOR
Adviser
Irish Banking Federation
E-mail: tom.oconnor@ibf.ie

ITALY

Angelo PEPPETTI
Retail Credit Department
Associazione Bancaria Italiana
E-mail: a.peppetti@abi.it

POLAND

Agnieszka NIERODKA
Mortgage Credit Foundation
E-mail: a.nierodka@ehipoteka.pl

PORTUGAL

Jesus MARTINS
Manager
Caixa Economica Montepio Geral
E-mail: JJMartins@montepiogeral.pt

SPAIN

Lorena MULLOR
Chief Economist
Asociación Hipotecaria Española
E-mail: lorena.mullor@ahe.es

Irene PEÑA CUENCA
Asociación Hipotecaria Española
E-mail: ipcuenca@ahe.es

SWEDEN

Christian NILSSON
Economist
Swedish Bankers' Association
E-mail: Christian.Nilsson@bankforeningen.se

UNITED KINGDOM

James TATCH
Council of Mortgage Lenders
E-mail: james.tatch@cml.org.uk



EXECUTIVE SUMMARY

- This study serves as an update to the 2003 study on definitions of Non-Performing Loans (NPLs) in EU Member States and provides statistical data on the evolution of NPL indicators in individual countries, taking into account national differences and focusing on country-specific analysis.
- Available information from participating countries suggests that indicators of NPLs— arrears, doubtful loans, and repossessions - largely differ in definitions across the individual markets surveyed in the study, so that an agreed definition at an EU level is not possible to attain.
- Evidence on the short-term evolution of NPL indicators in the EU countries for which we have information suggests that a rise in arrears and repossessions occurred in some EU markets (notably Denmark, Italy, Spain, and the UK) over the past two years, mainly due to the bottoming out of the latest housing and mortgage cycles which in turn has been exacerbated by the current macroeconomic downturn. Of these recent trends, unemployment will continue to be the largest potential contributor to increasing arrears and repossessions.
- However, a continued low interest rate environment is likely to offset the continued increases in unemployment rates, thereby mitigating against further increases in arrears and repossessions; moreover, upward pressure on arrears and repossessions in the current economic downturn is being softened by a number of other important factors, including: greater forbearance as evidenced by lenders' "coping strategies" and moratoria to avoid foreclosing on borrowers, and government programmes aimed at keeping borrowers in their homes.
- More importantly, once put in a long-term context, levels in arrears and repossessions after 2008 are still lower than those which were recorded in most EU countries during the previous housing recession in many EU markets (early 1990s). This is largely explained by the different macroeconomic scenario which characterised the previous recession in terms of higher mortgage interest rates - in accordance with a much more restrictive interest rate environment across the EU at the time - and higher unemployment rates.
- The table below summarises the information available in terms of countries covered, definitions of indicators (arrears, doubtful loans and repossessions), statistical units for each indicators, and time-range of the data collected.

Table ► Summary of the information available by indicator

Country	Arrears			Doubtful Loans		
	Definition	Statistical units of data	Data time-range	Definition	Statistical units of data	Data time-range
Belgium	<ul style="list-style-type: none"> when a due sum has not been paid either in part or in full three months following its due date, or when a due sum has not been paid either in part or in full one month after formal notice 	<ul style="list-style-type: none"> Number of arrears Value of arrears (EUR) Values of arrears as % of outstanding mortgage loans 	1994- August 2009	n/a	n/a	n/a
Denmark	Values in arrears amount to the percentage of mortgage payments relative to the entire amount due, which remain unpaid at a date of 3½ months after the due date.	<ul style="list-style-type: none"> Value of arrears (EUR) Values of arrears as % of outstanding mortgage loans 	1999 – Q3 2009	n/a	n/a	n/a
France	An arrear arises when the missed payments are equivalent to two monthly repayments; or in other cases, 60 days after the first missed payment	n/a	n/a	A mortgage loan is considered doubtful 6 months after the first missed payment	Value of doubtful loans as a % of total outstanding residential lending	2004-2008
Germany	Payments in arrears for at least 90 days in respect of claims used to cover Mortgage Pfandbriefe.	n/a	n/a	n/a	n/a	n/a
Ireland	A mortgage holder is in arrears when he is behind on payments of three months or more.	<ul style="list-style-type: none"> Number of residential mortgage accounts in arrears Percentage of total residential accounts over 3 months in arrears (%) 	December 2006 – September 2009	n/a	n/a	n/a
Italy	A mortgage is in arrears: <ul style="list-style-type: none"> past due 1 to 2 unpaid installments ("low arrear", <i>insolvenza leggera</i>) past due 3 to 5 unpaid installments ("serious arrear", <i>insolvenza grave</i>). 	<ul style="list-style-type: none"> Total value of existing arrears (million EUR), broken down by 1 to 2 month arrears and 3 to 5 month arrears Total value of existing arrears/ Total value of existing residential loans (%) 	2001-2008	A mortgage loan is considered doubtful when more than 6 installments are unpaid	<ul style="list-style-type: none"> Total doubtful mortgage loans outstanding (million EUR) Total doubtful mortgage loans outstanding/Total mortgage loans outstanding (%) 	2001-2008
Poland	n/a	n/a	n/a	A loan is considered doubtful when full repayment is considered uncertain and/or principal or interest is 90 days or more delinquent	Non-performing home loans for households (million EUR)	1999-2009 (Q1 to Q3 2009)
Portugal	A mortgage is in arrears when it has overdue installments either in principal or in interest; principal overdue should exceed 30 days and interest overdue should exceed (or be equal to) 1 day.	<ul style="list-style-type: none"> Total mortgage loans in arrears (million EUR) Total mortgage loans in arrears/ total mortgage loans outstanding 	1997-July 2009	<ul style="list-style-type: none"> Principal or installments not yet due on credit granted to a client in which there are overdue installments of principal and interest >25% of the total principal plus overdue interest; 	n/a	n/a

Country	Arrears			Doubtful Loans		
	Definition	Statistical units of data	Data time-range	Definition	Statistical units of data	Data time-range
Spain	See Doubtful Loans	n/a	n/a	<p>A loan is considered doubtful when:</p> <ul style="list-style-type: none"> ■ Repayment is considered uncertain and some losses are expected; ■ When the loan is in arrears: the obligor is past due more than 3 months on the mortgage credit obligation (including capital, interest payments etc) or when the total amount past due exceeds 25% of the mortgage debt 	<ul style="list-style-type: none"> ■ Doubtful loans as a proportion of total mortgage lending outstanding (%) (includes 3 types of mortgage lending: mortgage lending, house purchase, purchase and renovation) 	1998 – Q3 2009
Sweden	Loans for which interest, amortisations or overdrafts fell due for payment more than 60 days. An impaired loan is thus a non-performing loan if it fell due more than 60 days ago and lacks sufficient collateral to cover the total loan	n/a	n/a	<p>Two definitions of doubtful (impaired) loans can be applied:</p> <ul style="list-style-type: none"> ■ If a fixed capital asset has a lower value than the initial purchase value, and it can be assumed that the lower value will persist; ■ (According to major banks in Sweden) Impaired loans are those for which it is likely that payment will not be received in accordance with the contract terms (unless there is collateral that covers the principal, unpaid interest and any late fees). 	Swedish major banks' impaired loans gross, net loan losses and provision ratio	Q4 2007 – Q1 2009
United Kingdom	Mortgage arrears relate to any payments on a mortgage loan which are contractually due but not paid. However, loans in arrears on which an agreed payment is now being made because of difficulties faced by the borrower continue to be reported as «in arrears» unless the arrears have been capitalised, i.e. cases considered to be «performing» are included as arrears until such arrears are capitalised.	<ul style="list-style-type: none"> ■ Number of mortgage arrears (units), 3 to 6 months; and arrears as % of all loans ■ Number of mortgage arrears (units), 6 to 12 months; and arrears as % of all loans ■ Number of mortgage arrears (units), over 12 months, and arrears as % 	1990- Q2 2009	n/a	n/a	n/a

