Managing arrears and possessions

- This article presents findings from a survey that updates a previous review into how firms manage arrears and possession that was undertaken more than a decade ago. The intervening period has seen considerable changes in the wider economy, mortgage market and regulatory framework. Although the survey results relate mostly to 2005, they provide a useful backdrop to the recent deterioration in default experience and to the FSA's thematic review into the treatment of borrowers in arrears later this year.
- Statutory mortgage regulation has made little or no difference to how firms manage arrears, but has led to some changes in notification procedures.
- The vast majority of lenders manage their arrears fully or at least partly in-house.
- Lenders attach a very high importance to contacting borrowers who are falling into arrears quickly, with 90% of them aiming to make first contact when one part or full payment has been missed. Many lenders also showed diverse strategies to provide information and advice for borrowers.
- The survey found that in 2005 3.2% of homeowner mortgages were in arrears, but that these were heavily concentrated in the short-term category with two-thirds of cases 1-3 months down.
- Only about a fifth of borrowers in arrears had a current payment arrangement in place. This seems to be a relatively low figure, and not dissimilar to the experience of the early 1990s. The nature of arrangements has not changed much either, except that there is now greater use of temporary payment holidays.
- Lenders' forbearance strategies are influenced when mortgage interest payments are met, or are likely to be met, in full by mortgage payment protection insurance or income support. Partial coverage of interest payments makes some but much less of a difference.
- More than three-quarters of lenders have formal criteria in place for initiating court action. These tend to revolve around how long arrears have persisted, whether contact with the borrower has been made, and whether remedies have been exhausted or have failed.
- A key finding from the survey is that there are clear differences between the prime and non-prime sectors of the mortgage market (the latter being defined as including adverse credit and self-certificated mortgages).
- The rate of arrears in the non-prime sector was almost four times higher and possessions ten times higher. In 2005 about 1 in 200 properties subject to a non-prime mortgage were subject to possession. A much larger proportion of such possessions resulted in a shortfall, 31% in non-prime cases compared with 6% for prime ones.

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Introduction

This article presents the findings of a survey of lenders commissioned by the CML and carried out by the Centre for Housing Policy. The survey provides a detailed profile of home-owner arrears and possessions, and lenders' policies and procedures towards them.

The last review of lenders' role in the arrears and possessions process (Ford et al, 1995) was completed more than a decade ago at the end of a housing market recession marked by record arrears and possessions, falls in nominal house prices and extensive negative equity.

Chart 1: Arrears and possessions, 1980-2006

![Chart 1: Arrears and possessions, 1980-2006](image)

Source: Council of Mortgage Lenders

The arrears and possession situation today is materially different from the early-mid 1990s, although there has been some evidence of deterioration since 2004 (see Chart 1).

A review of lenders' management of arrears therefore appears timely. Much else has changed since the early 1990s which means that lenders are now managing arrears in a very different context, as detailed in the background section below. The remainder of the article presents the key findings of the research on arrears and possessions and their management.

Background

The housing and mortgage market

The housing market has strengthened substantially since 1994, with a prolonged period of house price rises amid an environment of historically low nominal interest rates. The bottom of the interest cycle has now passed and interest rates have been rising, while staying well below the levels experienced in the first half of the 1990s.
In 2000, the phasing out of Mortgage Interest Relief at Source (MIRAS) was completed, for all but residual numbers of elderly home income plan holders.

By the end of 2006 there were 11.7 million mortgages outstanding. While this represented a rise of more than 10% since 1994, the rate of growth had declined markedly compared to the previous decade (when the comparable increase was more than 40%).

First-time buyer numbers have declined. Having made up 55% of all new loans in 1993 and 1994 (the peak years), they only accounted for 36% in 2006 (CML, live tables). Typical loan-to-value ratios have edged down (from 95 to 90%) but income multiples have risen strongly (from 2.3 in 1994 to 3.2 in 2006).

The past decade has seen both a marked shift away from endowment-linked mortgages towards capital repayment mortgages and, over the past few years, stronger take-up of interest only mortgages without a specified repayment vehicle. Recently, these have accounted for as much as a quarter of new lending for house purchase (CML, live tables).

Industry structure and regulatory changes
The mortgage industry has also undergone significant structural change over the past decade. A wave of building society demutualisations took place in the mid-1990s with the consequence that banking organisations are now the dominant players in the market (Stephens, 2001; 2007).

