Irish Journal of Applied Social Studies

Est 1998. Published by Social Care Ireland

Volume 8 | Issue 1

2008-01-01

Local Authority Residential Mortgage Credit: a Source of Non-Market Sub-Prime Homeloans for Low-Income households

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Vol. 8(1), 2008, pp. 51-69

Abstract
As the volume of mortgage credit has risen in tandem with house price inflation, the sub-prime homeloan sector of this market has begun to expand in order to meet demand from those not serviced by the mainstream financial service providers. This article examines the role of local authorities in providing residential mortgages and assesses whether those who have traditionally borrowed from non-market (or public sector) lenders would be considered to be sub-prime borrowers by the private sector. It concludes that, in view of the relatively low average incomes of this cohort of borrowers, they represent a higher probability of homeloan default and as a consequence, would be subject to a higher cost of credit in the private sector. However, this paper highlights the favourable terms offered by local authorities and argues that their failure to price according to the risk profile of borrowers exposes the Exchequer to higher – and often unquantified – costs in pursuit of promoting home-ownership.

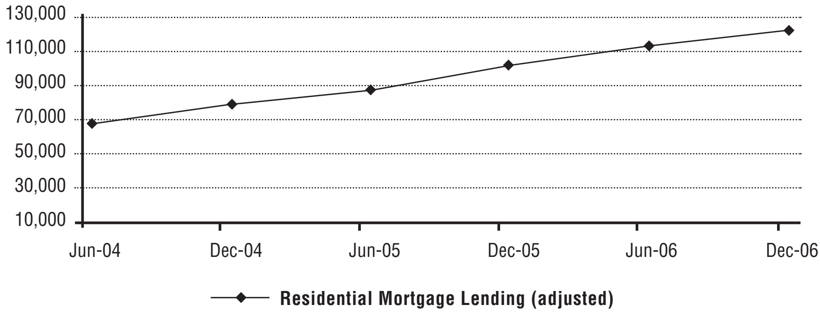
Keywords: Sub-prime lending; Mortgage Credit; Affordability

Introduction
Since the 1990s the twin dynamics of historically low interest rates post-monetary policy integration combined with unprecedented house price inflation as supply lagged behind demand have combined to drive Irish residential mortgage debt ever higher. Compared to most other European Union (EU) member states, Irish homebuyers rely heavily on debt financing. Consequently, the Irish housing market has produced high residential mortgages relative to GDP at 60 per cent plus compared to the EU25 average of approximately 40 per cent. This reflects an emergent pattern in the Anglo-Saxon region of the EU that includes the UK, Germany and others (European Capital Markets Institute, 2006).

Throughout 2006, more than 50,000 new homeloans were granted each quarter with new borrowing valued at almost €10b. These figures indicate continuing strong growth in demand for mortgage products and suggest a mortgage market with an annualised value in excess of €40b.

This lending brought the total residential mortgage market to €121bn with a growth rate of 26 per cent (CBFSAI, 2006). However, although the total outstanding mortgage credit has effectively doubled within 2 years (see Figure 1), the annual growth has fallen throughout 2006 and by the end of the year was at its lowest level since late-2005.

Figure 1: Trend in Outstanding Residential Mortgage Lending, 2004 – 2006



Source: Central Bank and Financial Services Authority of Ireland Monthly Statistics (Various, 2006).

In Ireland, as in many other countries, the market for residential mortgages is disjointed. The traditional lenders enjoy the largest market share but credit is also provided by public bodies and by specialist financial institutions other than the mainstream, commercial banks. Similarly, there exist more than one category of borrower; these can be classified as prime and sub-prime with the mainstream banks generally unwilling to service the latter, higher risk cohort.

These sub-prime borrowers tend to experience difficulties in accessing mortgage credit from traditional lenders for a number of reasons, such as previous credit problems, irregular income and recent marital separation amongst others (Irish Mortgage Corporation, 2006). Consequently, the projected higher probability of default associated with such borrowers is recognised in the pricing structure used by those private sector lenders willing to provide credit to these consumers and sub-prime borrowers can expect to pay significantly higher interest rates than their prime counterparts.

It has been estimated that this particular sub-section of the market is valued at €1b (or 2 per cent of all new residential mortgages in 2006) although this expected to rise to €4b by 2010. This is an emerging market with only one private sector lender providing sub-prime homeloans in 2006 although this is projected to expand as the value of the market grows. However, this is not the entire picture. Many homebuyers unable to access traditional mortgage products have availed of an alternative to the new private sector sub-prime lenders and indeed, have been able to do so for many years prior to the entrance of a private sector lender. For many decades, the local authority sector has been a source of residential mortgage credit and although it has been somewhat displaced by the growth of private sector lending, it is still effectively a 'lender of last resort' for those who cannot borrow from a commercial bank because their income is insufficient but who are deemed by this sector to have a good credit record nonetheless.

