

## Report

from a Working Group of Experts

appointed by the Prime Minister for an assessment of household debt problems

In consultation between the Government and representatives of the parliamentary opposition it was decided on October 15th to convene a Working Group of Experts from ministries, financial institutions and the Household Association to assess the cost of various approaches to resolving the problem of household debt. Mr. Sigurður Snævarr, Economic Counsellor to the Prime Minister, chairs the Working Group.

The main conclusions of the report of the Working Group are as follows:

- Close to 100,000 households reported real property on their tax returns in 2009, of which nearly 30,000 reported no mortgage debt.
- Almost 73,000 households reported mortgage debt amounting to a total of 1,200 billion krónur.
- The average mortgage debt amounted to nearly 18 million krónur.
- Mortgage debt is highest amongst people in their thirties, averaging 23 million krónur for couples and 17 million for singles.
- Over 20,000 homeowners owe more than the assessed value of their property, 28 per cent of mortgage debtors or 20 per cent of total homeowners.
- Interest payments reported on 2009 tax returns amounted to 59.5 billion krónur and interest tax credits to 12 billion krónur, about a third of interest payments.
- Arrears have increased in all financial institutions. Arrears exceeding 90 days amount to 10.4 per cent in commercial banks, 6.4 per cent with the Housing Finance Fund and 4.0 per cent in pension funds.
- The Working Group gauged the number of households in financial distress by subtracting from their disposable income a crude estimate of minimum living expenses. This residual is an estimate of a household's capacity to support its debt service. A family is defined to be in financial distress if this capacity falls short of its payment obligations.
- The Debtors' Ombudsman's guidelines for minimum living expenses for different family types were the reference point for living expenses. As these guidelines omit various expenses, the working group added 50 per cent to these expenses as its lower reference and 100 per cent as its higher reference. In addition, the cost of running one car was added in case families reported car ownership.
- By the lower reference point about 10,700 households are facing payment problems or are in distress, representing 14.7 per cent of households with mortgages or 11 per cent of the total number of homeowners. Gauging by the higher reference, the number rises to some 17,800 families, 24.5 per cent of households with mortgages, or around 18 per cent of homeowners.
- About half of the households facing payment problems owe more than their property is worth. More than 80 per cent of the households facing payment problems purchased their property in the years 2004-2008.
- More than 80 per cent of the households facing payment problems are in the capital area or on the Reykjanes peninsula.

- Most households facing payment problems are relatively low-income.

The Working Group considered 11 different ways to address the problem:

- A case-by-case debt readjustment.
- An across-the-board write-down of debt by 15.5 per cent.
- A write-down of debt to the original principal.
- A write-down to 110 per cent of the assessed value.
- A write-down to 100 per cent of the assessed value.
- A gradual write-down to 90 per cent of assessed value.
- An increase in interest tax rebate.
- A reduction in the interest rate to 3 per cent.
- A two-step approach (sale-/purchase option)
- Income contingent loan scheme.
- Asset expropriation and the write-down through an arbitration ruling.

The last three options could not be assessed within the framework set up by the working group.

The table below summarises the cost of each option in billion krónur and the reduction in the number of problem households for each approach as well as the total number of households that would be helped with each approach (no numbers are presented for the last three options).

<b>Summary of conclusions</b>			
	Cost, bn. kr.	Reduction in the number of households following measures	
		Ombudsman's reference living expenses + 50%	Ombudsman's reference living expenses + 100%
Case-by-case debt readjustment	18-26	2,100 (29.5%)	2,100 (19.6%)
An across-the-board write-down by 15.5 per cent	185	1,500 (21.0%)	2,100 (19.6%)
A write-down of debt to the original principal	155	1,250 (17.6%)	1,750 (16.4%)
A write-down to 110 per cent of assessed value	89	900 (12.6%)	1,050 (9.8%)
A write-down to 100 per cent of assessed value	125	1,250 (17.6%)	1,470 (13.8%)
A gradual write-down to 90 per cent of assessed value	150	1,450 (20.5%)	1,800 (16.7%)
An increase in interest tax rebate	2 a year, 40 if permanent	1,450 (20.5%)	1,070 (10.0%)
A reduction in the interest rate to 3 per cent	24 a year 240 if permanent	2,600 (36.3%)	3,770 (35.3%)

Attention should be drawn to the fact that the reference living expense is of great importance in judging these results. The higher reference expenses places more higher-income households in distress. In such a case, the increase for example in the interest tax rebate, that mainly helps lower-income households, is of less help than in case of the lower reference expenses.