While consolidation has continued, there has also been a number of new entrants, mostly operating on the specialist lender model – that is without a branch network and raising funds from a parental institution or on the wholesale markets, often through securitisation. Many of these new players are associated with the emergence of an important new market - the "non-prime" sector, which has extended lending to households who might otherwise have experienced difficulty in accessing mortgage finance (Munro et al, 2005; Pannell, 2006). There is no industry agreed definition of non-prime, but for the purposes of this paper we regard it as including both impaired credit mortgages, where the borrower has some history of default, and self-certificated
mortgages, where the borrower does not verify income (for example, because they are self-employed or their earnings are uncertain).

The changes in the industry have been reflected in the abandonment of the regulatory divide between the Building Societies Commission and the Bank of England, with each of their regulatory functions being assumed by the Financial Services Authority. The CML introduced a voluntary Mortgage Code in 1997 for lenders (and from 1998 for intermediaries) until it was superseded by statutory regulation of new residential mortgages by the FSA from October 2004.

**Growth in consumer debt**

There has been an unprecedented growth in personal indebtedness, both secured and unsecured, over the past decade, and inevitably greater repayment difficulties for some households as a consequence.

In recent years, there has been a significant rise in individual insolvency, in the form of bankruptcies and Individual Voluntary Arrangements (IVAs), an alternative to bankruptcy whereby the debtor reaches an arrangement with creditors, and their equivalents in Scotland (chart 2).

Growing numbers of charging orders, by which unsecured creditors secure the repayment of the debt from the proceeds of the sale of the property, also illustrate the increasing financial stress that some households are facing.

**Chart 2: Number of individual insolvencies in England and Wales, seasonally adjusted**

![Chart showing the number of individual insolvencies from Q1 98 to Q1 07, with categories for Total, Bankruptcies, and Involuntary arrangements.](chart2.png)
Safety nets

One of the key changes since 1995 has been the changes in the safety net for borrowers. From October 1995, a waiting time of nine months was introduced in most cases before borrowers with new mortgages became eligible for Income Support for Mortgage Interest (ISMI). The Government hoped that more borrowers would take out Mortgage Payment Protection Insurance (MPPI) to cover the gap. While MPPI coverage grew to 24% of mortgages in 2003, it has since declined to below 20% in the second half of 2006. Meanwhile ISMI claims have fallen from 529,000 claimants in 1994 (and a peak of 555,000 the previous year) to 236,000 in 2005 – primarily reflecting improvements in the labour market (Wilcox, 2007). The current OFT investigation into payment protection insurance seems likely to weaken sales of MPPI further.

A recent report found that 90% of borrowers have a short-term safety-net in the form of savings, flexible mortgage resources or employee benefit. However, 40% have no medium-term cover in the form of insurance. Only 12% have short, medium, and long-term cover (Ford et al. 2005).

A degree of uncertainty surrounds the way in which the current safety net would behave during a recession, although Ford and Wilcox (2005) estimated that there would have been a net increase of 80,000 (23%) mortgages in arrears of six or more months, had the post-1995 safety net regime been in force in 1992.

The research

During 2006, a questionnaire was sent to all CML members, asking lenders to provide detailed information on arrears and possessions and their approaches to their management. Data related principally to 2005.

43 lenders returned the questionnaire, between them managing nine million mortgages representing more than three-quarters of the industry total. Banks and building societies respectively accounted for 76% and 22% of the mortgages managed by survey participants. Specialist lenders managed a little over 2% of the total but accounted for 8% of new mortgages.

Among firms surveyed, just under 10% of mortgage assets were classified as ‘non prime’, defined by the research team as adverse credit and self-certified lending. The predominant business of the specialist lenders was non prime, building societies were relatively lightweight in this regard, and the banks had a share broadly in line with their overall market share.

Levels of arrears

The lenders in our survey reported that 3.2% of their borrowers were in arrears at the end of 2005 (chart 3). The arrears were heavily concentrated in the very short-term category of 1-3 months, which accounted for more than two-thirds of all arrears cases. By contrast, 0.6% of mortgages
were in arrears of 3-6 months; 0.3% of 6-12 months and only 0.1% for more than a year. These figures are similar to those published by CML for mortgages more than three months in arrears.

**Chart 3: Percentage of mortgages in arrears, 2005, survey and CML published data compared**

![Chart 3: Percentage of mortgages in arrears, 2005, survey and CML published data compared](chart3.png)

Source: CML survey of arrears management, Council of Mortgage Lenders
Notes: Base: 41 lenders (25 building societies; 13 banks; 3 specialist lenders)

As one would expect, the incidence of arrears was higher among non-prime mortgages. Overall, 11.3% of non-prime mortgages were in arrears, compared to 2.9% of prime mortgages. The differential between the proportion of non-prime and prime mortgages in arrears was greatest for short-term arrears and smallest for arrears of more than 12 months. The data is consistent with the view that earlier action in the case of non-prime arrears results in speedier resolution or possession than among prime mortgages.