It should be noted that those applying for non-market (public sector) mortgage credit share many of the characteristics attributed to sub-prime borrowers. Recent research (Shiels et al., 2007) undertaken by the Centre for Housing Research found that many homebuyers availing of local authority annuity loans were likely to be dependent upon social security benefits as their primary source of income and/or to have a household income below the national median. Similarly, these homebuyers were also likely to have a high incidence of payment arrears and most importantly, were actually required to prove an inability to access mortgage credit from a traditional lender in order to avail of a local authority mortgage.

This article examines the role of non-market mortgage credit and the relationship of these funds to market. The pricing structure of this credit is critically considered and the implications of the risk of default for the Exchequer are explored. This analysis is presented in three sections and these are as follows:

Section Two considers the role of the HFA (Housing Finance Agency) and the local authorities in the provision of residential mortgage credit to low-income homebuyers. The extent of competition and interplay between the public and private sectors is explored in addition to the comparative cost of funds.

Section Three considers the similarities between those accessing local authority annuity loans and those considered by the private sector to be sub-prime borrowers in order to determine whether any – or all – of the former are indeed sub-prime. Consequently, the author examines the balance between cost and risk for local authority loans and considers the efficacy of vetting and advisory mechanisms in protecting the Exchequer in the absence of financial penalties similar to those used by the private sector (e.g. very high interest rates). Finally,

Section Four sets out the key issues arising from this analysis.

Provision of Non-Market Homeloans

The local government sector has played a role in the provision of homeloans since 1899 and until the 1950's, these were available to all households (Norris and Winston, 2002). With the liberalisation of credit markets, the private sector has increasingly assumed a dominant portion in the provision of residential mortgage credit and consequently, restrictions were introduced limiting local authority loans to low-income borrowers. By 2005, the share of the mortgage market attributable to local authorities had fallen to 0.1 per cent from almost 50 per cent three decade before. Local authorities made loans to only 193 borrowers in 2005 (see Table 1) – a reduction of 60 per cent over a decade – although this excludes those who purchased under any of the affordable housing supports. When these are included, the actual number paid is probably closer to approximately 4,000 loans per annum.

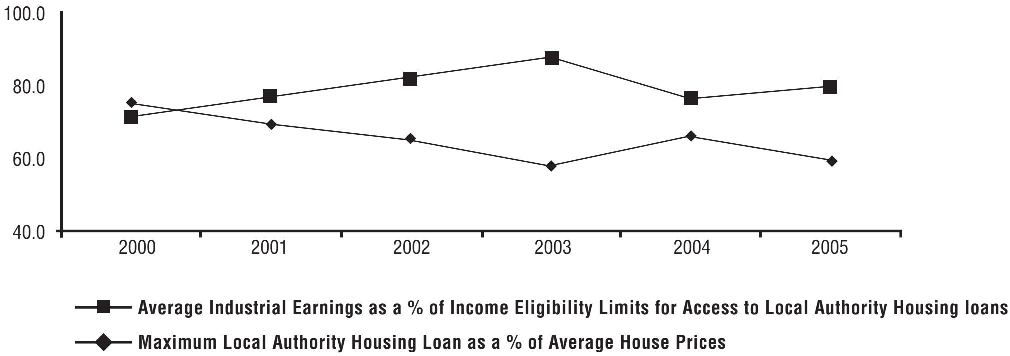
Table 1: Trend in Local Authority Mortgages Paid, 2000 – 2005

	New Houses	Other Houses	Total Mortgage		Share of Market
Year			N	€ m	
2000	52	61	113	4.7	0.1
2001	71	84	155	10.7	0.1
2002	93	131	224	17.6	0.2
2003	108	10	721	516.4	0.1
2004	134	812	151	6.2	0.1
2005	105	88	193	14.4	0.1

Source: Department of the Environment, Heritage and Local Government (various years). Note: Total volume of loans is exclusive of Shared Ownership, Affordable Housing and Tenant Purchase transactions.

The DoEHLG (Department of Environment, Heritage and Local Government) determines the income eligibility limits and loan maxima for these loans. These are not index-linked but rather, they are revised at irregular intervals – just twice in the five-year period 2000-05. In 2004, the income limit was raised to €36,800 from €32,000 and €92,000 from €80,000 for single and dual-income households, respectively. The maximum loan available from a local authority was raised from €130,000 to €165,000. This latter change brings the maximum loan value to 60 per cent of the average price of a new house compared to 80 per cent in 2000 (see Figure 2). Similarly, these changes meant that the average industrial wage equated to almost 80 per cent of the income eligibility limit for a single person. However, given that the average disposable income (after taxes and social transfers) was almost €50,000 per household at the start of the decade, this implies that those on intermediate incomes will exceed this threshold.