No single option solves all problems. It is therefore evident that not all households can be rescued. Consequently, it is of importance that financial institutions, the state and local governments reach an agreement on new housing initiatives, i.a. by establishing a strong tenant-ownership system.

### 1. Household debt

The Working Group decided to limit its remit to household mortgage debt, disregarding other debt, particularly consumer debt. This is done in conformity with the points of emphasis in the discussion, i.a. the proposals of the Household Association. This limit is viewed as reasonable since housing is seen as one of the basic necessities of households. Although the focus is on property-related debt, household debt problems certainly arise from other debt and other property. Those who are most deeply in other debt will not be helped with measures to alleviate mortgage debt.

Data on household debt have been somewhat hard to gather after the collapse of the banking system in October 2008. When the claims of the banks on households were transferred between the old to the new banks they were assessed with respect to the higher cost of financing and expected recovery and the claims were booked including their write-down, i.e., at below their face value. Information on the amount of write-downs has not been made public, but the write-downs have created a room for the banks to offer their customers in payment difficulties an array of alleviating measures. It should also be noted that court verdicts regarding exchange rate-linked mortgages or car loans (FX loans) to individuals will most likely radically amend the debt and repayment terms of such loans. After the sharp fall in the króna real exchange rate and real income, many households are carrying a heavy debt and repayment burden on these FX loans. The following table on the position on October 1<sup>st</sup> is therefore presented with a caveat.

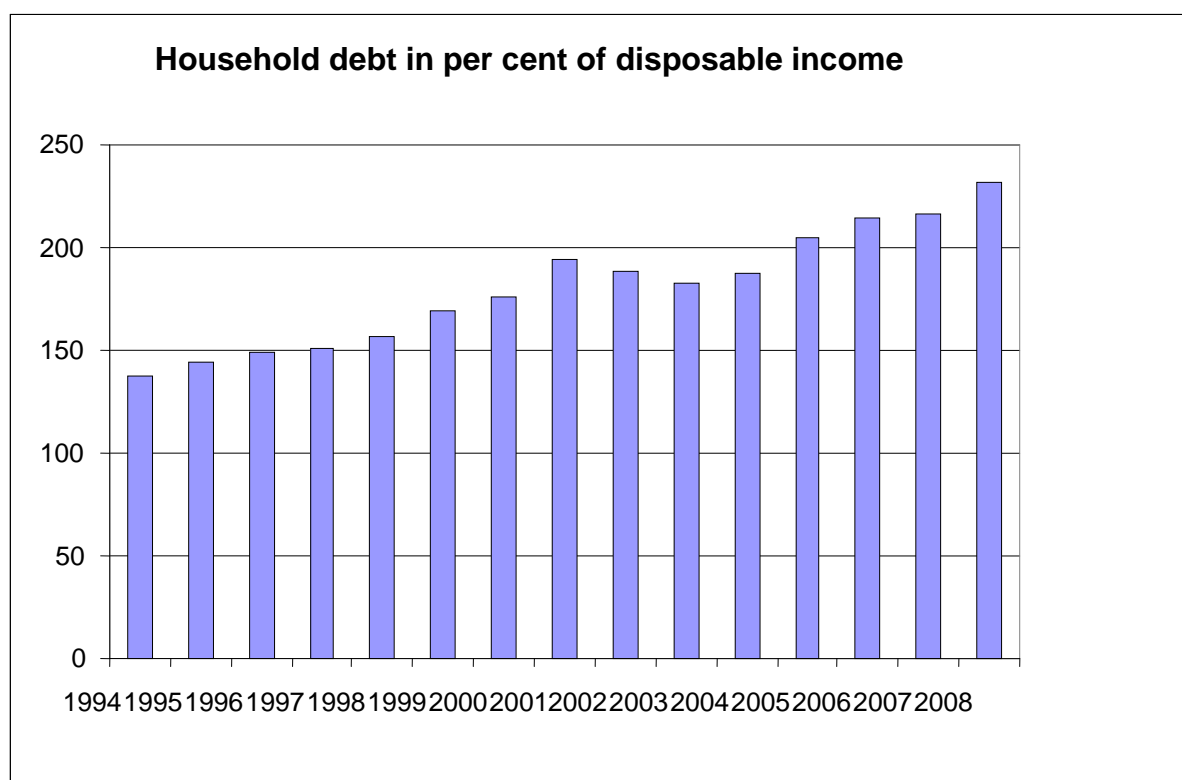
<b>Household mortgage debt, October 1<sup>st</sup> 2010</b>	
<b>Billion krónur</b>	
Index-linked mortgages	1,236
Exchange rate-linked mortgages <sup>1)</sup>	117
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Non-linked mortgages	39
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Mortgages, total	1,392
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<sup>1)</sup> Subject to the verdict of the Supreme Court.

