

## REVIEW OF THE PLP MORTGAGE RELIEF PLAN

BY LYNDEN NAIRN

Is the recently released PLP plan to rescue delinquent mortgagors viable? To answer that question, I have considered the current state of affairs, the government's proposal, the key details of the PLP's plan, and the impact of the PLP's plan on mortgagors, the banking sector and the government.

Let me make clear upfront that I do not find that the plan is thoughtless, promotes wealth transfer, is much ado about nothing, damages the financial sector, is inequitable to any segment of society; nor do I find that its implementation would result in a significant funding gap.

Instead, I find that the plan will: i. provide a real rescue line to hundreds of mortgagors; ii. improve banks' profitability; and iii. put hundreds more to work as economic activity is spurred. Moreover, I find that those events occur with limited exposure of the public purse.

### Current state of affairs

Presently, mortgages totaling \$620 million are in arrears and off that sum \$455 million are non-performing. A mortgage is regarded as non-performing when payments are 90 days or more past due. In such circumstances, banks discontinue recording interest on those loans in their income statements. In other words, right now, today, banks in The Bahamas have mortgages aggregating \$455 million that earn exactly \$0. Indeed, those mortgages are costing the banks because administrative costs continue, expenses associated with seeking to foreclose such as legal and appraisal fees are incurred and, perhaps most significantly, there is the incremental cost related to additional capital required for holding non-performing assets not to mention the impact of any provision for bad debt due to the fact that the market value of the property is less than the loan amount. Since 2008, those costs, inclusive of unpaid interest, are likely to have exceeded \$50 million per year.

No Bahamian is exempt from feeling the effect of this situation. Many face the indignity of watching helplessly as their properties are advertised for sale. Others wanting to take out new mortgages are constrained by more stringent requirements. Still others, including realtors, contractors, appraisers, engineers and those they might otherwise employ, confront the reality that the days of high construction demand between 2002 and 2007 are a fading memory.

In the circumstances, there is no moral or economic justification for non-interventionism. Too many are hurting; and too much is at stake.

At the same time, it would be inequitable to put in place a plan that encourages or promotes mortgage delinquency. In that regard, I believe it is absolutely essential that the PLP's mortgage rescue plan is made available to mortgagors who were delinquent on the day the plan was released. This must be made clear – only the roughly 3,000 mortgagors whose mortgages were delinquent on March 31, 2012 should benefit from this initiative.

The government's proposal

In October 2008, no doubt aware of the severity of the mortgage crisis and its rippling effect, the prime minister gave the following unambiguous commitment:

"[We will] put in place a relief program for homeowners who are unemployed or who because of circumstances clearly beyond their means, are unable to continue to keep current on their mortgage payments at the moment. And where banks are unwilling to work with them to continue to preserve their ownership of those homes, we will put in place a program to be able to assist such persons, probably as early as the beginning of next month, November."

Forty months later, it is my considered view that the prime minister has not done what he said he would do. However, I must acknowledge that many people do not share my view. Well, no matter one's view on this point, the unassailable evidence is that since the prime minister's commitment in 2008, the number of non-performing mortgages almost tripled! That is the government's record. Regardless of the validity of the government's attempts to cast doubt on the merits of the PLP's plan, the fact is that their policy, or lack of the same, yielded a much worse situation. It would not surprise me if some opine that it would be nothing short of a dereliction of duty if the government had a plan to ameliorate the suffering of mortgagors, as they now suggest, and failed to implement it. One wonders what could possibly be the motivation for the delay.

The PLP's Plan

The PLP's plan is innovative and well considered. The plan calls for there to be a 120 day moratorium as the government and lenders agree terms of a deal that would bring relief to delinquent borrowers.

Underlying this position is the view that the economic circumstances that existed post 2007 were extraordinary and were exacerbated by ill-conceived economic policies by the government. Thus there needs to be a period where the bleeding stops while the stakeholders agree on a decided course of action.

Next, the PLP will invite lenders to ignore the unpaid interest and fees, which as we have aforesaid, have not been treated as income by the lenders. Accordingly, in doing so, there would be absolutely no adverse impact on lenders. To suggest otherwise, demonstrates profound ignorance or is a calculated attempt to mislead. While not negatively affecting lenders, this action would put mortgagors in a better position to meet their mortgage obligations since the unpaid interest would not be added to their principals. Most people who have had problems paying their mortgages understand this.