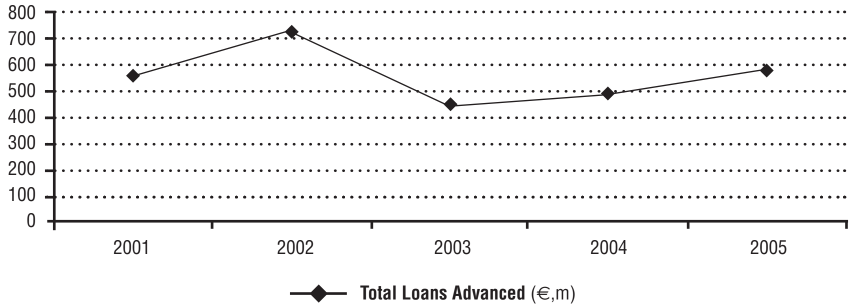
Figure 2: Trends in Local Authority Housing Loan Parameters relative to Prices and Incomes, 2000 – 2005 Source: Department of the Environment, Heritage and Local Government (various years)



Note: Income eligibility limits refer to a single person.

These loans are financed using funds raised by the Housing Finance Agency (HFA) using a government guarantee. The HFA has performed this role for twenty years; prior to 1986 the Office of Public Works (OPW) provided the funds for residential mortgages to the local authorities. The HFA raises funds from the financial markets in large tranches in order to minimise the associated cost of capital and provides the borrowings to the local authorities for housing-related purposes, including the provision of residential mortgages. In 2005, a cumulative total of €579m was advanced by the HFA, an increase of just 3 per cent in annual lending since 2001 and very small in the context of a rapidly expanding market (see Figure 3). Almost all of these funds were provided at a variable rate. This has tended to be the most common loan type in recent years as the use of fixed rate and index-linked loans has fallen from €100m to €100,000 since 2002.

Figure 3: Trend in the Value of Loans Advanced to the Local Authorities, 2001-2005



Source: Housing Finance Agency (2006).

By 2005, almost €3b in local authority mortgage debt was outstanding. This reveals that the non-market sector equates to approximately 3 per cent of total mortgage debt in the State. This outstanding credit is repayable to 64 local authorities – implying that 39 housing authorities have granted no homeloans for many years – although the extent of lending activity varies significantly with Dublin City Council accounting for one quarter of all outstanding debt (see Appendix). Furthermore, as Table 2 shows, half of all outstanding loans were of 21 to 30 years duration although, at 23 per cent, a significant minority of borrower's complete repayments within 5 years and perhaps this reflects a very low initial LTV (loan-to-value ratio) amongst many buyers.

Table 2: Outstanding Loans by Loan Duration, 2005

Duration	Total €m	%
0-5 years	677	23
6-10 years	138	5
11-15 years	227	8
16-20 years	361	12
21-25 years	984	34
26-30 years	509	18
	2,896	100

Source: Department of the Environment, Heritage and Local Government (various years) and Housing Finance Agency (2006).

When the HFA advances funds to the local authorities, the latter add 0.5 per cent for administration and servicing costs before making funds available to borrowers. At end-December 2006, mortgage credit was available to borrowers at a variable rate of 4.5 per cent, roughly equivalent to a 1 per cent margin (or 100 basis points) above the ECB rate. This is the same as the margins used by commercial banks when lending to prime customers but is significantly lower than the rate available to sub-prime customers from specialist banks which is typically 350 basis points or more above the ECB rate. The rate available from local authorities has also tended to be quite stable and although it broadly mirrored the trend in the ECB rate, the full extent of the fluctuations in the latter has not been transmitted to borrowers (see Figure 3). For instance, the ECB rate had moved on many occasions throughout 2005 but the local authority variable rate remained stagnant at 2.95 per cent and, indeed, it was not until the margin between the base rate and rate available to borrowers had fallen as low as 0.6 per cent that the rate was raised to 3.25 per cent in early 2006.