**Household mortgage debt by lender, October 1<sup>st</sup> 2010**  
**Billion krónur**

Housing Finance Fund	579
Pension funds	183
Commercial and savings banks	630
Mortgages, total	1,392

Personal tax returns contain various pre-entered data on personal debt. Mortgage debt is separately entered since interest tax credits are based thereon. At the end of 2009, household mortgage debt for the purchase of homes amounted to 1,196 billion krónur according to tax returns.

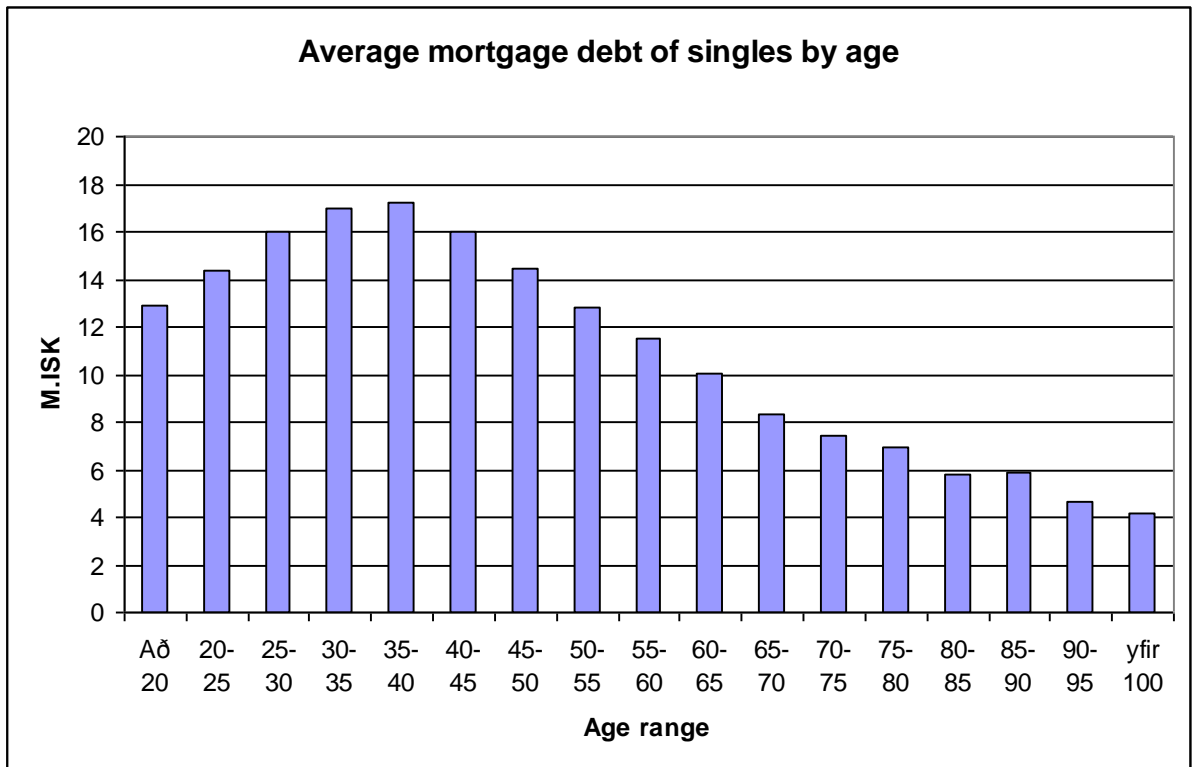
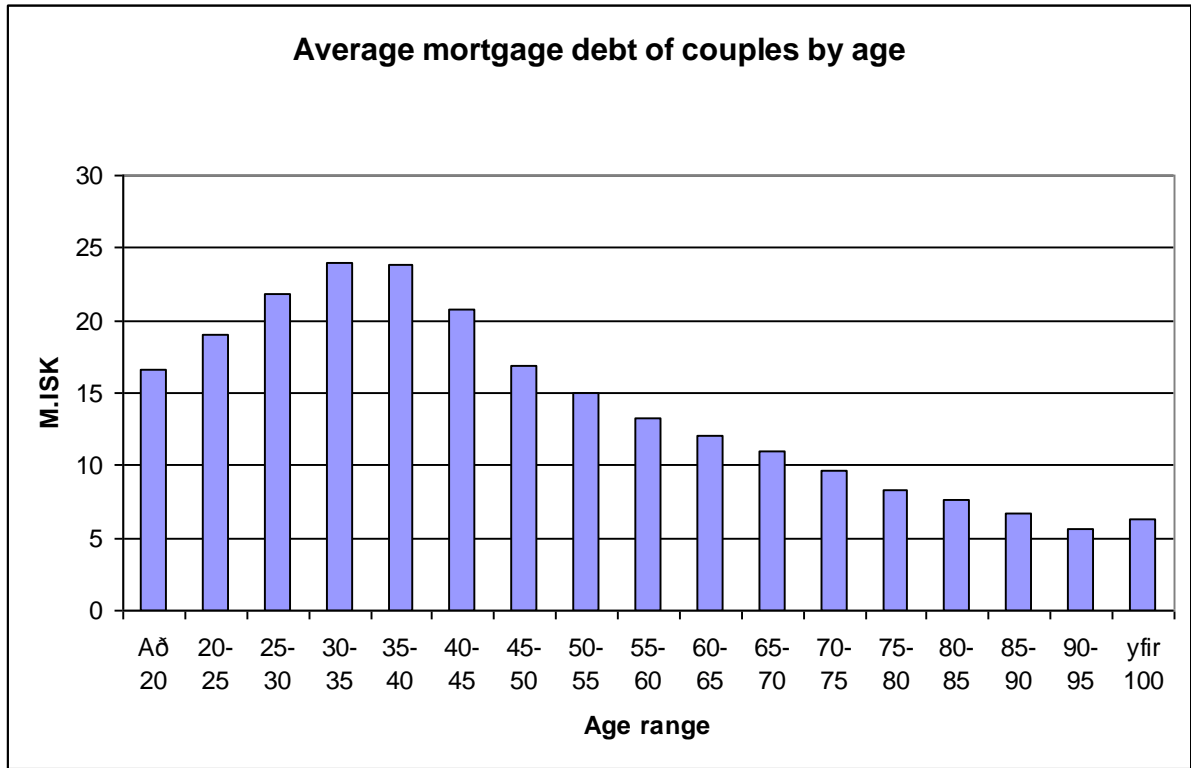


