APRIL 2020

MORTGAGE AND PROPERTY REPORT

Kensington

Welcome to the second edition of Kensington's Special COVID-19 Update Series. In this newsletter, we look at the use of mortgage payment holidays (MPHs) by customers in financial difficulties as a result of the coronavirus crisis. We examine the take up rate to date, and take a closer look at the common characteristics of loans that are on a MPH, and what this might mean when payment breaks come to an end.

Key Highlights

- Mortgage payment holidays have been granted to a significant portion of UK mortgage customers as a result of the COVID-19 crisis, with more than 1 in 9 loans now on a MPH
- Certain loan characteristics appear to increase the likelihood of a customer requesting a MPH
- There will be benefits for the industry to have standard options like capitalisation at the end of the payment holiday but this will need to be balanced against the specific needs of different customers.

Introduction

For many UK mortgage customers whose finances have been impacted by the current COVID-19 crisis, the government's announcement on March 16th that lenders would grant payment holidays on mortgages for up to 3 months was a welcome lifeline. The measure is unprecedented, and would have been unthinkable just a month earlier. Trade body UK Finance estimates that as of mid April, 1.2 million MPHs have been granted in the UK, at a rate of c. 60,000 per day in the first two weeks. This means that data can vary considerably by the date on which it is determined. In this newsletter, we examine the profile of customer who have been granted a MPH as of April 20th in Kensington's serviced portfolio, which includes both our own originations (legacy and new collateral) as well as third party clients' loans. In addition to being the largest non-bank specialist lender in the UK, Kensington is a leading mortgage administrator, servicing a total of c. 110K mortgage loans across its own and third party portfolios. Kensington's experience in the sector goes back almost 25 years through the various platforms it has acquired and built. Likewise, the group's serviced portfolio is varied, with a mix of owner occupied (OO) and buy-to-let (BTL), historic arrears cases, and a high proportion of outstanding loans originated before the 2008 financial crisis, as well as a growing post-2015 book. In the following analysis, we examine the serviced portfolio as a whole, noting trends along the way, and drawing conclusions where we can.

Fig 1: Distribution of Serviced Portfolio by Balance and by Count

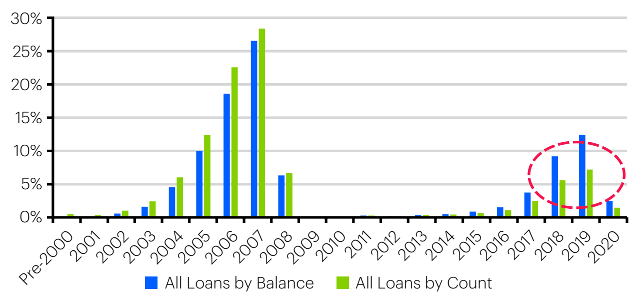
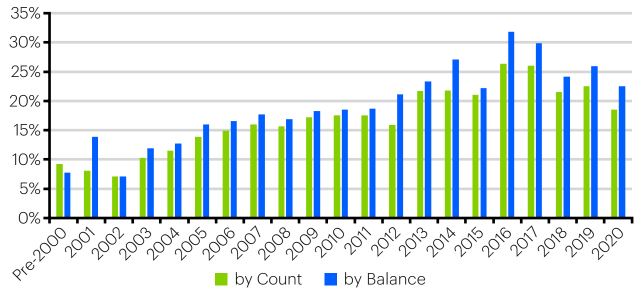


Fig 2: Percent of Loans on MPHs in each Vintage



Portfolio Trends

We start by looking at the correlation between a loan's vintage and the likelihood of it being on a payment holiday. Figure 1 shows the distribution of the total loan book which the following analysis is based on by origination year, both by balance and by loan count. The distribution of MPHs that have been granted broadly follows vintage, although there is some skewing in more recent years, with loans originated from 2014 onwards representing a greater proportion of MPHs than their weighting in the overall book. This is evidenced in Figure 2, which shows the percent of loans by vintage which have been granted a MPH. The most seasoned loans have the lowest take up rate, peak pre-2008 crisis loans are just over 15%, and most recent originations between 20-30%.