Moreover, although the local authorities do not compete directly with the private sector – they are prohibited from doing so as public policy promotes that sector as the lender of first resort for residential mortgages – the product they provide is quite competitive and tends to undercut private lenders by 0.25 per cent for variable rate loans and 0.05 per cent for a 5-year fixed rate loan. With regard to variable rate loans, the average in the private sector fell within a range of 4.35 to 4.78 per cent and as Table 4 shows, this can equate to a saving of €12 to €64 per month to local authority customers. Interestingly, mortgage finance is made available by the non-market (or public) sector at a competitive rate despite two principal constraints, as follows:

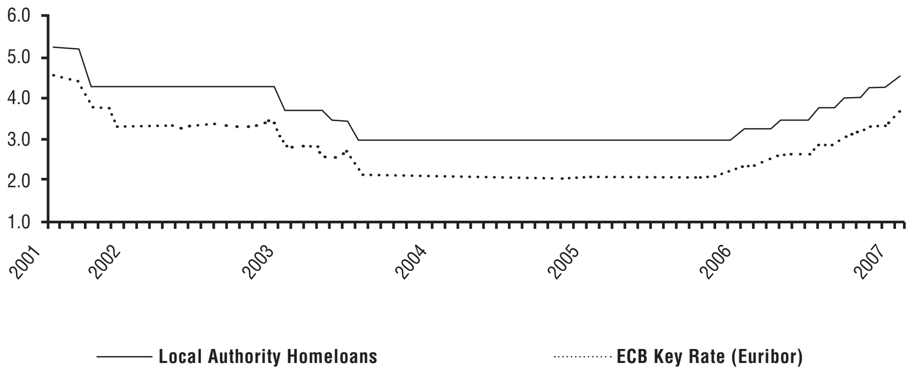
The credit risk for the local authorities is recognised as being potentially higher for a range of reasons; these are addressed in the following section, and The HFA does not engage in other forms of personal finance. In contrast, private sector lenders operate a business model which allows for narrow margins in the mortgage market to be compensated by higher margins elsewhere (e.g. credit cards, etc.) in order to attract new custom.

Table 3: Estimated Comparative Cost of Credit by Sector, 2006

	Private Sector Credit			Public Sector Credit	
Interest Rate	I	€ (annual)		i	€ (annual)
Upper Level	4.78%	12,686		-	-
Lower level	4.35%	12,063		4.25%	11,920
Difference (Saving to LA Borrowers)					
Upper Level					-766
Lower level					-143

Note: Costs of repayment calculated on a 30-year standard variable mortgage for €200,000. Mortgage protection and other charges excluded. Average variable interest rates in the private sector are as reported to the CBFSAI for November 2006.

Figure 4: Comparative Movements in Key ECB Rate and Interest Rates from Local Authorities to Borrowers, 2001(July)–2007(January)



Source: Housing Finance Agency (HFA) and European Central Bank (ECB), (Various Years). Note: The HFA does not offer a tracker mortgage product.

Since 1987, local authorities lend only to those who have been refused mortgage credit by the private sector and/or those low-income households participating in homeownership support schemes (e.g. tenant purchase, affordable housing, etc.) with the exception of those availing of the Affordable Housing Initiative (AHI) which can have no direct impact on the General Government Finances. In 2004, it was announced that a private sector lender would introduce a mortgage product for those purchasers approved by the bank. Prior to this development, mortgage finance for affordable housing purchasers (1999 Affordable Housing Scheme and Part V Affordable Housing Scheme) had been provided exclusively by the local authority sector.

This change had the benefit of introducing consumer choice and competition to the affordable housing market whilst also allowing this cohort of purchasers secure mortgages in excess of the maximum local authority loan limit and ensuring that the AHI would be operational. This change has not benefited all those households using these homeownership supports as it does not extend to those using the Shared Ownership Scheme. However, the availability of private sector credit has not proved popular and to date, only a small proportion of affordable housing purchasers have availed of this option (see Table 5) with more than 90 per cent continuing to use local authority loans within 18 months of their introduction.

It is important to note that the availability of this form of mortgage credit has been beneficial from a social policy perspective. Over and above simply facilitating access to owner-occupation, it is possible to argue that it has contributed to the better re-distribution of wealth. Housing has come to represent the main source of wealth held by any individual household (Malpass, 2005) and in the context of the current house price boom, this is particularly true for Ireland. By making the purchase of a home a feasible proposition for many low-income households, these local authority loans have enabled them to benefit from the strong capital appreciation of the past decade.

Moreover, although this has been achieved at some cost to the State (see Section 3) there is likely no alternative scenario in which the Exchequer would save financially. For example, were the State to charge an interest comparable to that of the private sector – or indeed, to abolish these loans completely – it is likely that many potential borrowers would de-facto be debarred from owner-occupation. Many of these, in turn, would likely fall back on the State provision and it is likely, the consequent cost would be even greater. For example, in the absence of this form of mortgage credit the volume of applicants for social housing would likely rise with knock-on public expenditure under rent supplement (in the interim), the construction and management of social housing and the making available of discounts under the Tenant Purchase scheme.