Country	Repossessions		
	Definition	Statistical units of data	Data time-range
Belgium	n/a	n/a	n/a
Denmark	The term «Forced Sale» is considered more accurate. This is a public sale (an auction) of a mortgaged property following foreclosure of the loan secured by that property. A forced sale by the courts may or may not end up as a «repossession». A repossession will occur when the credit institution having secured its loan in the property has the highest bid at the public auction. Proceeds of the forced sale are used to satisfy the claims of lenders. The forced sales procedures will take on average 6-8 months after the first expected payment was overdue. Note that repossessed properties only include owner-occupied dwellings.	Number of properties taken into possession in period	2000 – Q3 2009 (all repossessed properties)
France	n/a	n/a	n/a
Germany	n/a	n/a	n/a
Ireland	n/a (see statistical units of data)	Number of properties (owner-occupied and Buy-to-Let) repossessed by mainstream lenders	2007 – Q3 2009
Italy	n/a	n/a	n/a
Poland	n/a	n/a	n/a
Portugal	A mortgage property may be foreclosed, due to non-payment of the mortgage loan and when possibility of resumption of payment has been exhausted.	n/a	n/a
Spain	n/a	<ul style="list-style-type: none"> ■ Total number of properties taken into possession in period ■ % of foreclosures on total housing stock (units) ■ % of foreclosures on total population ■ % of foreclosures on total households ■ % of foreclosures on unemployed 	<ul style="list-style-type: none"> ■ Q1 2007 – Q2 2009 (quarterly) ■ 2008 ■ 2008 ■ 2008 ■ 2008
Sweden	In order to protect a claim, a credit institution may: <ul style="list-style-type: none"> ■ At a public auction, on a Swedish or foreign exchange or an authorised marketplace or any other regulated market or at a foreclosure sale, purchase property which has been seized or constitutes security for the claim; and ■ Where there is reason to assume that the institution would otherwise incur significant losses, take over property which constitutes security for a claim or other property, in payment of the claim. 	n/a	n/a
United Kingdom	Repossessions are recorded in any case when the lender takes physical possession of the mortgaged property. This should include all possessions, whether or not a court order has been granted. It will therefore include evictions, abandonments and voluntary surrender of keys.	<ul style="list-style-type: none"> ■ Number of properties taken into possession in period; ■ Number of possessed properties sold in period; ■ Number of households with possessed properties; ■ Number of households with possessed properties/Number of households with mortgage properties (%) 	1990 – H1 2009

1.1 Aim and rationale of the study

From the onset of the economic and financial crisis in 2008, there has been growing interest in the behaviour of mortgage loans, in particular delinquencies leading to foreclosures and repossessions. As a result, the EMF has decided to update a 2003 study which at the time was intended to input into the Federation's ongoing work on the Basel Committee's review of bank capital adequacy - focusing on comparable definitions of defaults and losses for mortgage loans.

The aim of the present study is twofold. Firstly, the methodological framework aims to provide national definitions of non-performing mortgage loans (NPL) across EU countries, focusing on the evolution of a mortgage loan from the moment the borrower fails to pay an installment on a due date until the end of the enforcement procedure according to national definitions and procedures in force in individual Member States. The approach taken in the 2002 study considered firstly the various levels of uncertainty from a credit risk perspective and finally what should be considered as the definitive loss (the "non-performance"). The results show that definitions of defaults largely vary in individual countries with regards to factors, such as the time after which a loan is considered in default or with regard to the conditions which need to occur so that a loan can be considered in default. Thus, definitions on NPL indicators significantly differed from country to country. Consequently, it was decided to limit the scope of this updated study to only three indicators: arrears, doubtful loans and repossessions.¹

In some Member States, mortgage loans are considered in arrears if the borrower fails to make a payment after 3 months (Belgium, Denmark, Ireland, Poland, Spain, Sweden), and are considered doubtful after 6 months (France, Italy). Similarly, the enforcement of real estate collateral involves foreclosure and repossession, but these definitions differ considerably between markets, making it very difficult to draw out comparisons across countries and also making it unlikely to come to an agreed definition at the EU level for each of these three indicators.

Secondly, the study contains an analysis of the evolution of NPL indicators during the last 15 to 20 years, putting these developments into historical and macroeconomic context. The fact that these indicators differ considerably in definitions across EU markets pointed naturally to a country-specific analysis, looking at a longer historical time series in order to better contextualise the recent evolution of NPL indicators. In this respect, it was also felt that a wider approach, considering macroeconomic factors as major drivers for NPL indicators was needed.

National definitions of NPL (arrears, repossessions, doubtful loans) and available statistical data on NPLs are presented in Country Sections for the individual countries that have sent information on NPLs to the EMF (Belgium, Denmark, France, Germany, Ireland, Italy, Poland, Portugal, Spain, Sweden and the UK). This serves to avoid any misguided cross-country comparisons.

¹ Please note that the three above-mentioned indicators refer to residential mortgage lending (lending for house purchase to households). Investors and developers are not included in these indicators.

1.2 Evolution of Non-Performing Loans in the EU

In addition to a descriptive part on definitions of NPL in individual countries, the present study includes for the first time available data on arrears and repossessions for individual countries. The availability of data on arrears and foreclosures varies between different EU countries which explains why in some cases, a proxy, such as credit losses is used. Historical data is available at least up to 2008 and to Q3 2009 for some markets, and is reported either in quarterly or annual series depending on its availability.

In general, data shows a number of similar trends across the EU, the most recent of which are a direct result of the closing out of the past housing cycle, exacerbated by a severe recessionary environment. However, this should not invite straight cross-country comparisons for markets which, though sharing similar characteristics, are subject to different legal frameworks, and apply different approaches to the calculation of arrears, doubtful loans and repossessions (see par. 1.1); arrears ratios should also be examined in context: some represent the number of mortgage loans in default as a percentage of the total number of mortgage loans outstanding, while another ratio looks at the value of the missed payments over the total value of outstanding residential lending in the market.

Despite the fragmented and heterogeneous nature of the data, some observations can be made. Most markets show resilient arrears and repossession levels even as the economic situation in the EU worsened sharply after September 2008: this is true for Belgium, France, Germany, Poland and Portugal. Where there is evidence of arrears and repossession rates increasing, it should be borne in mind that since the current crisis was preceded by a period of unusually high growth in mortgage lending – which was boosted, among other factors, by very low interest rates in the EU - repossession figures leading up to 2008 are lower than under normal economic circumstances. Hence, where we do see an increase (in Denmark, Spain and the UK *inter alia*), it is from a very low base, and certainly not to very high levels when compared to a baseline year of 1990, 1995 or even 2000.

However, it is true that short-term data shows that most markets for which we have information recorded increases in arrears and repossession rates due to the deterioration of the economic situation in the EU during the second half of 2008 and in the first half of 2009. For instance, in the UK, with rising unemployment and high levels of overall indebtedness (in a context of declining house prices) it is inevitable that repossessions have risen from the exceptionally low base level seen in 2004 (the lowest level in repossessions seen since 1982). Equally, in Denmark arrears have been historically low in the period 1996-2008, in fact close to zero in 2006-2007; in Spain repossessions, although on an upward trend, are considerably low, as they only represent 0.2% of the total housing stock; arrears though are expected to increase in 2009 and 2010 as a result of unemployment pressure, but these increases will likely be softened by the fact that the segment of borrowers who are most exposed to unemployment is smaller than the one exposed to interest rate risks, and also due to the effect of state subsidies and to a mortgage moratorium recently approved by the Government.

More importantly, according to empirical evidence, arrears and repossessions data showed an increase on past years but were far below levels experienced during previous housing recessions. This was due to a number of factors: at a macro-level, a low interest-rate environment, and relatively low unemployment; from a regulatory and behavioural perspective, government programmes to aid households in financial difficulties, and evidence of greater forbearance by mortgage banks. Moreover, arrears and repossessions were expected to rise in the event of an increase in policy rates by Central Banks, and they were also expected to increase in those countries where unemployment is rising rapidly. Conversely, in some markets (i.e. Spain), the effects on the number of arrears due to the rise in unemployment rates were largely offset by the decreases in mortgage rates as a response to record cuts in central interest rates by the ECB and other Central Banks.

The data collected in this study highlights the need to contextualize trends in arrears and repossessions within the operational macroeconomic environment. The much higher number of mortgages in arrears and repossessed homes during the previous housing recession (early 1990s) suggests that macroeconomic factors played a predominant role in exacerbating the social consequences of the housing and mortgage crisis for borrowers. Levels in arrears and repossessions were indeed much higher in the early 1990s when unemployment rates and mortgage interest rates were, in fact, higher than during the current crisis; in the current crisis, mortgage interest rates have come down to historical lows over the latest quarters (Q1 and Q2 2009) in many mortgage markets, and unemployment rates - although rising rapidly in some EU countries - are still much lower than their historical peaks.



COUNTRY SECTIONS



Country Sections

BELGIUM

Arrears

According to definitions provided by the Central Credit Register, a mortgage is considered to be in arrears when a due sum has not been paid either in part or in full, three months following its due date, or when a due sum has not been paid either in part or in full one month after formal notice has been served by recorded delivery letter.