The PLP also proposes to invite lenders to reduce the interest rate on the renegotiated mortgages to prime + 1% in return for a 5 year government guarantee. For those mortgagors participating in the plan, a fee of one half of one percent would be assessed annually and placed into a fund. It is not true, as has been reported, that the plan requires mortgagors whose mortgages are current to contribute to the fund. That would be improper. The PLP will use the assets of the fund to meet the government's 5 year interest guarantee as and when necessary.

Some people have asked: Why is it that I have to pay a relatively high interest rate on my mortgage while others who are now delinquent will benefit from a lower rate? The fact is that same question might be asked about every social program from food stamps to unemployment benefits that the government puts in place. In the end, we should accept that every society must have safety nets for people who fall on hard times. Eventually everyone benefits.

The impact of the PLP's plan

The PLP's plan will positively impact borrowers, the banking sector and the government. Borrowers will clearly benefit as they will enjoy restructured mortgages that exclude accumulated unpaid interest, and a substantially reduced interest rate. The schedule below, which assumes a 5 year delinquency and interest rate of 8 percent, shows how mortgagors would benefit by the PLP's proposal.

Balance 5 years ago	Monthly payment	New monthly payment	Total savings
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\$75,000	\$810	\$472	\$101,573
\$100,000	\$1,081	\$629	\$135,431
\$150,000	\$1,621	\$943	\$203,147
\$200,000	\$2,161	\$1,258	\$270,862

Clearly, from the above, more mortgagors, who were previously delinquent, would be able to meet their mortgage obligations.

Lenders will benefit enormously since mortgages that are now non-productive will suddenly become productive. For instance, if mortgages totaling \$200 million are restructured, the banking sector's profitability would jump \$11.5 million! That amount does not include administrative savings, recovery of provisions for bad debt, and the positive effect on capital requirements. It is hard to imagine any banker having a difficulty with this plan.

It is true that there is an increased likelihood that the people who are beneficiaries of the PLP's initiative are more likely to subsequently default than those whose mortgages are now current and that would argue for a higher not lower interest rate. However, there are two countervailing actions that must be factored. First, the 5 year government guarantee, which by itself renders the collection of interest for the period of the guarantee risk free. Second, following 5 years of mortgage repayment, and normal real estate inflation, the equity in the mortgaged property will ordinarily rise thus reducing the lender's exposure. In any event, the reality is that the bulk of delinquent mortgages cannot be normalized in the absence of some kind of concession from the banking sector.

The direct impact on the government will be limited. Contrary to what is being suggested in the media, there is no "significant funding gap". Indeed, if less than 9% of the borrowers who are beneficiaries of this initiative become delinquent within 5 years, the cost to the government would be \$0! If mortgages totaling \$200 million are restructured and the delinquency rate is 20%, the net cost to the government would increase to \$1.5 million per year for 5 years. If the entire block of \$455 million is restructured and the subsequent delinquency rate is 25%, the net cost to the government would be \$5 million per year.

The impact on the wider economy will be extremely positive. Firstly, the inventory of homes available for sale will fall dramatically igniting the construction and real estate sectors. Acquisition of repossessed homes will no longer be an option.

Secondly, as hundreds of loans become productive, banks' overall asset quality will improve and the banking sector's capacity to take on more mortgages will likewise improve. Lenders will become more liberal in their lending practices and more people will qualify to borrow for vacant land and homes. Lawyers and appraisers are among those who will benefit.

Thirdly, the increased economic activity occasioned by the rise in construction activity will result in a growth in government revenue, which will materially outpace the net cost, if any, associated with the government's guarantee. Moreover, the increased activity will by itself result in a normal reduction in delinquencies.

It is my thoughtful view that the PLP should be commended for their plan to address the mortgage anomaly that directly affects thousands and indirectly impacts all of us during this period of economic travail. I know personally that they consulted broadly and it is evident that all of the relevant issues and stakeholders were taken account of. I fully support the PLP's mortgage relief plan.