Table 4: Use of Public and Private Sector Credit among Affordable Purchasers, 2005

	1999 Affordable Scheme		Part V Scheme	Affordable
County Councils	Total	Private Credit	Total	Private Credit
Carlow	0	0	2	0
Clare	0	0	14	14
Cork	98	2	121	1
Donegal	0	0	5	0
Dun Laoghaire- Rathdown	0	0	93	3
Fingal	16	0	198	0
Galway	36	10	11	0
Kerry	0	0	6	0
Kildare	0	0	33	0
Kilkenny	0	0	10	0
Laois	44	0	22	0
Leitrim	0	0	0	0
Limerick	5	0	15	15
Longford	0	0	0	0
Louth	8	6	2	2
Mayo	6	0	53	0
Meath	0	0	17	9
Monaghan	29	0	0	0
North Tipperary	0	0	1	1
Offaly	0	0	13	1
Roscommon	0	0	0	0
Sligo	0	0	0	0
South Dublin	237	0	97	0
South Tipperary	0	0	11	1
Waterford	0	0	41	11
Westmeath	3	0	18	1
Wexford	16	0	24	0
Wicklow	18	0	1	0
City Councils				
Cork	46	32	6	0
Dublin	295	2	138	0
Galway	0	0	1	0
Limerick	0	0	0	0
Waterford	0	0	9	1
Grand Total	857	529	62	60
%	100.0	6.1	100.0	6.2

Source: DoEHLG. Note: Figures for Town Councils are subsumed into the relevant County Councils.

Local Authority Customers – Sub-prime Borrowers?

The local government sector provided mortgage finance to approximately 4,000 households in 2005 – in addition to the 193 purchasers referred to in Section 2, there were also 730 Shared Ownership transactions and the overwhelming majority of those 3,500 affordable housing and tenant purchasers who opted to avail of local authority loans.

These loans can be made up to 97 per cent of the value of a property subject to a maximum loan of €185,000 in 2007. In order to be assessed as eligible, applicants must comply with the following criteria:

- Be able to prove that you cannot get a loan from a bank or building society (some local authorities require evidence of more than one refusal)
- Comply with the income test
- Be in need of housing
- Be registered on a local authority housing waiting list
- Be a local authority tenant or tenant purchaser wishing to return your property to the local authority, and
- Be a tenant in a home provided by a voluntary body wishing to return you property to the local authority.

These criteria ensure that there will be a higher potential risk associated with borrowers but this is offset by the social policy advantage of promoting both credit and homeownership opportunities. The requirement that borrowers be unable to access private sector mortgage finance implies that, by definition, they are sub-prime. Recent research conducted by the Irish Mortgage Corporation (2006) found that sub-prime customers experience problems in obtaining credit from the traditional banks and tend to show the following characteristics:

- Irregular income
- Recently separated
- Previous credit difficulties.

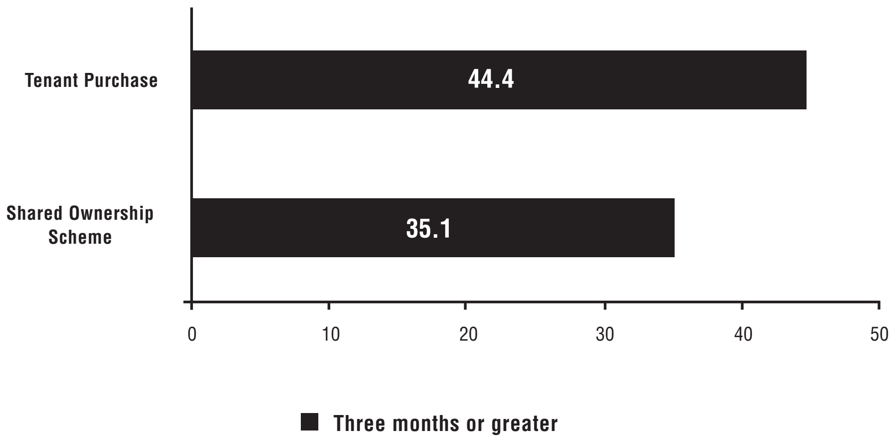
These characteristics are also shared by many of those who have accessed local authority loans and moreover, there are similarities in terms of loan delinquency and other factors. Given these observations, it is worth noting that customers of the private sector sub-prime market pay significantly higher repayments by virtue of their risk profile. For instance, the principal incumbent Start – a joint venture between GE Money and IFG Group – achieved 360 basis points above the Euribor (ECB) and it is expected that a new entrant will target a margin of

300 plus (Davy Research, 2007). By contrast, local authorities do not charge similarly high rates – regardless of the risk of default – but take only a margin of 100 basis points, as previously mentioned, and thus borrowers save significantly. On the basis of the example in Table 4, a local authority customer could pay up to €3,000 or more extra per annum in the private sector.

