Briefing on mortgage rates relating to the Central Bank (Variable Rate Mortgages) Bill 2016

For the Joint Committee on Finance, Public Expenditure and Reform and Taoiseach

From [redacted] The Fair Mortgage Rates Campaign 17th October 2016

Key points

- Irish lenders charge new customers 1.5% more than the average Eurozone rate.
- An Irish family with a €200,000 mortgage is paying around €3,000 more in interest than they would be paying in another country. Over the course of a 25 year mortgage, such a borrower would pay an additional €46,000 in mortgage interest.
- These rates are not justified by higher costs of funds - Irish banks are paying depositors lower rates than banks in other Eurozone countries.
- It's not just variable rates which are higher. In other Eurozone countries, borrowers can avail of very long term low fixed interest rates. For example, a Dutch borrower with an LTV of <65% can fix for 10 years at 1.64%. They can fix for 20 years at 2.31%.
- Mortgage holders tend to be families with children and the additional €3,000 would help with important things like childcare, education, pensions etc.
- Around 35,000 non-tracker mortgage holders are in arrears. The high mortgage rates have been a significant contributor to their arrears.
- In some cases, the higher rates caused the arrears. And the irony is that the borrower now can't switch to a cheaper lender because of their impaired credit record.
- Switching will not solve the problem:
  - the cheapest lender is still charging 1.5% more than the average across the Eurozone
  - Around 100,000 customers can't switch due to arrears or negative equity
- Fixing will not solve the problem. Bank of Ireland customers who are paying 4.5%, can fix at a lower rate. But this ties them into an interest rate which itself is about 1.5% higher than it should be.
- More competition will not solve the problem because a majority of lenders compete using cash back incentives or lower rates for new customers only – leaving existing customers paying higher rates.
- If Danske Bank which charges 4.95% SVR or any of the vulture funds raises their mortgage rates to 10% tomorrow, there is absolutely nothing anyone can do about it.

We need this legislation urgently

We have been campaigning for two years for lenders to charge fair mortgage rates. In that time, Irish banks have reduced their rates by 1% while Eurozone banks have reduced their rates by 0.75%. Irish lenders have been given enough time to treat customers fairly. We need legislation now.

- Lenders should be obliged to charge existing customers the same rates as new customers and to offer existing customers the same deals, so that all customers would benefit from competition.
- The Central Bank has to be given the power to stop lenders charging excessive rates.
- If the banks continue charging excessive rates and if the Central Bank fails to take action, a hard limit of say, 2% to 3%, above the cost of funds should be set in legislation.
- This issue needs to be dealt with now before the ECB rate rises.

Table 1 Irish banks charge more for mortgages but pay less for deposits

	Ireland	Eurozone	Difference
Average mortgage rate new business August 2016	3.47%	1.89%	+1.58%
Average deposit rate August 2016	0.14%	0.54%	-0.4%
Average margin	3.33%	1.35%	+1.98%

On a mortgage of €200,000 an Irish family pays €3,160 more than they should be paying, each and every year. Over the course of a 25 year mortgage, such a borrower would pay their lender an additional €46,000 in mortgage interest.

The relationship between the cost of funds and mortgage rates is broken. Irish banks should charge less than their Eurozone counterparts because they are paying less for their funds.

Table 2 Mortgage rates for new business

Loan to Value	50%	60%	70%	80%	90%
AIB	3.1%			3.3%	3.5%
Haven – the broking arm of EBS	3.1%			3.3%	3.5%
EBS	3.3%			3.5%	3.7%
Ulster Bank		3.5%		3.7%	4.3%
UB mortgage >€200k, current account				3.1%	
UB mortgage >€350k, current account					3.5%
Permanent tsb	3.7%	3.8%	3.9%	4%	4.2%
KBC (after current account discount)	3.1%	3.15%		3.2%	3.65%
Bank of Ireland		3.9%		4.2%	4.5%

Although the lowest rate on the market is 3.1% for mortgages with LTVs of less than 50%, the Central Bank continues to claim that the average rate for new business is 3%. The Central Bank classifies restructured tracker mortgages as new business, although no new tracker mortgage has been issued since 2008. The true average rate for new customers, when you exclude trackers, is 3.47%.