**Chart 4: Percentage of mortgages in arrears, 2005, prime and non-prime sectors**

![Chart 4: Percentage of mortgages in arrears, 2005, prime and non-prime sectors](chart4.png)

Source: CML survey of arrears management
Notes: Base: Prime Sector: 37 Lenders; Non-Prime Sector: 12 Lenders
Management of arrears

It is rare for lenders to fully outsource arrears management functions. Most firms (71%) manage arrears entirely in-house, with a further 24% using a combination of in-house staff and external staff.

The vast majority of lenders (eight in ten) reported that statutory regulation had made little or no difference to their management of arrears cases, but had prompted changes in notification, suggesting that lender practices already conformed to what is now statutorily required. In the few cases where firms reported that statutory regulation had led to significant changes, these included staff obtaining the CeMap qualification, more quality assurance checks on staff, the introduction of quarterly arrears statements and telephone call recording.

The vast majority of lenders place a high importance on making early contact with borrowers. Almost all lenders (90%, covering almost 80% of borrowers) aimed to make first contact after one full or part payment had been missed.

Moreover, 81% of lenders, representing three-quarters of borrowers, exceeded the statutory requirement by providing information to all their customers in a durable medium within 15 business days of two missed payments, not just those with regulated mortgages.

Chart 5: Strategies to assist borrowers with arrears, % of lenders using specified strategies

Source: CML survey of arrears management
Notes: Base: Prime sector: 40 lenders (25 building societies; 13 banks; 2 specialist lenders); non-prime sector: 16 lenders (7 building societies; 5 banks; 4 specialist lenders)

All respondents identified the resumption of normal payments plus a contribution towards the arrears as being a strategy employed in the prime sector to recover arrears, with slightly fewer employing a strategy of full interest payments combined with a contribution towards arrears
(chart 5). A similar pattern is seen among loans in the non-prime sector, although fewer lenders appear to employ specific recovery strategies.

Within the prime sector, only 20% of borrowers with arrears had a payment agreement in place. This seems to be a relatively low figure, although past research suggests that during the last housing recession lenders improved the incidence of contacts and agreements from a relatively low base (Ford et al., 1995).

Some of this may reflect the fact that two-thirds of arrears cases were less than three months down and an agreement may not yet have been put into place. If we examine mortgages that are three or more months in arrears, a slightly higher proportion (23%) had an agreement in place, with a further 6% having had an agreement which had subsequently broken or lapsed. However, the majority (71%) had no agreement in place yet.

The survey also suggested that once an outright possession order had been obtained, agreements were rare.

More than 80% of arrangements fell into three categories. The most common arrangement was the combination of normal payments with payments towards arrears (42%); while reduced monthly payments (22%) and temporary payment holidays (20%) were also important. While figures are not strictly comparable with Ford et al (1995), a similar pattern was observed in the early 1990s with monthly payments plus something towards arrears being the most frequently used type of payment arrangement, closely followed by reduced payments and normal payments – the key difference over the last decade is the substantial increase in the use of temporary payment holidays.

The survey did not provide us with sufficient data to examine the different use of payment arrangements within the non-prime sector.

The nature and level of services to borrowers in arrears varies between lenders. Both lender and the FSA advice suggests that borrowers experiencing payment difficulties should contact lenders as soon as possible. In this respect, some 60% of lenders provided a named contact, 45% an evening phone line and 21% a free-phone helpline. Four fifths (81%) of lenders provided information about independent advice services. Three fifths of lenders provided debt counselling and around half provided daytime branch interviews and home visits. Almost half (49%) of lenders always charged for home visits and more than three fifths always (39%) or sometimes (21%) charged for letters. It was rare for charges to be made for outward bound phone calls and no lender reported charging for branch interviews.
Lenders clearly attach importance to a borrower’s eligibility for the state social security (ISMI) and private insurance (MPPI) safety nets (Table 1).

Eight in ten lenders stated that coverage of all interest payments by ISMI always or usually made a difference in making arrears decisions; in the case of MPPI the impact was almost universal (98%). When part of the interest payment is met, these figures dropped to 46% for ISMI and 56% for MPPI. The prospect of qualification would always or usually make a difference in 70% of cases for MPPI, but never ‘always’ and only 41% ‘sometimes’ in ISMI cases.