The associated disadvantage with sub-prime lending is loan arrears and in the worst-case scenario, serious delinquency followed by repossession. Serious delinquency has been defined as mortgages that are more than 90 days in arrears. The US experience suggests that sub-prime borrowers are seven times more likely to be seriously delinquent than their prime counterparts and although there are no directly comparable statistics for Ireland, the differential is likely to be comparable. For instance, recent research has found that approximately half of all low-income purchasers in Ireland (e.g. those availing of local authority mortgage credit) recorded some degree of arrears in 2003 (Shiels et al, 2007). These rates are far in excess of those of the commercial mortgage lending institutions where, for example, 7.2 per cent of mortgages had arrears in 2001 (Irish Mortgage and Savings Association, 2002).

In the case of non-market sub-prime borrowers, the incidence of serious delinquency is very high, ranging from a fifth to two-fifths of users of the schemes. Figure 4 shows the results for borrowers under a selection of schemes in two urban local authorities. The figures for the Tenant Purchase and Shared Ownership schemes cited below indicate the level of serious delinquency. The research by Shiels et al (2007) noted that those with substantive arrears were likely to have initially defaulted on the payment of their mortgage protection insurance before beginning to miss mortgage repayments at a later date, followed ultimately by more pronounced non-payment. This is consistent with the behaviour of borrowers in the US and Chinloy (1995) notes that default is a three stage sequential process consisting of initial delinquency, long-term non-payment and ultimate default. However, it remains unclear the extent to which local authorities in Ireland pursue the ultimate sanction of repossession.

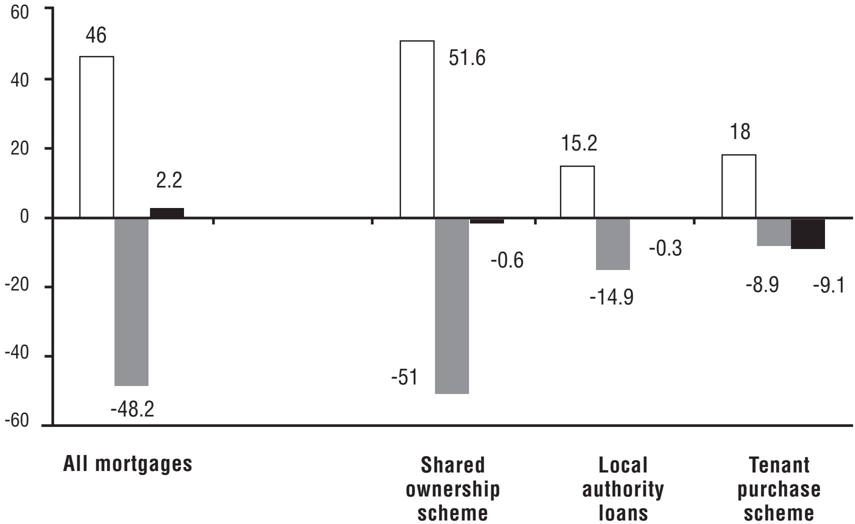
Figure 5: Percentage of Participants in the Low-Income Home Purchase Support Schemes in Urban Local Authority Areas who Experienced Loan Arrears of Three Months or More at end-2003



Source: Shiels, Norris, Coates and Kane (2007).

The incidence of arrears on these types of mortgages has increased in recent years – a review conducted by the DoEHLG in the late 1990's found that almost 20 per cent of loans were in arrears but the comparable figure in 2003 was much higher. This change has occurred at a time when the underlying demographic composition of those households accessing local authority loans has also been changing. Specifically, households are now less likely to be married but rather, are more likely to be headed by a single or separated person (see Figures 5) reflecting a further comparison with the characteristics of sub-prime borrowers, as outlined earlier. This trend applied to all mortgages and particularly those who availed of the Shared Ownership scheme. A similar shift was evident for the tenant purchase scheme and the local authority loans scheme, but it was less dramatic.