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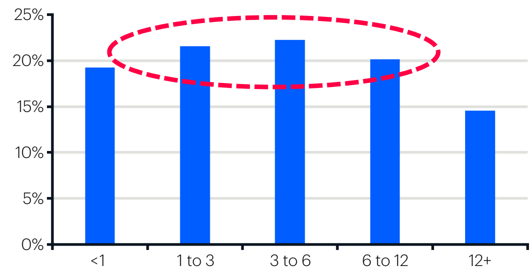
Fig 3: Percent of Loans in each Month in Arrears Bucket on a MPH (by balance)



This trend is one of the first to emerge, and there are several hypotheses for this pattern. One is that legacy loans are more likely to have been in arrears previously, and that borrowers with prior missed payments are generally less likely to call their lender or servicer to discuss difficulties than ones for whom the situation is unfamiliar. Figure 3 shows what percentage of each arrears bucket in the overall portfolio has been granted a payment holiday (granted is assumed to be the same as requested in this analysis, as customers who ask for a MPH receive one in almost all cases, in line with government guidance). Interestingly, the lowest take up rate is indeed in the 12+ MIA bucket. Performing loans are the next lowest, possibly driven by the fact that these borrowers are more probable to have savings to cover mortgage payments even in the face of lost income. Customers in the 1-6 MIA range have taken up rates of just over 20%.

A key distinction to keep in mind is that the absence of a MPH does not signify the absence of financial difficulties, but just a failure to request a payment break from the lender. In looking at the data more closely, we found that c. 2% of the total portfolio cancelled their direct debit (DD) mandates between the end of February and end of March, but a significant portion of these customers had not (or not yet) requested a payment holiday. There is a large variance in tendency to pay by DD by vintage, as seen in figure 4, with most recent originations at close to 100% DD payers, vs. c 60% for pre-2008 loans. The latter are more likely to miss a payment without speaking to their lender, as this requires no action on their part.

The next pattern we observed is that customers on higher Contractual Monthly Instalments (CMIs) exhibit a much greater likelihood to be on a MPH than those with lower ones (Figure 5). This trend is not unexpected, but it is notable how pronounced the correlation seems to be . Customers on a CMI of less than £500 (who account for over 60% of the total book by count and 44% by balance) had a MPH take-up rate of between 5-15%, gradually increasing, up to over 30% for those with CMIs over £1500. When we looked at how this compares to loan balance (Figure 6), it is clear that a similar trend is seen. Customers with a loan balance of less than £50K had a take up rate of c. 10%, which gradually increases with higher loan balances, up to almost 30% for loans of £300K or more (which only represent c. 3% of the total serviced portfolio). When comparing this to LTV, the pattern remains the same, but less pronounced, moving from 10% at less than 25% LTV, to 20% at LTVs over 85%.

The final trend is a higher take up rate by customers on owner-occupied loans than BTL, of c.17% vs c.12% (Figure 8). MPHs are typically granted to landlords whose tenants are experiencing financial difficulties. It may be the case that tenants are failing to communicate with their landlords about their circumstances. Alternatively, some landlords may be paying their loan even where the tenant is not, as if they have the means to cover the payment (which is typically lower as it will be on an interest only basis), they should do, so as not to accrue interest unnecessarily.

Fig 4: Percent of Loans in each Vintage paying by Direct Debit (by Count)

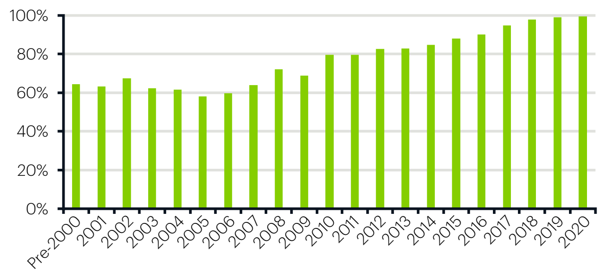


Fig 5: Percent of Loans by CMI on a MPH (by Balance)

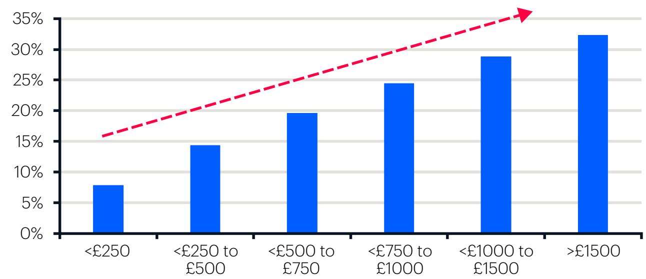


Fig 6: MPH by Current Loan Balance (by Count)