It is not clear why lenders’ attitudes to safety net payments should differ according to their source – apparently preferring MPPI to ISMI. Nor is it clear why the same resource (MPPI or ISMI) should prompt such different responses from lenders. The findings of the present study are consistent with earlier evidence that suggested that lenders may be less willing to forbear during the ISMI wait period than MPPI deferral period and are less sympathetic when shortfalls are present (Ford and Quilgars, 2001). They may in part also reflect the capped nature of ISMI payments.

**Table 1: Important factors for arrears decisions, % of lenders stating factor made a difference**

<table>
<thead>
<tr>
<th></th>
<th>Always</th>
<th>Usually</th>
<th>Sometimes</th>
<th>Rarely</th>
<th>Never</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formal safety nets (ISMI and MPPI)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ISMI covers part of interest</td>
<td>13</td>
<td>33</td>
<td>44</td>
<td>10</td>
<td>-</td>
</tr>
<tr>
<td>ISMI covers all of interest</td>
<td>41</td>
<td>39</td>
<td>15</td>
<td>5</td>
<td>-</td>
</tr>
<tr>
<td>Qualify for ISMI in future</td>
<td>-</td>
<td>41</td>
<td>18</td>
<td>28</td>
<td>13</td>
</tr>
<tr>
<td>MPPI covers part of payment</td>
<td>18</td>
<td>38</td>
<td>40</td>
<td>5</td>
<td>-</td>
</tr>
<tr>
<td>MPPI covers all payment</td>
<td>56</td>
<td>42</td>
<td>2</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Has MPPI; may qualify in future</td>
<td>10</td>
<td>60</td>
<td>23</td>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td><strong>Borrower resources</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Considerable equity</td>
<td>7</td>
<td>42</td>
<td>29</td>
<td>17</td>
<td>5</td>
</tr>
<tr>
<td>First time in arrears</td>
<td>15</td>
<td>49</td>
<td>22</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Multiple debts</td>
<td>22</td>
<td>32</td>
<td>22</td>
<td>17</td>
<td>7</td>
</tr>
<tr>
<td>Charging order related to another loan on property</td>
<td>5</td>
<td>18</td>
<td>33</td>
<td>18</td>
<td>28</td>
</tr>
<tr>
<td><strong>Social factors</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health problems or disability</td>
<td>22</td>
<td>37</td>
<td>42</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Borrower over state retirement age</td>
<td>15</td>
<td>32</td>
<td>44</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Source: CML survey of arrears management
Notes: Base: 42 lenders
Of the other factors that lenders identified, whether this was the borrower's first time in arrears and the existence of health problems emerged as the most significant. The existence of a charging order was the least likely of the factors suggested to make a difference.

**Litigation and possession**

Possession is only one possible outcome of arrears and possession actions by lenders and the courts. The Ministry of Justice figures show that mortgage possession proceedings in the county courts in England and Wales strongly outweigh CML estimates of actual possessions. In 2006, 131,681 claims and 91,195 orders were made by the courts, representing an increase of 14% and 30% on 2005 figures, respectively (MoJ 2007).

The survey identified more than three-quarters of lenders (78%) as having formal criteria in place for initiating court action. These tended to be designed around two key aspects of arrears: first, many lenders had a time criterion (most commonly three months, but also two, four and in one case six months); second, many lenders also coupled this with a criterion that no contact had been established with the borrower, all other remedies had been exhausted and/or occasionally debt counselling was unsuccessful.

Among those lenders that were able to provide data for 2004 and 2005, there was a 29% increase in the number of applications made for a first court hearing. These appear to have been concentrated in the non-prime sector.

Table 2 indicates the outcomes of first judgments. A suspended possession order was granted in just over half of cases (53%), whereas an outright possession order was granted in 40% of cases. Most other cases were adjourned; hardly any were dismissed. There were only minor differences in the outcomes for cases involving prime and non-prime loans.

These findings are broadly consistent with the aggregate 2005 figures for England & Wales issued by the Ministry of Justice.