Table 3 New business mortgage rates in other Eurozone countries May 2016

Ireland	The highest	3.6%
Cyprus	The second highest	3.09%
Malta	The third highest	2.81%
	Average Eurozone	1.84%
Finland	The lowest	1.15%

Who is most affected by this?

There are about 300,000 borrowers with non-tracker mortgages, all of whom are paying at least 1.5% more than the Eurozone average.

However, some are more seriously affected.

Many customers who would benefit from switching to a lower priced lender, can't switch because of negative equity, high Loan to Value, mortgage arrears or mortgage restructuring. For example, a customer of Danske Bank is paying a Standard Variable Rate of 4.95% and can do absolutely nothing about it, if they cannot switch lenders.

The most seriously affected are those who bought around the peak of the market with non-tracker mortgages. They are generally working families who are the future of the country. They are already hit by increased childcare and education costs. And now they are paying €3,000 extra in mortgage interest.

Borrowers in other countries benefit from long term fixed rates

Table 4 New business mortgage rates from ABN Holland

	<65% LTV	65% to 85% LTV	>85% LTV
Variable rate	1.9%	2.1%	2.6%
10 years fixed	1.64%	1.84%	2.34%
20 years fixed	2.31%	2.51%	3.01%

The longest fixed rate term available in Ireland is 10 years from Bank of Ireland, which costs 3.95% for less than 80% LTV. That is over twice the ABN rate.

But haven't the lenders responded to Ministerial pressure to reduce mortgage rates?

Table 5 Changes in mortgage rates since the Fair Mortgage Rates Campaign began

	Irish mortgage rate	Eurozone mortgage rate	ECB rate
August 2014	4.50%	2.64%	0.15%
August 2016	3.47%	1.89%	0%
drop	1.03%	0.75%	0.15%

Bank of Ireland has not cut its SVR, so many of its customers are still paying 4.5%. Permanent tsb has not cut its SVR, so many of its customers are still paying 4.5%. Danske Bank has not cut its SVR of 4.95%.

Most lenders have cut mortgage rates, but only by a fraction more than their counterparts in other Eurozone countries. All mortgage rates have fallen in line with the drop in funding costs.

Quantitative Easing has dramatically reduced the cost of funds for all European banks over the past two years.

The high rates are exacerbating the Mortgage arrears problem

We still have around 70,000 mortgage holders in arrears, about half of whom are non-tracker mortgage holders. The very high mortgage rates are exacerbating this problem.

In some cases, the high rates themselves have caused the arrears. In these cases, the borrowers are hit by a double whammy. The high rates have pushed them into arrears. And because they are in arrears they can't switch lender.

Isn't switching the solution?

Switching helps. But the lowest rates available in Ireland are still way above what the borrower would pay in any other Eurozone country.

It is estimated that 100,000 borrowers, who could benefit from switching to a cheaper lender, are stuck with their lenders and cannot switch

- They have been in arrears in the last 5 years
- Their mortgage has been restructured
- They are in negative equity
- They have a Loan to Value in excess of 80%
- Their income has reduced since they took out the mortgage

There are probably another 30,000 borrowers with small mortgage balances where the savings from switching would not justify the costs and hassle involved. These borrowers are effectively stuck with their current lender.

Can't existing borrowers reduce their mortgage rates by fixing?

Table 6 Lowest fixed rates from each lender for existing customers

	Variable rate	Lowest fixed rates for existing customers
AIB	3.1% to 3.5%	3.5% for 1 year
Ulster Bank	3.1% to 4.3%	3.25% for three years (<60% LTV)
Bank of Ireland	3.9% to 4.5%	3.1% for 3 years (<80% LTV)
KBC	Not quoted	3.7% for two years (all LTVs)
Permanent tsb	3.7% to 4.2%	Not offered to existing customers

The AIB fixed rate is equal to or above the variable rate, so the borrower gains no benefit from fixing.

The fixed rates for Ulster Bank are not very different from the variable rates for the same LTV.