	Number of arrears	Value of arrears (EUR)	Value of arrears as % of outstanding mortgage loans
1994	25,884	233,068,000	n/a
1995	34,512	331,070,000	n/a
1996	37,026	357,160,000	n/a
1997	38,305	400,039,000	n/a
1998	39,238	440,687,000	0.87
1999	39,220	439,592,000	0.74
2000	41,364	492,833,000	0.77
2001	43,749	600,775,000	0.89
2002	45,530	641,725,000	0.86
2003	45,215	722,124,000	0.87
2004	43,867	679,237,000	0.76
2005	42,038	607,691,000	0.60
2006	40,412	568,800,000	0.50
2007	38,056	538,316,000	0.43
2008	37,808	552,006,000	0.40
August 2009	39,028	660,012,000	0.46

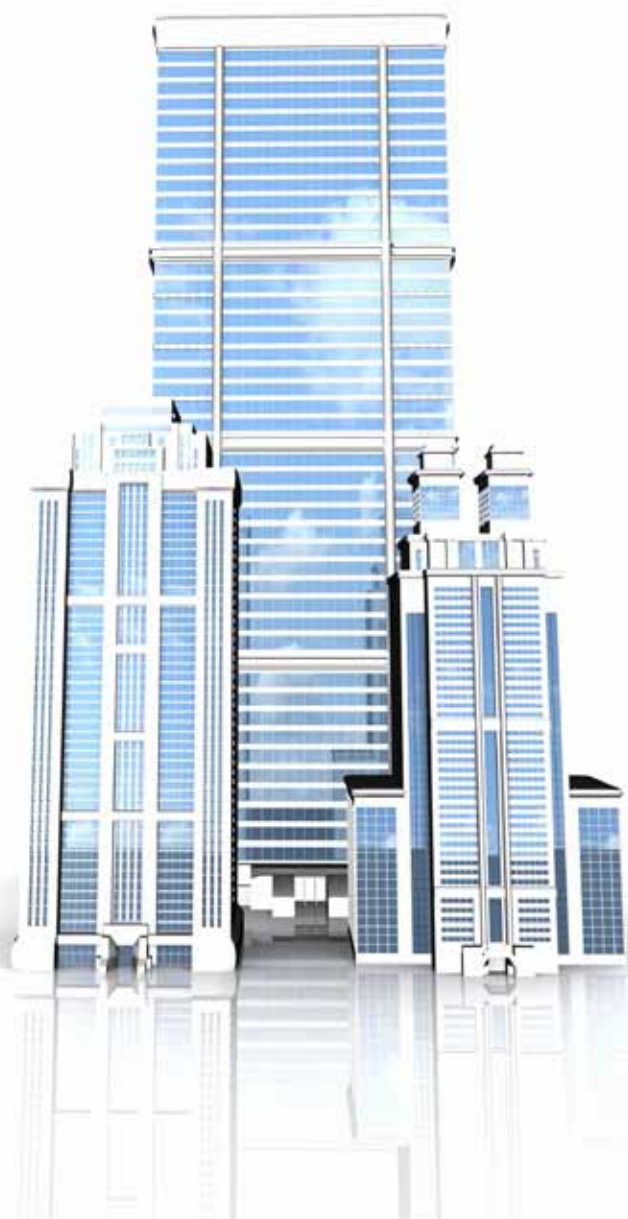
Doubtful loans

Not available

Repossessions

Not available

Source: Belgian Credit Register



DENMARK

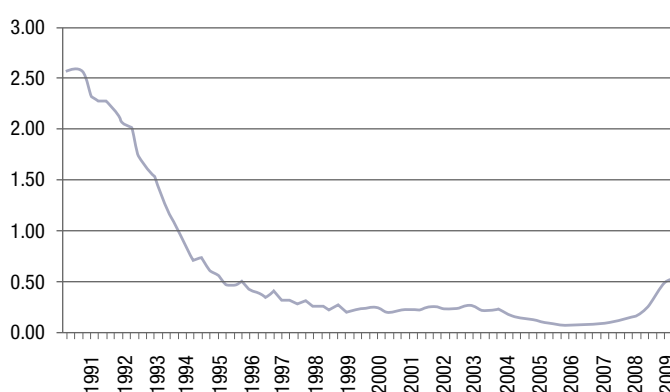
Arrears

Arrear is defined as the legal term for debt overdue after missing an expected payment. Values in arrears amount to the percentage of mortgage payments relative to the entire amount due, which remain unpaid at a date of 3½ months after the due date. Hence, arrears reflect the outstanding payments, not the outstanding balance of the loan.

Arrears in Danish mortgage loans have been minimal over the past 15 years. In 2008 this stable trend was broken as arrears started rising. 3½ months past June 30 arrears stood at 0.53%. That resembles a trebling relative to the level at the beginning of 2008. Considering this development it must be taken into account that arrears have been historically low in the period 1996-2008 - in fact close to zero in 2006-2007.

End of period data	Value of arrears - 3½ months outstanding (EUR)	Value of arrears as % of outstanding mortgage loans
1999	4,336,205	0.26
2000	3,862,953	0.22
2001	4,935,034	0.27
2002	5,014,266	0.26
2003	4,510,767	0.23
2004	2,699,597	0.14
2005	1,524,564	0.08
2006	1,885,255	0.09
2007	3,492,617	0.14
2008	10,157,239	0.39
2009 Q2	13,716,107	0.53

Chart 1 ► Arrears in Denmark (%)



Doubtful loans

Not available (the concept is not used in Denmark)

Repossessions

The term «forced sale» is considered more accurate in a Danish context. It is defined as a public sale (an auction) of a mortgaged property following foreclosure of the loan secured by that property. Forced sale is administered by the courts. A forced sale by the courts may or may not end up as a «re-possession». A repossession will occur when the credit institution having secured its loan in the property has the highest bid at the public auction. Proceeds of the forced sale are used to satisfy the claims of lenders. The forced sales procedures will take on average 6-8 months after the first expected payment was overdue.

	Number of properties taken into possession in period
2000	257
2001	385
2002	478
2003	472
2004	340
2005	136
2006	48
2007	43
2008	216
2009 Q2	248
2009 Q3	241

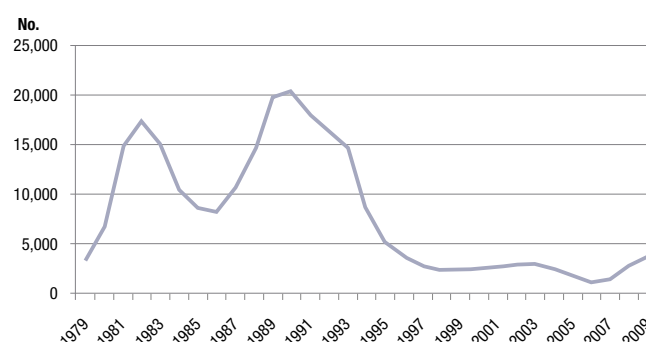
Note: the numbers of repossessed properties only include owner-occupied dwellings.

Source: Reports from the Danish Mortgage Banks to the Association of Danish Mortgage Banks (Realkredittæadet).

Forced sales

Arrears, if not dealt with, may lead to a forced sale of the property unless the owner does not manage to sell the property in the market.

Chart 2 ► Number of forced sales (all properties) in Denmark

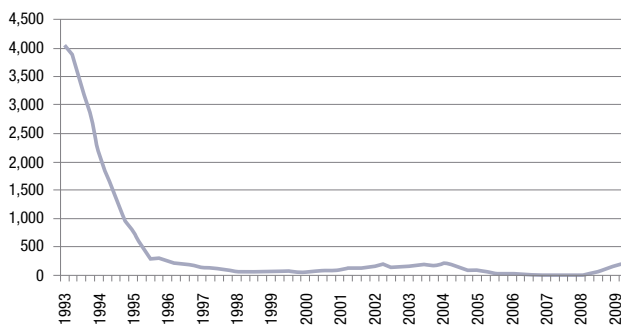


Note: The number for 2009 is calculated by the Association of Danish Mortgage Banks based on information from the first nine months of 2009.

Forced sales in 2009 are expected to come in just below 4,000. This number will equal the level reached in 1995, but it will remain 5 times lower than the peak of 20,000 in the early 1990s.

In the Danish judicial system a forced sale by definition has to occur prior to repossession. During forced sales proceedings, the mortgage bank might repossess the property, if no third party bids higher than the mortgage bank. Like arrears, repossessions have been extremely low since 1996.

Chart 3 ▶ Repossessions in Denmark



Source: The Association of Danish Mortgage Banks

The steep rise in arrears through 2008 and the beginning of 2009 has yet to materialise in the number of homes repossessed by Danish mortgage banks. In fact, the stock of 241 repossessed homes by the third quarter of 2009 is still a very low number historically.

Factors affecting arrears, forced sales and repossessions

Arrears, forced sales and repossessions are directly influenced by households' ability to repay their mortgages. Traditionally, the main variables affecting households' disposable incomes are wages/employment and taxation. Naturally, households holding a variable rate mortgage are also exposed to swings in short term interest rates.