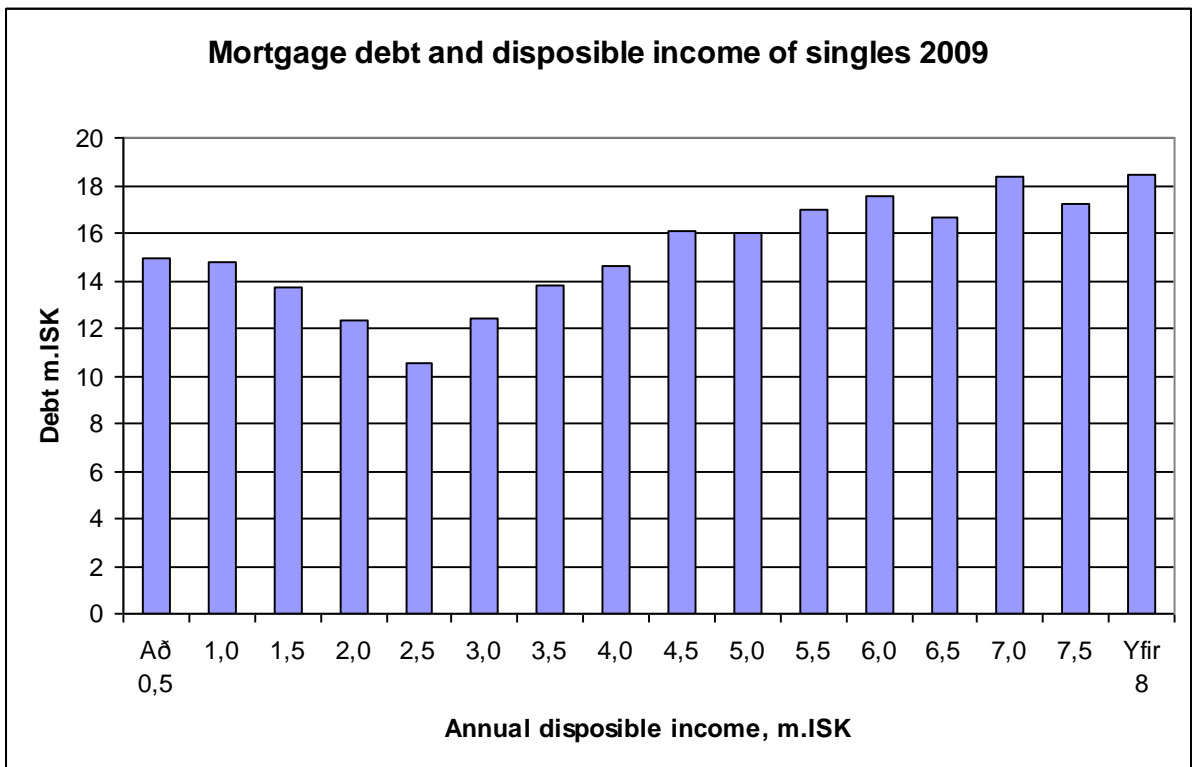
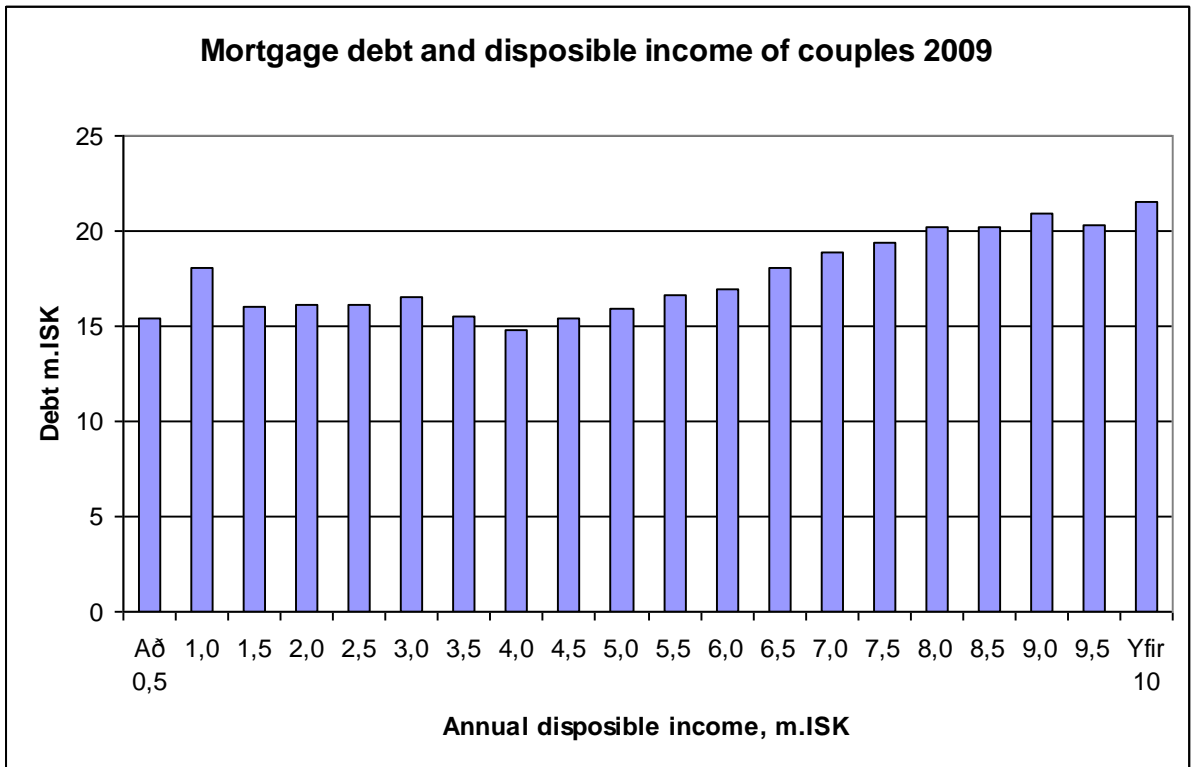
## 2. An analysis of household mortgage debt at the end of 2009