A Bank of Ireland variable rate customer with an LTV of <80% can reduce their rate by fixing but they have to tie themselves into this excessive and restrictive rate for three years.

The cheapest rate a KBC customer can get is 3.7% and a condition of fixing is that they roll off the fixed rate onto the KBC SVR which is 4.05%. So they would be very foolish to fix.

Permanent tsb does not allow existing customers to fix.

As we have seen a Dutch borrower can fix for 10 years at rates as low as 1.64%

Isn't more competition the solution?

An increase in competition which reduces rates for new customers would benefit the existing customers of AIB and Ulster Bank, because when they cut rates, they cut them for both new and existing customers. If a new entrant causes them to reduce their rates for new customers, the existing customers of AIB and Ulster Bank would indeed benefit.

However, KBC competes for new business by offering rate cuts to new customers only. They have not cut rates for existing customers.

Permanent tsb and Bank of Ireland compete for new business, by offering 2% cash back. They can claim to offer new and existing customers the same mortgage rates, but this is misleading. They keep their rates artificially high but attract customers with 2% cash back.

EBS, which is a subsidiary of AIB, is also now offering 2% cash back. As a result of this, when AIB last cut their mortgage rates, EBS did not.

But if Irish mortgages are so profitable, why don't we have new entrants coming into the market?

The scale of the Irish market would not justify a new entrant, other than a small, specialist lender.

There is very little new lending being done.

Around half of the existing mortgages are trackers, so they will never switch.

Around half of the non-tracker mortgages can't switch due to negative equity or mortgage arrears.

And even where they could benefit from switching, Irish borrowers seem very reluctant to switch lenders.

A new entrant into the Irish market will only help if lenders are obliged to offer existing customers the same rates as new customers and if they are prevented from offering cash-backs which would force them to compete for new customers through lowering their mortgage rates.

As we have seen, KBC does not pass on rate cuts to existing customers. Bank of Ireland, ptsb and EBS compete for new business by offering cash back.

Lenders should be obliged to compete for new business on the basis of mortgage rates alone with no gimmicks or incentives which are offered to new customers only.

If that happens, then any increase in competition would help all customers of the active banks.

Obliging lenders to offer the same rates to new and existing customers would be of no benefit to the customers of the lenders who are no longer lending in the market

Danske Bank charges its customers 4.95%. They are not looking for new customers, so obliging them to treat existing customers the same as new customers would not help their customers.

It is the same for former customers of Irish Nationwide, Start Mortgages and Bank of Scotland Ireland whose mortgages have been bought by vulture funds.

The only way to protect these customers is to give the Central Bank the power to control excessive mortgage rates.

If we bring in this legislation, won't it discourage a new entrant from coming into the market?

Since the Fair Mortgage Rates Campaign began two years ago, this argument has been trotted out.

A new entrant who wants to charge the same inflated rates as the existing lenders would be of no benefit to Irish borrowers, so it does not matter if they are discouraged.

While a new entrant charging lower rates would be welcome, it would only help customers who could switch to them and the existing customers of AIB and Ulster Bank if they reduce their rates to compete.

A new entrant would be of no benefit to the 150,000 borrowers who can't switch. They cannot be left without any protection.

But don't we need profitable banks in this country?

Absolutely. We are the Fair Mortgage Rates Campaign, not the Cheap Mortgage Rates Campaign. We are not asking that all borrowers get cheap trackers. We are asking that mortgages should be priced fairly based on the costs of funds and the level of risk involved.

The Irish lenders have used the excuse of historically high default rates to justify higher rates. But the banks have fully provided for their losses on home loans. In fact, because of the increase in house prices, the banks have started writing back these provisions, so they are now increasing the banks' reported profits.

They claimed that high non-tracker rates were needed to subsidise the cheap trackers. With the drop in deposit rates, all of the lenders are now making profits on their tracker mortgage book.

But even if high defaults and cheap trackers were a drag on the banks' profitability, that would not be an excuse to fleece some customers. If a pub tried to charge some customers €10 a pint on the basis that they sell pints other customers at a loss, the overcharged customers would take their business elsewhere.

Mortgages should be priced fairly to generate an appropriate profit for that product range and not to build up the reserves of the banks.