To further assess the issue, The Association of Danish Mortgage Banks has asked its members to pinpoint the most significant factors affecting forced sales. The main factors identified include:

- Divorce (the most significant factor);
- Unemployment (however, so far not reported as a significant factor);
- First time buyers, cheaper homes, low equity clients are heavily represented;
- Excessive private spending

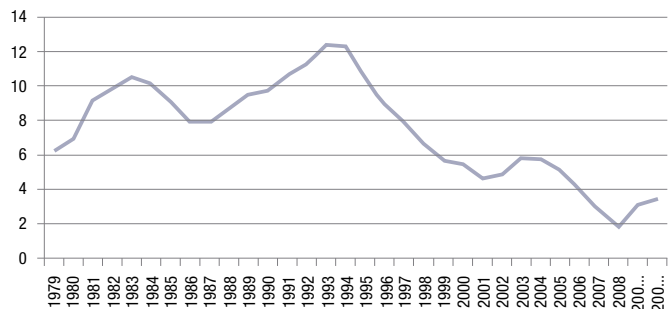
Divorces are mentioned as one of the main factors affecting arrears and repossessions. The number of divorced couples in Denmark stood at 14,600 in 2008. The number has varied in the range of 13,500 to 15,000 over the past 10 years. While a divorce is a significant trigger for a forced sale, the development in divorces cannot explain the recent rise in forced sales. However, combined with a low turnover in the housing market, a divorce is more likely to cause a forced sale down the road.

The Danish labour market model is often dubbed «flexicurity». Corporations easily employ and lay off personnel. In general, the Danish social security system supports unemployed workers financially until they are able to re-enter the job market.

To certain degree unemployment coincide with arrears, forced sales and repossessions. However, to a large extend the Danish social security system is built to absorb shocks to the Danish labour market - eventually sheltering homeowners. Still, in the early 1990s an increasing unemployment rate was

among the factors contributing to the extensive rise in arrears, forced sales and repossessions.

Chart 4 ▶ Unemployment rate in Denmark (as % of the labour force)

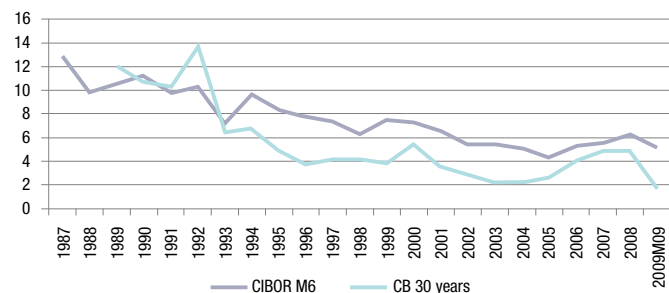


Note: The methodology changed in 2001. The latest 2 observations are quarterly observations for 2009.

Today approximately 100,000 people are unemployed in Denmark. This level corresponds to an unemployment rate of 4%. The Danish Central Bank expects unemployment to rise to 160,000 in 2010 - and to 180,000 into 2011. Hence, going forward unemployment is likely to put an upward pressure on arrears, forced sales and repossessions.

Like unemployment, short and long term interest rates have come down over the past 15 years. Since variable rate mortgages were introduced by Danish mortgage banks in 1996, household disposable incomes have become increasingly exposed to changes in short term interest rates. Today approximately half of Danish home owners have financed their home with a variable rate loan. A rise in the short term interest rate will put upward pressure on arrears, forced sales and repossessions.

Chart 5 ▶ Short and long term interest rates, end of period (%)



Looking ahead

Arrears have risen sharply, but from a historically low level. For now forced sales and repossessions have also risen, but not nearly as sharply as arrears.

Factors affecting arrears, forced sales and repossessions negatively include unemployment, however interest rates are low and have mainly supported households' disposable incomes. Also a lower income tax rate effective from 2010 will boost household disposable incomes.

The main risk for Danish homeowners over the next 12 months are associated with rising interest rates and unemployment. A lowering of Danish income taxes in 2010 will on the other hand support households' disposable incomes.

Source: Association of Danish Mortgage Banks (Realkredittædet), Danish National Bank, Statistics Denmark

FRANCE

Arrears

In France, payment defaults are registered in the FICP (*Fichier National des Incidents de Remboursement des Crédits aux Particuliers / National Deliberate Defaults Register*) when, in case of a loan with monthly repayments, the missed payments are equivalent to two monthly repayments; or in other cases, 60 days after the first missed payment (Article 3 of Regulation n°90-05 of 11 April 1990 on the deliberate default register of the Banking and Financial Regulation Committee).

Doubtful loans

In France, according to Article 3 of the CRC Regulation N°2002-03 of 12 December 2002 regarding the treatment of credit risk, a loan is considered doubtful 3 months after the first missed payment but it is 6 months in case of mortgage loans.

Doubtful loans as a percentage of total outstanding residential lending (%)

31/12/2004	31/12/2005	31/12/2006	31/12/2007	31/12/2008
1.10	1.00	0.94	0.91	0.93

Source: Banque de France, Comité des établissements de crédit et des entreprises d'investissements, 2009



GERMANY

The German housing market developed differently from most of the other European housing markets: instead of an investment boom coupled with strong price increases followed by a strong downturn the market developed in a stable manner. Investment volume, construction sector output and house prices have been stable for several years. Also in the first six months of 2009 we could see only slight decreases in housing market activity. Also the structure of housing finance did not change significantly. House price income ratios and loan to value ratios also did not change significantly since 2002. Due to low interest rates, the debt burden ratio is also rather low from a historical point of view. The current economic crisis did not lead to significantly higher unemployment rates and the economic situation of the private households generally can be seen as stable. Due to these factors Germany does not expect an increase in the number of foreclosures.

Doubtful loans

Not available

Repossessions

Different sources publish figures about the number of scheduled hearings for forced sales at court. Data is only available for all property types grouped together (residential and commercial buildings). It is important to note that a large proportion of the hearings are second or third hearings.

Arrears

Pfandbrief Banks are obliged to publish data about the total amount of the payments in arrears for at least 90 days in respect of claims used to cover Mortgage Pfandbriefe.



IRELAND

Context

In Ireland the housing and lending sectors grew at some of the strongest rates in Europe but since early 2007 house prices have been falling while residential mortgage lending has also decreased. Ireland is a small, open, export-reliant economy that has been affected by the global economic downturn. Real Gross National Product is estimated to have fallen by 11.3% in 2009.

Unemployment has also increased significantly, rising from 4.8% in early 2008 to 12.4% in September 2009. The rate of unemployment is a significant factor in residential mortgage arrears, which have risen but from a very low level. There are currently no evident indications that the rise in arrears corresponds in terms of scale with the increase in unemployment.

The Financial Regulator is establishing regular quarterly mortgage arrears and repossessions data reporting from all mortgage-lending institutions, which is expected to be a valuable data source in terms of monitoring trends in arrears and repossessions levels.

Mortgage lenders in Ireland have traditionally exhibited significant forbearance in dealing with customers in arrears, as shown by the very low numbers of properties taken into possession and that the industry had a voluntary Code of Conduct on Mortgage Arrears in place since 2000. Lenders have only moved to take possession in situations where there is no foreseeable likelihood of resolution, such as instances of relationship breakdown.

Regulatory and Legislative Developments

Polymakers have focussed on the issue of households experiencing financial difficulties since the global economic downturn began to have an impact. In February 2009, the Financial Regulator published [the Code of Conduct on Mortgage Arrears](#) which was heavily based on the existing industry voluntary code referred to above. The Regulator's Code sets out procedures for lenders in dealing with customers in arrears and restricts lenders to waiting for at least six months to pass from when arrears first occur before initiating legal proceedings. In February 2010, the Financial Regulator extended this period to 12 months for borrowers who are engaging with their lender to find a workable solution to their difficulties. A lender is also required to communicate with the customer, notifying them of the first missed payment. Lenders are obliged to consider each arrears situation on its own individual merits and must also consider a number of options in seeking a resolution to the arrears situation; these options may include a change to the monthly repayment, extending the term of the loan or changing the type of mortgage. Lenders are also required to refer the customer in arrears to the Money Advice and Budgeting Service (MABS) where appropriate and to maintain communication during the legal process also.

Two mortgage lenders in Ireland participate in the Government's Recapitalisation Scheme which also includes further commitments by the participating lenders in dealing with customers in arrears, namely an extension on the moratorium on legal proceedings until one year after arrears first occur.

The legal process in Ireland has also been slow and expensive for both the lender and borrower. The Land and Conveyancing Law Reform Act 2009, which will be fully enacted before the end of the year, will also limit lenders

to pursuing legal proceedings in the Circuit Court with respect to new mortgages created under that legislation, while new Circuit Court rules implement revised procedures aimed at streamlining the process.