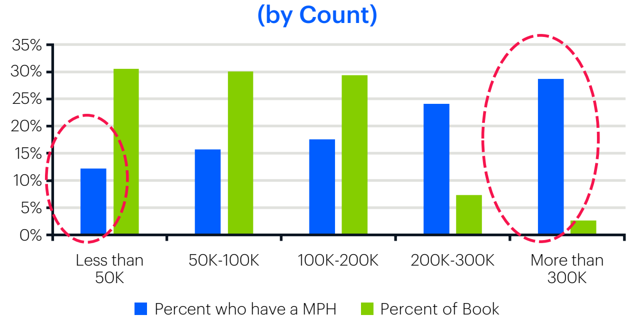
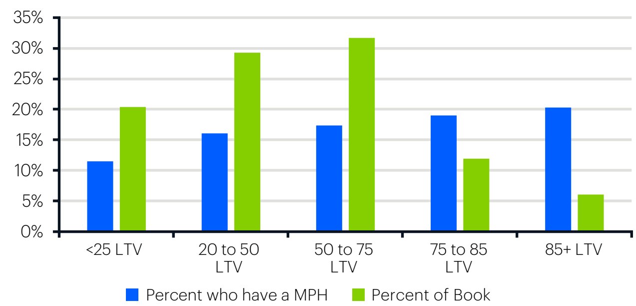


Fig 7: MPH by Current LTV (by Count)



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Interestingly, one trend we expected to see which we did not, was a greater tendency for Purchase loans to go on a MPH than Re-mortgages, given the latter will generally have lower balances and LTVs, and a track record of affording their mortgage payments. We looked at more recent originations (2014 through 2020), as for very seasoned loans the difference will have become insignificant in any case, but found that the take up rate was very similar, at 21% for Re-mortgage vs 24% for Purchase loans.

Fig 8: MPH by Occupancy

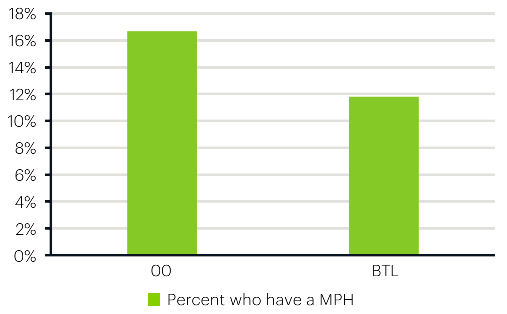
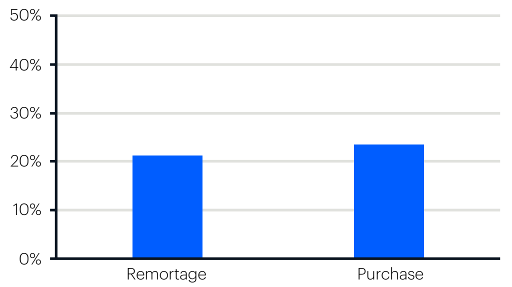


Fig 9: Percent of Loans Originated Between 2014-2020 which are on a MPH, by Purpose (by Count)



Conclusion

Ultimately, the big question that arises out of this is how customers will come out of these payment breaks and whether the trends seen above can help us understand how easy or difficult that will be. There is some reassurance in seeing that the majority of MPHs have been granted to customers with previously performing loans, as well as the fact that the loans in recent vintages with higher take up rates were made to customers whose affordability was assessed using post MMR rules that require a significant buffer in customer affordability (even if not enough for the current situation). With no clarity on when the economy will recover, it is difficult to predict how the situation will play out and factors such as the industry in which a customer is employed and when the lockdown and/or present restrictions are lifted on those particular roles, will play an important part. There will be significant operational benefits of a single form of restructuring (such as capitalisation) for getting so many customers 'back to normal' in a narrow window, but one solution will not work for the individual circumstances of all customers so the industry is going to have to balance these two factors at the end of the payment holiday period, whenever that may be.

Notes

1. Due to a skew caused by very small sample size for 2010, data has been adjusted to reflect average for the period 2009-2011.
2. 2020 origination data is up to end of February originations
3. Arrears, CMI, and balances are all as of end of February 2020

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