But the Central Bank has said that they don't want this power, so why give it to them?

The Central Bank prioritises the profitability of the banks in Ireland ahead of the interests of borrowers. They have taken no action to stop the banks from fleecing their customers.

However, what is the alternative? The power to control rates could not be given to a government department.

If the Central Bank were given the power, they would at least be able to encourage the banks to stop fleecing customers.

If the banks continue to fleece customers and if the Central Bank does not use its power, then, the Oireachtas would have to put in a hard limit on mortgage rates in the legislation. For example, a matrix of rates could be set based on the cost of funds and the Loan to Value. The threat of a hard cap in the legislation, should prompt the Central Bank to take action.

Appendix – The Current Lending Practices of Irish banks

The following lending practices have been inferred from the actions of the banks.

KBC – Variable rates for new customers

	50%	60%	70%	80%	90%
KBC (after current account discount)	3.1%	3.15%		3.2%	3.65%

KBC is the only lender which does not have variable mortgage rates for existing customers on their website.

KBC quotes attractive rates for new business. But it does not pass on rate cuts to existing customersSo while a new customer today with a loan to value of less than 50% can get a rate of 3.1%, some existing customers with the same Loan to Value are paying 4.05%.

They know that most customers don't know what they are paying and aren't organised enough to switch.

KBC Fixed rates for new and existing customers compared

	1 year	2 years	3 years	5 years
New customers (<80% LTV)	3.3%	2.99%	3.1%	3.45%
Existing customers	Not available	3.7%	3.75%	3.8%

At the end of the fixed rate period, the borrower rolls onto the Standard Variable Rate, currently 4.05% and not the variable rate.

Bizarrely, the theme of their current ad campaign is "no gimmicks."

Bank of Ireland

	50%	60%	70%	80%	90%
Variable rate		3.9%		4.2%	4.5%
1 year fixed				3.4%	3.55%
5 year fixed				3.3%	3.55%
10 year fixed				3.95%	4.2%

Bank of Ireland has the highest variable rates in the market at all LTVs.

Their short term fixed rates are similar to the variable rates on offer from the better value lenders.

They can attract new business only by offering 3% cash back. (2% up front and 1% after 5 years.)

Existing customers who want to reduce the rates they are paying must fix their mortgage with Bank of Ireland or switch.

Permanent tsb

	50%	60%	70%	80%	90%
Permanent tsb Managed Variable Rate	3.7%	3.8%	3.9%	4%	4.2%

While permanent tsb has passed on rate cuts to existing and new customers, they have kept their rates artificially high. They attract new business by offering new customers a 0.5% discount for the first year and by offering 2% cash back to new customers only.

Any customer on an old Standard Variable Rate mortgage can apply to ptsb to move to the lower Managed Variable Rate.

Permanent tsb does not make fixed rates available to existing customers, but does make them available to new customers. They are the only lender with this policy.

AIB

	50%	60%	70%	80%	90%
AIB	3.1%			3.3%	3.5%

AIB passes on all rate cuts to new and existing customers alike.

However, if a borrower's LTV falls from its original level, they do not allow the borrower avail of the lower rate. In fairness, when house prices fell and so the LTVs increased, they did not charge them extra.

EBS

EBS used to charge the same rates as AIB. Up to now they have passed on the same cuts to new and existing customers alike. However, when AIB last cut its mortgage rates, EBS did not cut theirs.

EBS subsequently introduced a 2% cash back for new customers. So it appears that their strategy is to compete for new customers with cash back rather than on mortgage rates.

Ulster Bank

	50%	60%	70%	80%	90%
Ulster Bank		3.5%		3.7%	4.3%
UB mortgage >€200k, current account				3.1%	
UB mortgage >€350k, current account					3.5%

Ulster Bank has high rates for high LTV customers but lower rates for larger loans and low LTV loans.

They are the only lender which allows borrowers to apply for a reduced rate if they reduce their original Loan to Value. So if a borrower takes out a 90% LTV mortgage at 4.3%, but their LTV subsequently falls to 80%, they can apply for the lower rate of 3.7%.