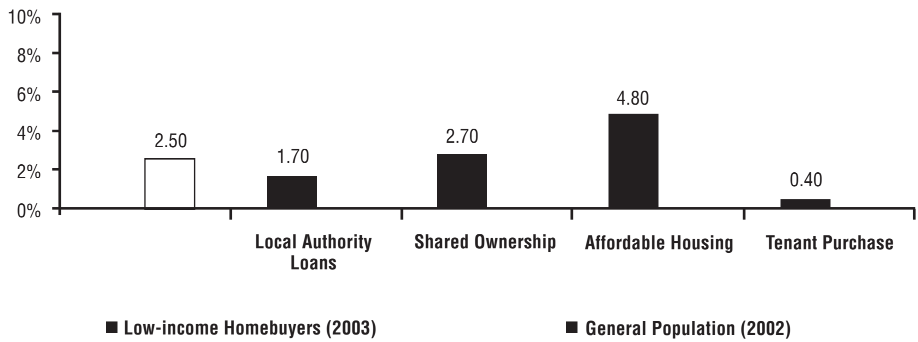
Figure 6: Change in Marital Status of all Mortgage Borrowers and Participants in the Low-Income Home Purchase Support Schemes between 1992/93 and 2002/03



Source: Shiels, Norris, Coates and Kane (2007). Note: The reference to Local Authority Loans excludes those availing of these loans under the terms of the other schemes.

Figure 6 indicates that households headed by a separated person were over-represented relative to the general populace. This implicit relationship between marital status and the incidence of arrears amongst those availing of non-market mortgage credit is again similar to the position in the private sector sub-prime market. Moreover, the international research in this field has found that the sustainability of owner-occupation among low-income households implies that such households are more likely to require two earners and that family break-up will have a disproportionately adverse impact upon women (Early and Mulholland, 1995; Malpass, 2005). With regard to the latter issue, the majority of separated heads of household in Figure 6 were women.

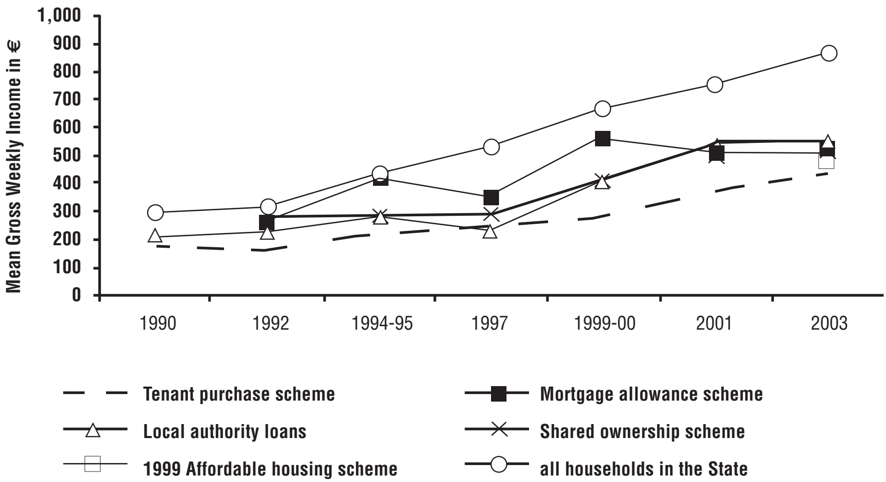
Figure 7: Proportion of Separated Non-Market Borrowers Compared to the General Irish Population, 2002/03



Source: Shiels, Norris, Coates and Kane (2007).

Given the presence of the income test and the relatively low level at which the thresholds are set, the mean income of those who have borrowed from the local authorities tend to be low. This, in turn, implies that proportion of income required to service borrowings is likely to be high and this raises important questions regarding the sustainability of homeownership as evidenced by the extent of loan arrears. Figure 7 shows that the income of those with local authority mortgages has tended to lag behind that of all households in the State. This gap has widened over time and by 2003, the gross mean weekly income of those local authority tenants purchasing their home was only half that of the national average with those using the Shared Ownership and Affordable Housing schemes only slightly better-off.

Figure 8: Change in Estimated Gross Mean Weekly Household Income for Low-Income Home Purchase Supports and All Households, 1990–2003



Source: Shiels, Norris, Coates and Kane (2007).

On this basis, it is reasonable to conclude that many, though not all, of those availing of local authority loans share the same characteristics as sub-prime homebuyers in the private sector – in terms of low-income, marital status and the incidence of arrears – and would be considered to do so by that sector. However, the non-market sector does not impose higher repayment costs to balance the higher risk of arrears and/or default, as is the norm among commercial lenders, but rather, makes credit available at a competitive rate. Although this plays a positive role in broadening opportunities for homeownership, it does expose the Exchequer to a potential high risk of non-repayment with the associated costs, particularly given the fact that local authorities are not always proactive in managing arrears with the opportunity cost of such funds foregone borne by the State.