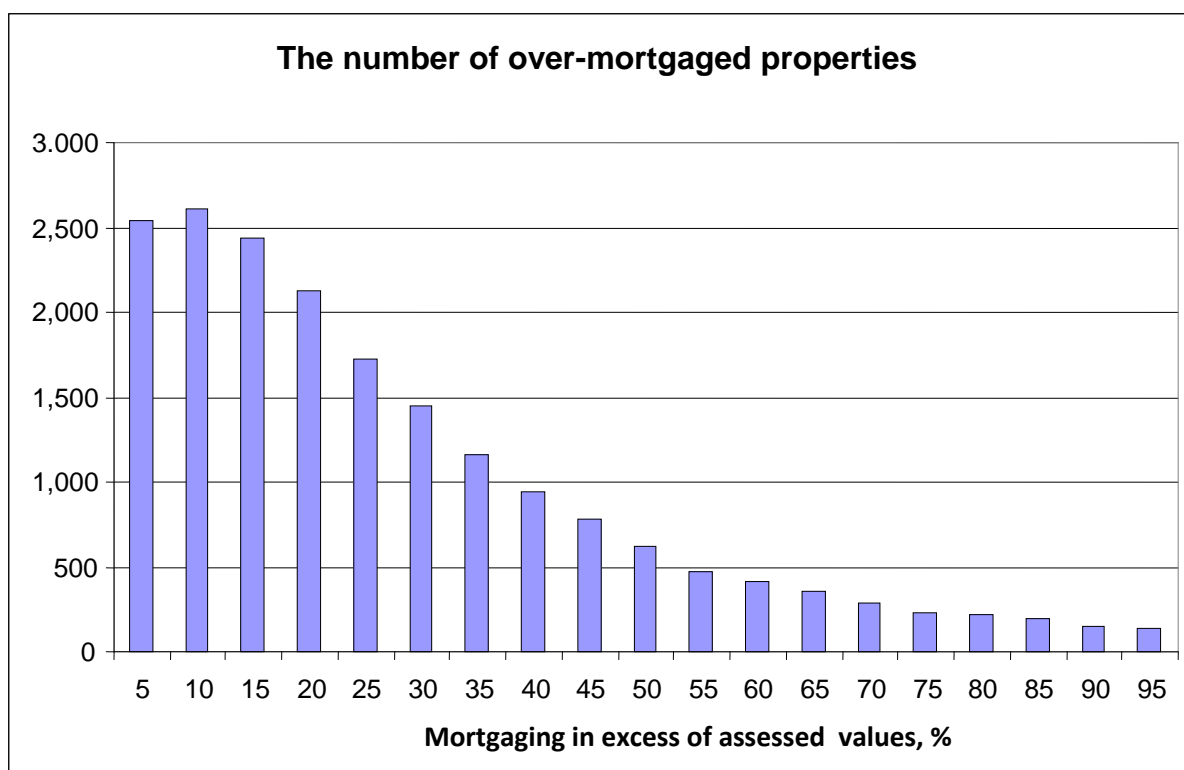
A total of 100,000 households recorded real property on their tax returns in 2009, 41,495 singles and 58,769 couples. Tax returns show that mortgage debt amounted to a total of 1,196 billion krónur for 72,761 households, the average debt being 17.8 million krónur.