Arrears

Recent arrears data comes from a survey conducted by the Financial Regulator in late 2008 into the arrears and repossessions handling procedures of mortgage lenders. Mortgage holders in arrears are considered to be those behind on payments of three months or more. The scope of this exercise included specialist, or sub-prime lenders, a small segment of the market.

PERIOD	Number of residential mortgage accounts in arrears of 3 months or more	Percentage of total residential accounts over 3 months in arrears (%)
End-2006	11,252	1.21
End-June 2008	13,931	1.44
End-Sept. 2009	26,271 ¹	3.32

Additional recent data from securitisation reports indicate:

- In Q2 2009, the weighted average of Irish prime residential mortgage backed securities pools that were 90+ days in arrears was 2.3% of loans (1% in Q2 2008);
- In Q1 2009 the arrears figure for securitised mortgages sold to investors was 1.7% (1% a year earlier).

Note: The data indicates a general deterioration but the crisis had already happened before this deterioration occurred.

Doubtful loans

Not available (the concept is not used in Ireland)

Repossessions

IBF gathers regular data on mortgage repossessions. The figures below outline the number of properties (owner-occupied and Buy-to-Let) repossessed by mainstream lenders in the period by court order, voluntary surrender or abandonment.

2007	51
2008	99*
Q1 2009	40
Q2 2009	30
Q3 2009	98

*Revised figure.

Sources: Financial Regulator, Moody's Investors Services

¹ End-September figures account for owner-occupied properties only. According to IBF calculations, specialist lenders accounted for 2% of mortgage accounts but significantly higher proportion of properties repossessed.

ITALY

Arrears

A mortgage is in arrears past due 3 to 5 unpaid installments.

	Value of mortgages in arrears, 1 to 2 months (Million EUR)	Value of mortgages in arrears, 3 to 5 months (Million EUR)	Total value of existing arrears (Million EUR)	Total value of existing arrears/Total value of existing residential loans, 1 to 2 months (%)	Total value of existing arrears/Total value of existing residential loans, 3 to 5 months (%)
2001	2,228	1,238	3,466	1.8	1.0
2002	2,142	1,142	3,284	1.5	0.8
2003	2,773	1,560	4,333	1.6	0.9
2004	5,571	2,063	7,634	2.7	1.0
2005	6,090	1,948	8,038	2.5	0.8
2006	4,693	2,208	6,901	1.7	0.8
2007	6,084	3,042	9,126	2.0	1.0

Doubtful loans

A mortgage loan is considered doubtful when more than 6 installments are unpaid.

	2001	2002	2003	2004	2005	2006	2007	2008
Total doubtful mortgage loans outstanding (Million EUR)	1,857	2,428	2,947	3,507	3,897	4,141	6,084	9,234
Total doubtful mortgage loans outstanding/Total mortgage loans outstanding (%)	1.5	1.7	1.7	1.7	1.6	1.5	2.0	3.0

Repossessions

Not available

Source: "Osservatorio Credito al Consumo", Assofin-CRIF- Prometeia, December 2008.

POLAND

A loan is considered doubtful when full repayment is considered uncertain and/or principal or interest is 90 days or more delinquent.

The mortgage market in Poland is very young – in 2001-2002 the inflation rate in Poland was higher than 10% and the interest rates were correspondingly high, making a mortgage loan too expensive for the average consumer. Since 2005, a mortgage boom has taken place – caused by the record low interest rates, very good macroeconomic conditions (quick recovery after the 2000-2002 economic downturn) and - to some extent – speculative demand. It must be noted however that the vast majority of homes/flats in Poland is bought for residential purposes (not for investment / speculative purpose) and that fact greatly influences the customers' willingness to repay, and subsequently – the quality of the mortgage portfolio.

In recent years, the quality of the mortgage portfolio has been far better than any other sector of loans for households. Still, it must be borne in mind that the short history of the Polish credit market may influence the assessment of the credit portfolio quality and both periods of very slow and extremely fast growth of credit portfolio are statistically vulnerable. So far, the worst period in terms of portfolio quality was noted in 2001-2003 – the deterioration of banking portfolios was caused by the huge economic slowdown recorded in Poland. The current market disturbances have not been reflected in the level of NPL yet.

In terms of currency, the the foreign exchange (FX) portfolio has always been of better quality in comparison to Zloty-denominated loans. The reason for that is the stricter creditability assessment for FX loans and the interest rates disparity, which has always been favorable for the clients.

Doubtful loans

End of period data	NPL - home loans for households (in million EUR)	Share of NPL in total home loans for households (in %)
1999	28	2.0
2000	75	3.1
2001	149	3.9
2002	405	7.8
2003	363	5.4
2004	262	3.3
2005	337	2.7
2006	352	1.8
2007	360	1.2
2008	557	1.0
2009 (Q1 to Q3)	666	1.4

Source: Polish Financial Supervisory Authority



PORTUGAL

Arrears

Loans in arrears are those that have overdue installments either in principal or in interest; principal overdue should exceed 30 days and interest overdue should exceed (or be equal to) 1 day.

	Total mortgage loans in arrears (Million EUR)	Total value of existing mortgages in arrears/ total mortgage loans outstanding (%)
1997	335	1.4
1998	381	1.2
1999	449	1.1
2000	544	1.1
2001	675	1.2
2002	905	1.4
2003	1,074	1.6
2004	1,072	1.5
2005	1,177	1.5
2006	1,139	1.2
2007	1,264	1.3
2008	1,570	1.5
2009 (Q1 to Q3)	1,817	1.7

Doubtful loans

Doubtful loans are those that have overdue principal or interest or that relate to clients that have other overdue credits. In accordance with the Notice n.º 3/95 released by the Bank of Portugal, doubtful loans are specifically defined as follows:

- Principal not yet due on credit operations in which there are overdue installments of principal and interest exceeding 25% of the total principal plus overdue interest;
- Installments not yet due on all credit granted to a client when the total overdue installments of principal and interest of that client represents at least 25% of the total principal in debt plus overdue interest.

Repossessions

A mortgage property may be foreclosed, due to non-payment of the mortgage loan and when the possibility of resumption of payment has been exhausted.

Source: Bank of Portugal

SPAIN

In recent years arrears in residential lending to households have increased at a higher pace in Spain than in other European mortgage markets as a consequence of a combination of the increase in unemployment and the higher interest risk borne by Spanish borrowers (as a result of having more than 90% of the mortgage portfolio at variable rates, referenced to an index, the 12-month Euribor, which is particularly sensitive to changes in the ECB's monetary policy).

As the Spanish data further down shows, the percentage of doubtful loans rises from rates of around 0.4% in 2005 up to 3% in 2009. Though this is still 3% lower than the highs reached around 1994 (see Chart 1 below).

Regarding the segments affected, the increase in interest rates during the last 3 years especially impacted those who subscribed their loans between the years 2002 and 2006 when very low interest rates were prevailing.

A similar trend was observed in the early 1990s, when for instance in 1993-94 the ratio of doubtful loans to mortgage lending was above 5.0%. This was essentially due to very unfavorable monetary policy conditions across the EU, i.e. mortgage rates were very high after the EMS crisis, combined with record highs in unemployment rates (in Spain it reached 19.5% in 1994).

Nevertheless, the most recent decreases in mortgage interest rates have sharply reduced the mortgage debt servicing costs for borrowers. There is no doubt that the recent evolution of the reference indexes in the Spanish market had a huge positive impact on households' budget in 2009 (see chart 2), because borrowers faced -and probably will face in 2010- lower mortgage instalments than in previous years and even lower than those they initially faced.

Overall, arrears are still expected to increase in 2009 and 2010 as a result of unemployment pressure, though these increases will be soft given that the segment of borrowers exposed to unemployment is lower than the one exposed to interest rate risks, and also owing to the existence of state subsidies, and a mortgage moratorium recently approved by the Government.

It is also important to note that the data on doubtful loans encapsulates the Bank of Spain definition of "doubtful" (from an accounting and provisioning

point of view) when the obligor is past due more than 3 months (i.e. the loan is in arrears) or repayment is considered uncertain and some losses are expected (see definition below).

Therefore, the existing figures on doubtful loans are an indicator of the performance of mortgage loans, but they do not mean at all that all these loans will remain in arrears and become "default loans". They do not quantify the expected losses either.

In that sense, credit institutions will always try to use all the tools at their disposal - debt-restructuring, repurchase of a house, *Dation in payment*, etc. - to enable the debtor to remain in his/her home and also to avoid judicial foreclosure, which remains very much a last resort given that it is always the most dramatic and expensive alternative for both borrowers and lenders.

As regards repossessions, data is only available for the past three years, ruling out a more meaningful analysis over a longer time period. Table 1 shows that repossessions, although on an upward trend, are considerably low; they only represent 0.2% of the total housing stock.