**Table 2: Outcomes at first judgment, 2005, % of court cases**

<table>
<thead>
<tr>
<th>Outcome</th>
<th>Prime</th>
<th>Non-prime</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Granted outright possession order</td>
<td>36%</td>
<td>41%</td>
<td>40%</td>
</tr>
<tr>
<td>Granted suspended possession order</td>
<td>52%</td>
<td>55%</td>
<td>53%</td>
</tr>
<tr>
<td>Adjourned</td>
<td>11%</td>
<td>4%</td>
<td>6%</td>
</tr>
<tr>
<td>Dismissed</td>
<td>0.2%</td>
<td>0.4%</td>
<td>0.2%</td>
</tr>
<tr>
<td>All</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: CML survey of arrears management
Notes: Base: 21 lenders providing all figures (16 prime lenders; 3 non-prime lenders; 2 missing on breakdown)
Managing arrears and possessions

Chart 6 shows the number of possessions in 2004 and 2005 amongst lenders responding to the survey. Our survey indicates that while there was an overall increase in possessions of 58% in 2005 compared to 2004, this was concentrated in the non-prime sector where possessions reported by survey respondents rose by more than 150%. Our break-down between possessions relating to prime and non-prime mortgages reveals considerable differences in the proportion taken into possession: 0.05% of prime mortgages against 0.51% of non-prime mortgages.

**Chart 6: Possessions, 2004 and 2005, by prime and non-prime sectors**

Where lenders were able to provide information about shortfalls relating to properties that had been taken into possession, overall around one-fifth (21%) had a shortfall, but again this varied between cases that arose from prime and non-prime lending (6% compared to 31%). By far the most common method of disposing of a property that had been taken into possession was sale through an estate agent (69%); relatively few (8%) were sold at auction. In 5% of cases, the property was actually returned to the borrower after their arrears had been cleared.

**Conclusions**

This article has reported the findings of a survey of lenders’ arrears and possessions profiles and practices relating to 2005.

The most striking finding are the clear differences between the prime and non-prime sectors of the mortgage market, in part reflecting the differing risk profiles of borrowers. The rate of arrears in the non-prime sector was almost four times greater than in the prime sector. The percentage increase in applications for first court hearings was eleven times greater in the non-prime sector compared to the prime sector. Properties that provided security for non-prime loans were ten times more likely to be taken into possession than were properties providing security for prime loans. Among the properties taken into possession, those relating to non-prime mortgages were on average more than five times more likely to result in a shortfall than those relating to prime mortgages.
prime mortgages. While the number of lenders providing individual pieces of data varied, there is little reason to suppose that these findings do not reflect the experience of the industry as a whole.

The research supports the case that the non-prime sector is contributing to the overall deterioration of arrears and possessions (Cunningham, 2007). As outlined in previous articles (Pannell, 2006), no-one can be certain how this sector will perform in a market downturn as it was in its infancy in the early 1990s recession. Whilst providing an important role in providing credit to those who might otherwise be excluded from the mortgage market, it also remains the sector where there is 'likely to be more consumer detriment' (FSA 2006, p. 5). It also needs to be remembered that government targets to increase home ownership will necessitate drawing in more financially marginal households (CLG, 2007) who may disproportionately rely on the non-prime sector.

Taking the data presented here as a whole, their value is to establish existing experiences and practices as we move into a period where the environment will be less benign. Whilst a repeat of the early 1990s housing crisis is unlikely, consumers are now facing a more demanding economic environment with higher interest rates and growing debt levels (FSA, 2007). If the survey is repeated, they will serve as a baseline from which future policy and practices can develop, in much the same way as the FSA intends to use its effectiveness reviews of the mortgage market.

The survey did not reveal significant impacts arising from the increased use of Individual Voluntary Arrangements, the recent rise in charging orders and reforms to the bankruptcy laws. In part this reflects the lack of recording within lenders and the quality of reporting by the Ministry of Justice. It would be desirable for the necessary information systems to be put in place sooner rather than later.

The article cannot cover the borrowers' perspectives, as the data are based on a survey of lenders. This clearly leaves an important gap in our knowledge and the utility of the data collected in the survey would be enhanced greatly if it were to be filled. Again the next stage of the FSA's review will consider the treatment of borrowers in arrears and this should provide information from which to compose a complete picture of the situation.
References


Wilcox, S. (2007) UK Housing Review2006/7, Coventry: Chartered Institute of Housing
Further information on Housing Finance

Housing Finance is an authoritative online journal which provides in-depth articles on a wide range of mortgage related issues. For free online access to other recent articles and a subject index see [http://www.cml.org.uk/cml/publications/research](http://www.cml.org.uk/cml/publications/research). A package of CML Statistics that complement Housing Finance online is free to members and associates or can be subscribed to by non-members (for details see [http://www.cml.org.uk/cml/statistics/statssub](http://www.cml.org.uk/cml/statistics/statssub)). For further information on Housing Finance articles contact the editor Bob Pannell.