It hardly comes as a surprise that mortgage debt is highest among young people. Mortgage debt proves to be highest among people in their thirties and the debt of couples in that age range averages 23 million krónur and 17 million krónur for singles. This is shown in the following graphs which also show that debt declines rather fast with age.

Attention is called to the relationship between housing debt and disposable income as is done in the graphs below. This relationship is perhaps smaller than many have suspected.





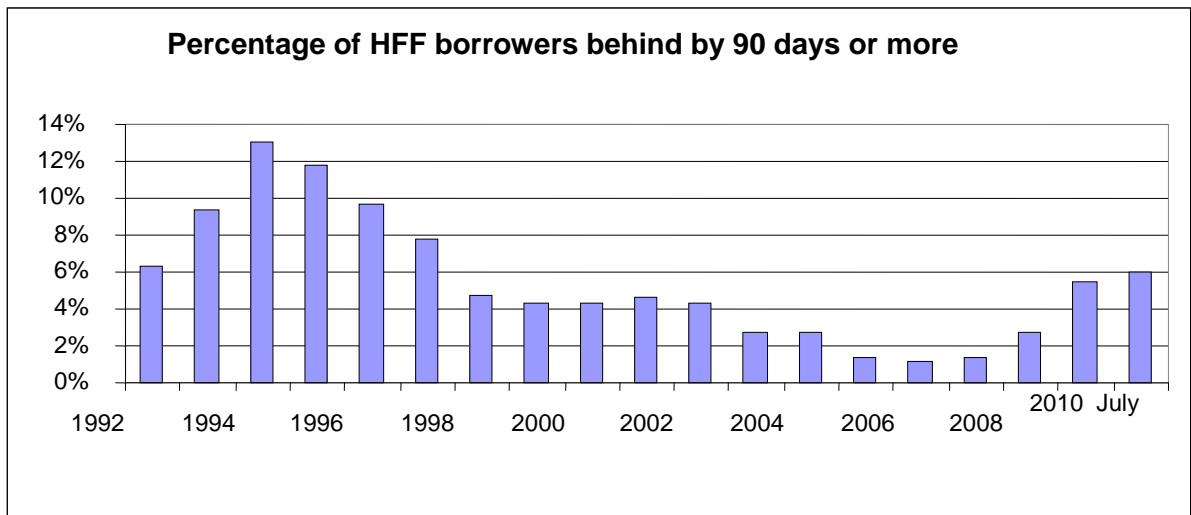


### 3. Debt in arrears

Debt in arrears and its development provides an important insight into the payment problems at hand. Heavy and persistent arrears precede creditor measures. Household debt arrears have generally increased in all financial institutions. At the beginning of October, about 12 per cent of borrowers were behind on their payments for 60 days or more in the three commercial banks, of which 10.4 per cent were behind by 90 days or more. Arrears were lower with the Housing Finance Fund and the pension funds.