Arrears

See the definition of doubtful loans below.

Doubtful loans

In Spain a loan is considered doubtful when:

- Repayment is considered uncertain and some losses are expected;
- When the loan is in arrears: the obligor is past due more than 3 months on the mortgage credit obligation to the credit institution (that includes capital, interest payments etc) or when the total amount past due to the lender exceeds 25% of the mortgage debt (and it has not been considered in default yet).

	Doubtful Mortgage lending for house purchase (million EUR)	Doubtful loans as a proportion of total mortgage lending outstanding (%)	Doubtful Residential lending for housing purchase (including mortgage lending) (million EUR)	Doubtful loans as a proportion of total mortgage lending outstanding (%)	Doubtful Residential lending (purchase + renovation) (million EUR)	Doubtful loans as a proportion of total mortgage lending outstanding (%)
1998	n/a	n/a	779	0.66	836	0.68
1999	613	0.46	654	0.47	713	0.49
2000	700	0.44	750	0.44	808	0.46
2001	786	0.42	849	0.43	907	0.44
2002	899	0.42	960	0.43	1,026	0.44
2003	877	0.35	927	0.35	996	0.36
2004	900	0.29	939	0.30	1,013	0.30
2005	1,547	0.38	1,618	0.38	1,751	0.39
2006	2,073	0.41	2,164	0.42	2,332	0.43
2007	4,153	0.72	4,242	0.72	4,495	0.73
2008	14,309	2.36	14,838	2.39	15,582	2.40
Q1 2009	17,033	2.82	17,648	2.86	18,623	2.88
Q2 2009	18,051	2.97	18,652	3.00	19,659	3.02
Q3 2009	18,209	2.99	18,918	3.04	19,931	3.05

Repossessions

Number of mortgage foreclosures registered in Courts during the period. There is no data about the average term for a foreclosure procedure, but the Asociación Hipotecaria Española estimates that it is currently between 8 and 9 months.

Table 1 ► Repossessions, 2007-2009

	2007				2008				2009	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Number of properties taken into possession in period	5,688	5,935	5,484	8,836	11,050	12,938	13,487	21,211	23,433	23,700

Table 2 ► Relevant ratios for the number of properties taken into possession in period

	TOTAL 2007	TOTAL 2008	T ₁₂ ¹ (%)	% of foreclosures over /total housing stock	% of foreclosures on total population	% of foreclosures on total households	% of foreclosures on unemployed
TOTAL NATIONAL	25,943	58,686	126.2	0.24	0.13	0.41	1.83
ANDALUCIA	4,595	11,458	149.4	0.27	0.14	0.47	1.35
ARAGON	545	1,254	130.1	0.17	0.10	0.28	1.97
ASTURIAS	546	756	38.5	0.13	0.07	0.19	1.55
BALEARES	723	1,754	142.6	0.30	0.17	0.57	2.52
CANARIAS	1,436	3,216	124.0	0.32	0.16	0.58	1.44
CANTABRIA	275	561	104.0	0.17	0.10	0.31	2.24
CASTILLA LEON	888	1,876	111.3	0.11	0.08	0.21	1.41
CASTILLA MANCHA	1,235	2,845	130.4	0.24	0.14	0.47	1.98
CATALUÑA	4,538	11,240	147.7	0.29	0.16	0.49	2.47
C. VALENCIANA	5,369	10,591	97.3	0.35	0.21	0.71	2.77
EXTREMADURA	361	723	100.3	0.11	0.07	0.20	0.83
GALICIA	701	1,369	95.3	0.09	0.05	0.15	1.06
MADRID	2,802	6,501	132.0	0.23	0.10	0.35	1.88
MURCIA	1,013	2,715	168.0	0.36	0.19	0.72	2.41
NAVARRA	178	451	153.4	0.15	0.07	0.24	1.80
P.VASCO	584	985	68.7	0.10	0.05	0.13	1.11
LA RIOJA	154	391	153.9	0.21	0.13	0.39	2.51

Chart 1 ▶ Ratio of doubtful loans to outstanding residential lending (%), quarterly data

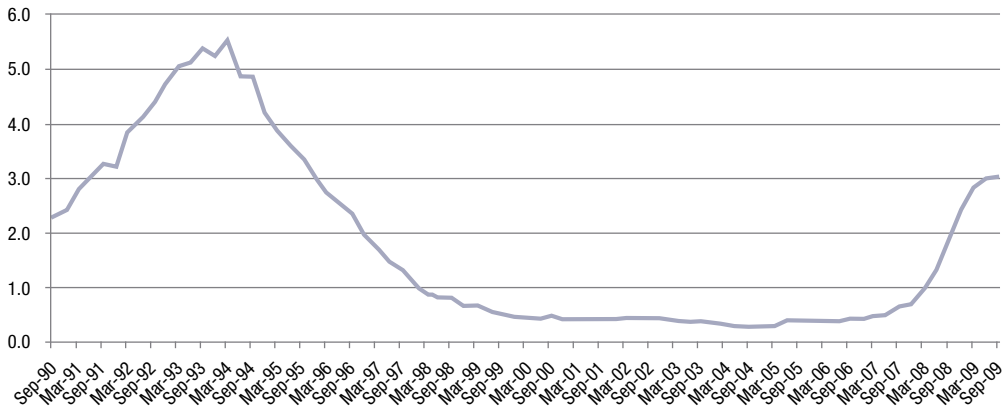
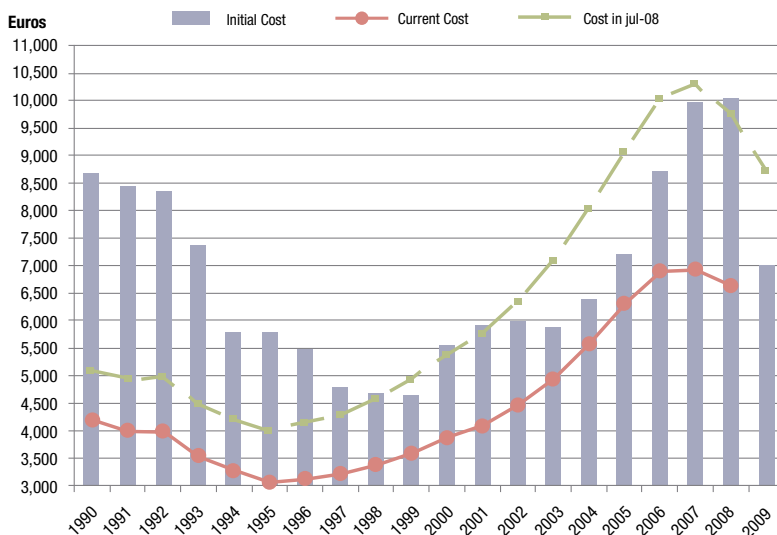
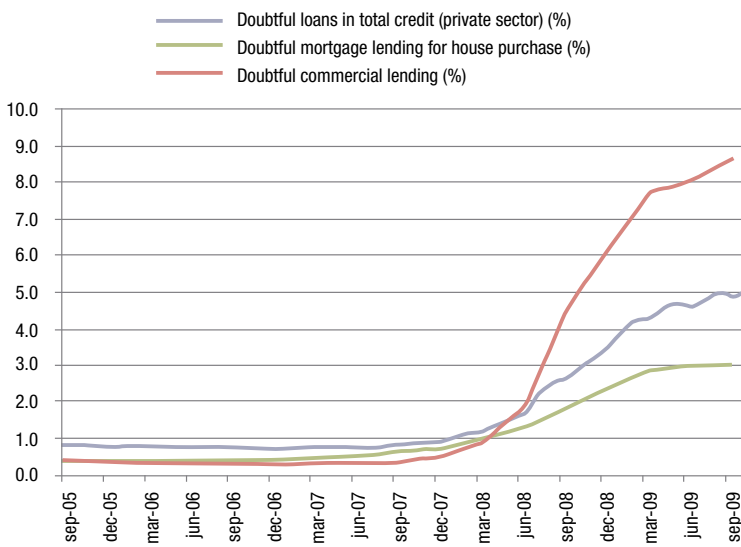


Chart 2 ▶ Interest rate risk and doubtful loans



SWEDEN

The Riksbank, the Swedish Central Bank, has written an article on the subject of loan loss definitions. They write that a good place to start when trying to understand the concepts is the bank's balance sheet and what in some cases results in loan losses, that is the bank's lending. Initially, the bank records the loan on the balance sheet as the sum that has been lent. Loans are then accounted currently as the sum lent with any deductions for provisions for probable loan losses and write-offs for realised loan losses. On the closing day, the bank assesses whether there are objective grounds for writing down the loans. In order to determine the write-down for loan losses, both individual and group valuations of the loans are used. An individual provision is made for the probable loan loss from a loan that is identified as impaired. To identify the write-down requirement that cannot yet be allocated to individual loans, a group valuation is then made of the loans that are not classified as impaired in the individual assessment.