It is therefore worth considering the systems in place to minimise the risk of arrears and whether these can be effective in protecting the Exchequer. In the first instance, credit counselling is available to low-income borrowers and ideally, this should mitigate the risk of non-repayment of mortgages. This type of service is common in many countries and in Ireland the Money Advice and Budgeting Service (MABS) provide financial advice to those seeking assistance. By 2006, almost 11,000 new clients had been seen by MABS and these clients reported €48m outstanding in debts to financial institutions including banks and credit unions (DoSFA, 2006). Although approximately 21 per cent of MABS clients had mortgages, there are no statistics available on the rate of mortgage default post-counselling and as such, it is difficult to fully assess the effectiveness of this service.

Moreover, commercial lenders avail of credit checking facilities in order to minimise the risk of default on any mortgages granted. This process involves an examination of the credit history of an applicant and a determination on the degree of risk associated with any loan. Ireland does not have a compulsory public credit register but since 1963 there has been a private credit bureau. This bureau pools information from many lenders over a number of years and the lenders then use this system of information sharing on the creditworthiness of their borrowers in order to reduce default rates. The type of information shared in Ireland includes arrears, defaults and debt exposure (Jappelli and Pagano, 1999).

However, the vetting processes employed by local authorities would seem to be much less developed. Several officials in this sector informed the author that the only steps undertaken prior to approving a loan were to confirm that household income complied with the income test criteria and to check the level and cost of any outstanding loans. Consequently, the process used does not generally allow a local authority make an informed decision based upon any gradation of risk – notwithstanding the obvious initial refusal of the commercial lender – but rather, they can only chose to grant or refuse the application of an eligible household. On this point, the same officials informed the author that for this reason the volume of refusals was very low and that the balance between applications received and refused was not actively monitored by the DoEHLG.

Conclusions

The availability of relatively low cost mortgage credit from the local government sector has a number of key advantages for both low-income households and public policy generally. These loans expand opportunities for credit and homeownership and in doing so, ensure that the market is complete with the greatest benefit accruing to those who are unable to use the services of traditional lenders.

Local authorities make mortgage finance available to low-income homebuyers and in doing so, there is necessarily a trade-off between expanding opportunities for accessing credit at an affordable cost against a risk of non-payment of this debt. This paper has set out the case for classifying those availing of this type of mortgage finance to be sub-prime, both in terms of income and demographic factors but more importantly, taking the incidence of serious delinquency and previous mortgage refusals as the benchmark. This cohort can avail of loans from the non-market sector and can do so at a cost of repayment which is significantly less than that charged by specialist lenders in the private sector. Moreover, sub-prime borrowers in the latter sector will often use these lenders in the short to medium term in order to repair a poor past credit history prior to re-financing with a traditional lender; this option is open to those with local authority loans but without the additional cost.

It is for the purpose of removing this obstacle to ever greater owner-occupation that these loans are available but questions must be raised as to whether, in their current format, they are always beneficial to mortgagor and mortgagee. The level of repayment difficulties encountered by many borrowers implies that a high proportion of mortgages granted are unsustainable and that the vetting procedures are insufficient – these do not supply local authority lenders with much needed data and as such, represent an imprudent approach to risk and financial management of public funds. Given that these loans are apparently intended for those with low incomes but a good credit history, it is important that the DoEHLG consider whether the extant combination of vetting procedures and credit counselling are sufficient to minimise the risk of arrears and achieve overall public policy ends.

Moreover, the current levels of immigration combined with a strong take-up of self-employment opportunities would suggest that the demand for sub-prime mortgage finance will increase in the future, as these are typically determinants of the need for this type of credit. Given the comparative savings available from the non-market sector, this would suggest that demand for local authority loans will rise and both the DoEHLG and the HFA should consider the ability of the sector to respond accordingly and seek to minimise the potential cost and risk to the Exchequer.

As such, it is possible to set out a number of alternative scenarios from a public policy perspective therefore, including:

Were this source of non-market loans to be abolished, it is unlikely there would accrue any saving to the Exchequer. In contrast, the loan arrears avoided could well be more than countered by the cost to the State in terms of an increased take-up of rent supplement, social housing and other supports.

Rather than abolition – or even a higher interest rate – a review of the systems and procedures for vetting and approving applications could prove more effective. This would better enable the loans to achieve their stated objective whilst ensuring greater value for money.

The provision of residential mortgage credit by the local authority sector to those unable to access private sector alternatives is an important housing policy intervention. However, the systems and procedures must be sufficiently robust to protect both the borrower and the Exchequer.

*The views expressed in this article are those of the author and do not necessarily reflect those of the funders or board of management of the Centre for Housing Research.

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