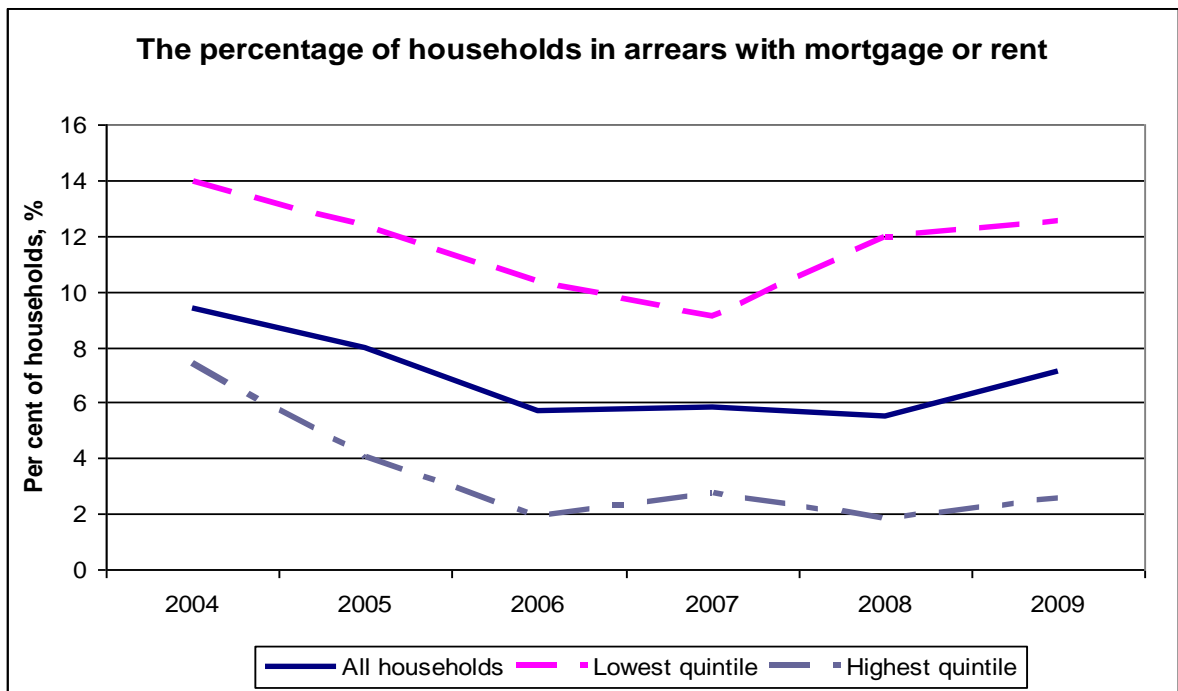
<b>The percentage of borrowers more than 90 days behind</b>	
Commercial banks	10.4%
Housing Finance Fund (HFF)	6.4%
Pension funds	4.0%

Data on arrears with mortgages from the state-owned Housing Finance Fund is available from 1992. The following graph reveals that almost 13 per cent of mortgage holders were in serious arrears in the mid 1990s, when a severe housing bust was accompanied by high unemployment. It should be stressed that at that time, the various measures now available to aid debtors were not in place. The graph also shows that around 1 per cent of HFF mortgage holders were in arrears in 2006-2008.



Source: Housing Finance Fund

Another yardstick by which to measure the development of arrears is to be found in the Statistics Iceland survey on income and living conditions, available from 2004. The following graph reveals that low-income households are much more likely to be in arrears than high-income households. While the proportion of households in arrears with either mortgage payment or rent has risen sharply since 2007, the highest income quintile on the other hand reports no increase in arrears.



Source: Statistics Iceland.