Arrears

Non-performing loans are described by the Swedish Central Bank in the following way (this is a term that often comes up in connection with impaired loans, i.e. see doubtful loans below): they are loans for which interest, amortisations or overdrafts fell due for payment more than 60 days ago. An impaired loan is thus a non-performing loan if it fell due more than 60 days ago and lacks sufficient collateral to cover the total loan.

Doubtful loans

Two definitions of doubtful loans can be applied in Sweden:

- According to the Annual Financial Report Act (*Årsredovisningslagen*), if a fixed capital assets has a lower value than the initial purchase value, the asset shall be written down to the lower value, if it can be assumed that the lower value will persist;
- There is also the definition which is given by the major banks in Sweden, according to which impaired loans are those for which it is likely that payment will not be received in accordance with the contract terms. A loan is not impaired if there is collateral that covers the principal, unpaid interest and any late fees by a satisfactory margin.

Impaired loans are described by the Swedish Central Bank as follows: every claim that gives rise to provisions is included at its full amount in gross impaired loans even if parts of the claim are covered by collateral. Gross impaired loans with deductions for provisions for probable losses constitute net impaired loans. A loan is not impaired, however, if there is collateral that by a comfortable margin covers both the principal, unpaid interest and any charges for late payment.

Repossessions

In order to protect a claim, a credit institution may:

- At a public auction, on a Swedish or foreign exchange or an authorised marketplace or any other regulated market or at a foreclosure sale, purchase property which has been seized or constitutes security for the claim; and
- Where there is reason to assume that the institution would otherwise incur significant losses, take over property which constitutes security for a claim or other property, in payment of the claim.

According to the Banking and Financing Business Act, chapter 7 section 9, a credit institution's total qualifying holding of shares or participating interests in undertaking other than credit institutions, foreign credit institutions, electronic funds companies, securities undertakings, financial institutions, related undertakings, and insurance undertakings, including reinsurance undertakings may not exceed 60% of the credit institution's own funds. Such a holding in an individual undertaking may not exceed 15% of the credit institution's own funds.

Source: Annual Financial Report Act (*Årsredovisningslagen*), Banking and Financing Business Act (*SFS 2004: 297*), Finansinspektionen (Swedish FSA), Credit Market Barometer, Financial Stability Report 2009:1, The Riksbank

	Impaired loans, gross	Provision ratio	Loan loss level, net
Q4 1997	3.5	55	0.5
Q1 1998	3.3	56	0.4
Q2 1998	2.9	56	0.4
Q3 1998	2.9	57	0.5
Q4 1998	2.6	59	0.2
Q1 1999	2.1	57	0.2
Q2 1999	2.1	61	0.2
Q3 1999	2.1	61	0.1
Q4 1999	1.7	65	0.0
Q1 2000	1.6	62	0.0
Q2 2000	1.8	70	0.1
Q3 2000	1.7	68	0.1
Q4 2000	1.7	65	0.1
Q1 2001	1.7	65	0.1
Q2 2001	1.6	62	0.1
Q3 2001	1.6	66	0.2
Q4 2001	1.6	65	0.2
Q1 2002	1.5	67	0.2
Q2 2002	1.5	66	0.2
Q3 2002	1.5	67	0.2
Q4 2002	1.4	71	0.2
Q1 2003	1.3	75	0.2
Q2 2003	1.3	73	0.2
Q3 2003	1.3	75	0.2
Q4 2003	1.2	74	0.2
Q1 2004	1.2	75	0.2
Q2 2004	1.1	78	0.1
Q3 2004	1.0	77	0.1
Q4 2004	0.9	78	0.1
Q1 2005	0.9	83	0.0
Q2 2005	0.8	83	0.0
Q3 2005	0.8	83	0.0
Q4 2005	0.7	85	0.0
Q1 2006	0.7	84	0.0
Q2 2006	0.6	83	0.0
Q3 2006	0.6	81	0.0
Q4 2006	0.6	78	0.0
Q1 2007	0.5	79	0.0
Q2 2007	0.5	77	0.0
Q3 2007	0.5	80	0.0
Q4 2007	0.5	76	0.0
Q1 2008	0.5	75	0.0
Q2 2008	0.5	69	0.0
Q3 2008	0.6	64	0.1
Q4 2008	0.7	60	0.2
Q1 2009	1.0	59	0.4

Swedish major banks' impaired loans, loan losses and provisions (%)

Note: Loan losses are calculated as for rolling four quarters, while the provision, while the provision ratio is stated as a proportion of impaired loans, gross

UNITED KINGDOM

Definitional notes

Mortgage arrears in the UK relate to any payments on a mortgage loan which are contractually due but not paid. Contractually deferred interest does not constitute arrears. However, loans in arrear on which an agreed payment is now being made because of difficulties faced by the borrower continue to be reported as «in arrears» unless the arrears have been capitalised, i.e. cases considered to be «performing» are included as arrears until such arrears are capitalised.

Arrears that are capitalised and become part of the main loan as a result of a negotiated loan refinancing are omitted. If, after capitalisation, a loan goes back into default, only new arrears are reported, and not any that have been capitalised.

The effects of annual review schemes are ignored. Thus, if rates rise sharply during the year, leading to a significant underpayment of interest, such under payments should not be recorded on the return. Arrears calculations should be based on the contractual payment not the interest charged.

With respect to insurance premiums and fees it is the contractual obligation and timing that will determine whether or not they are in arrear; this may differ between individual lenders. Arrears are measured as at the close of business on the last day of the reporting period i.e. 31 March, 30 June, 30 September and 31 December. No assumptions are made about represented direct debits, i.e. if a direct debit collection has failed, this is regarded as an arrear. If a cheque has been accepted and credited to an account this is regarded as a payment, even though after the reporting date it might subsequently bounce. If however the payment is held in suspense then the account is regarded as being in arrear.

Arrears

Arrears in the UK have been increasing since the second half of 2004. The longest-running metric we have for mortgage arrears is for cases over 6 monthly payments in arrear. By this measure in H2 2004 there were 41,000 mortgages (0.36% of all loans) over 6 months down. As at H1 2009 this figure had risen to 154,000, or 1.38% of all loans. Before looking at the drivers behind this, the rise in arrears needs to be contextualised:

- By this long-run measure UK mortgage arrears are still at historically quite low rates. The number of cases is nearly 60% lower than at the peak in the last housing market downturn, when there were 352,000 such arrears cases;
- The arrears rate needs to be treated with caution, due to a technical adjustment in the estimated total number of mortgages outstanding. At the start of 2009 there was a downwards revision of around 500,000 loans, approximately 5% of the estimated total. This was the effect of some lenders excluding “legacy loans” from their reporting for the first time, to come in line with the CML’s long-standing reporting convention. Legacy loans are those which have been materially paid off but a nominal balance is retained by the lender, for example for “deeds store,” or payment of related insurance premiums. Because there are no material mortgages payments expected on these loans they would not show up as arrears cases. So their exclusion now has resulted in an upwards revision to arrears rates, due to a decreased denominator with no compensating decrease to the numerator. This effect is also seen in the possessions rates shown later;

- Over the course of 2008 and early 2009 there has been a distorting arithmetic effect on mortgages measured by the number of months that arrears represent, because of the unprecedented rapid falls in interest rates. The “months in arrears” (MIA) calculation is defined as the value of arrears/current monthly payment. When rates fall, a borrower in arrears instantly becomes a greater number of months in arrear without having accumulated any more arrears in monetary terms. Because the Bank of England’s base rate, to which a substantial proportion of the UK mortgage stock are either directly or indirectly linked, has fallen from 4.5% in October 2008 to just 0.5% in March 2009, there has been a considerable upward shift in the MIA measure purely from this arithmetic effect. The number of mortgages over 3 months in arrear rose from 167,000 in Q3 2008 to 265,000 in Q1 2009 – an increase of around 60%. CML also has a second measure of arrears - mortgages that are in arrears representing over 2.5% of the outstanding balance – and this measure is unaffected by interest rate changes. This measure showed a much more modest increase, rising from 151,000 to 204,000 arrears cases. This is an increase of 35% which more accurately reflects the true movement in arrears over this period;

- The mortgage market now has a markedly different composition to that in the last downturn. In the early 1990s the UK residential mortgage market was almost entirely for owner-occupiers. But since 1997 the buy-to-let (BTL) has become an increasingly significant component – as at Q2 2009, BTL represented around 11% of total balances outstanding, and a broadly similar proportion of the arrears cases. So the number of owner-occupied mortgages in arrears (using the MIA measure), was around 241,000 at the end of Q2.

The key drivers of mortgage arrears in the UK are unemployment and the level of overall indebtedness (taking secured and unsecured commitments together). Unemployment has been rising since the inception of the credit crunch and, at 1.6 million in August 2009, is around double the number two years previously. This is set to increase further but central forecasts do not see this rising to the peak numbers seen during the downturn of the early 1990s, when there were 3 million unemployed. Aside from these drivers of higher arrears, a key factor keeping arrears at comparatively low levels is the unprecedentedly low interest rate environment. With a third of mortgages at variable rates, borrowers who might otherwise have entered into (or sunk deeper into) arrears have been prevented from doing so as a result of lower contractual payments.

In addition, there are a range of forbearance measures available to borrowers that were less widely available in previous downturns. Lenders now commonly offer borrowers flexible options such as payment holidays, switching to paying mortgage interest only for a period, or paying less than the originally contractually agreed amount for a period. In some cases these are features built into the contractual loan terms, in others they are facilities that lenders may offer at their discretion (concessions). And there are also government initiatives, such as the homeowners mortgage support scheme, which complement the existing range of forbearance tools lenders already operate. But all have had the same overall effect, which is to help borrowers who are experiencing payments problems and either prevent them going into arrears or keep those arrears at lower levels than they would otherwise have risen to.

Given the potentially confusing range of coping strategies they may be able to utilise, there is also a significant and growing advice sector, where borrowers in difficulties can have access to independent advice as to their options.

Doubtful loans

Not available

	Number of mortgage arrears (units), 3 to 6 months	Mortgage arrears as % all loans	Number of mortgage arrears (units), 6 to 12 months	Mortgage arrears as % all loans	Number of mortgage arrears (units), over 12 months	Mortgage arrears as % all loans
1990	n/a	n/a	123,100	1.31	36,100	0.38
1991	n/a	n/a	183,600	1.87	91,700	0.93
1992	n/a	n/a	205,000	2.07	147,000	1.48
1993	n/a	n/a	164,600	1.62	151,800	1.50
1994	169,100	1.62	133,700	1.28	117,100	1.12
1995	177,900	1.69	126,700	1.20	85,200	0.81
1996	139,300	1.31	101,000	0.95	67,000	0.63
1997	117,800	1.10	73,800	0.69	45,200	0.42
1998	129,100	1.19	74,000	0.68	34,900	0.32
1999	96,700	0.88	57,100	0.52	29,500	0.27
2000	95,300	0.85	47,900	0.43	20,800	0.19
2001	81,400	0.72	43,200	0.38	19,700	0.18
2002	66,600	0.59	34,100	0.30	16,500	0.15
2003	55,800	0.49	31,000	0.27	12,600	0.11
2004	60,500	0.53	29,900	0.26	11,000	0.10
2005	69,400	0.60	38,600	0.33	15,000	0.13
2006	64,900	0.55	34,900	0.30	15,700	0.13
2007	71,700	0.60	40,500	0.34	15,300	0.13
2008	117,400	1.01	72,000	0.62	29,500	0.25
End-June 2009	116,600	1.05	94,100	0.85	59,700	0.54

Repossessions

Coverage of data

Figures include arrears and possessions all first charge mortgages, but exclude any subsequent charge loans. Buy-to-let loans are included in both arrears and possessions figures. However, if a receiver of rent has been appointed for a non-performing buy-to-let mortgage, these cases are excluded from both arrears and possessions figures.

Possessions are recorded in any case when the lender takes physical possession of the mortgaged property. This should include all possessions, whether or not a court order has been granted. It will therefore include evictions, abandonments and voluntary surrender of keys.

As with arrears, possessions have risen significantly since 2004. In 2004 8,200 mortgaged properties taken into possession (or 0.08% of the total stock of mortgaged properties). But in 2008 this had risen to 40,000, which is 0.34% of the stock. As with mortgage arrears, this needs to be contextualised:

■ Whilst mortgage possessions have risen significantly, they remain substantially below the peak seen in the last downturn (75,500 possessions in 1991). And as with arrears, a substantial proportion of mortgage possessions are in the BTL sector, which did not exist in the previous downturn. In the first half of 2009 2,800 possessions – 12% of the total – were in the BTL sector. Rising possessions have similar adverse effects on mortgage and housing market dynamics and confidence regardless of the type of borrower. But BTL possessions do not result in borrowers losing their homes, and so do not have the same social consequences;

■ The reduction in the estimated number of mortgages outstanding (detailed above) has also had the effect one-off of increasing the possessions rate from 2008 to 2009. So whilst the number of new possessions rose only modestly – 21,500 in H2 2008 to 24,100 in H1 2009 – the possessions rate rose more significantly, from 0.18% to 0.22%, but this increase in the rate was artificially inflated by the decrease in the denominator.

Possession is always a lender's last resort. It often results in a loss, and even when this is not the case this route is will be less profitable than working with the borrower through their difficulty and seeing the mortgage through back to fully performing status, if this is possible. As detailed above borrowers have a much greater range of forbearance options available to them now, compared with previous downturns, to help them through periods of difficulty.

But inevitably, some borrowers cannot recover from mortgage arrears in these cases it is not in the borrowers' interests (or the lenders) to let further debts accrue which the borrower has no reasonable expectation of meeting. So in an adverse housing market, with rising unemployment and high levels of overall indebtedness as seen above, it is inevitable that possessions have risen from the exceptionally low base level seen in 2004, which was the lowest number of possessions seen since 1982.

It should also be noted that even when the borrower and lender have exhausted all possibilities for recovery from arrears, possession is not always inevitable, and lenders will work with borrowers to arrive on a solution that works best for the borrower. This may be an assisted sale, or the government's newly created Mortgage Rescue scheme, whereby borrowers at risk of repossession can move to a shared ownership or social rented tenure.

	Number of properties taken into possession in period	Number of possessed properties sold in period	Number of households with possessed properties	Number of households with possessed properties/Number of households with mortgage properties (%)
1990	43,900	n/a	36,200	0.38
1991	75,500	n/a	67,400	0.69
1992	68,600	n/a	65,000	0.66
1993	58,600	n/a	39,900	0.39
1994	49,200	n/a	29,400	0.28
1995	49,400	n/a	27,200	0.26
1996	42,600	n/a	16,200	0.15
1997	32,800	n/a	13,900	0.13
1998	33,900	33,200	13,900	0.13
1999	29,900	33,700	10,800	0.10
2000	22,900	25,800	7,900	0.07
2001	18,200	20,400	5,600	0.05
2002	12,000	14,600	2,800	0.02
2003	8,500	8,700	2,500	0.02
2004	8,200	6,900	3,600	0.03
2005	14,500	10,300	5,900	0.05
2006	21,000	18,300	8,500	0.07
2007	25,900	22,800	12,200	0.10
2008	40,000	29,300	22,700	0.19
H1 2009	24,100	26,500	20,600	0.19

Source: Council of Mortgage Lenders

- Definitions for the indicators of Non-Performing loans (NPLs) – arrears, doubtful loans, repossessions - largely differ across the individual markets surveyed in this study, so that an agreed definition at the EU level is not possible to attain. More specifically, these national definitions vary with regards to factors, such as the time after which a loan is considered in default or with regard to the conditions which need to occur so that a loan can be considered in default.
- For most markets, 2008 was a pivotal year when arrears and repossessions started to increase following on from several years of historically low levels across the EU, this itself the result of a major housing and mortgage boom. The increase in arrears and repossessions observed in 2008 marked a definitive end to this boom. This trend was exacerbated by the recessionary environment (notably the rise in unemployment rates in several countries). Unsurprisingly, the deep diversity in housing and mortgage markets across Europe was apparent with some countries showing very modest increases while others showed a more noticeable increase from 2008 up until the present period.
- As the macroeconomic downturn takes hold, developments in interest rates and unemployment rates can play a key role in triggering a further increase in arrears and repossessions. Nevertheless, a continued low interest rate environment would largely offset the continued increases in unemployment rates, thereby mitigating against further increases in arrears and repossessions; moreover, upward pressure on arrears and repossessions in the current economic environment is being softened by a number of other important factors, including: greater forbearance as evidenced by lenders' "coping strategies" to avoid foreclosing on borrowers, and government programmes aimed at keeping borrowers in their homes.
- If considered in a longer-term historical context, levels in arrears and repossessions after 2008 are still lower than those which were recorded in most EU countries during the previous housing recession in many EU markets (early 1990s). This is largely explained by the different macroeconomic scenario which characterised the previous recession in terms of higher mortgage interest rates - the result of more restrictive interest rate environments across the EU at the time - and higher unemployment rates.



Study

2010 EMF

Methodological note and survey on
Non-Performing Loans in the EU



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RATES
(simple)