

Residential interest only mortgages

Volumes, concentrations and maturity horizons



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Our thematic review on the maturity of interest-only mortgages has considered four key areas:

- Analysis of the size, scale and time horizon of future maturities of interest-only mortgages;
- Understanding consumers' readiness to repay the capital due at the end of the term and the management of any potential shortfall;
- A sample review of firms' current strategies, policies and practices in respect of interest-only mortgages; and
- A review of the application of our Rules and Principles in respect of post maturity interest-only mortgages.

We commissioned the analysis in this report to support the first of these objectives.

The analysis provided throughout this report, based on data covering over 95% of regulated residential interest-only borrowers in the UK, has been invaluable in providing an overview of the characteristics of the interest-only loans maturing now and into the future.

It has helped to inform our strategic response to this issue, which is aimed at minimising any potential future detrimental impact of this risk on borrowers and lenders alike.

The analysis provided throughout this report, based on data covering over 95% of regulated residential interest-only borrowers in the UK

Executive Summary

The aim of this analysis is to provide insight and understanding of consumers who are approaching their interest only mortgage maturity and to establish a time horizon of all residential interest only mortgages due to reach the end of term over the next 30 years. The analysis in this report looks at the volume and value of residential interest only mortgages within the UK and examines concentrations by geography, demography and credit exposure of segments of the UK population.

The remit of this analysis is to consider FCA regulated residential interest only mortgages, and identify homeowners who have exposure to maturity risk. Buy-to-Let, Off-set and Lifetime mortgages are outside the scope of this analysis.

Through a combination of the FCA Product Sales Data (mortgage origination information) and Experian data on the monthly position of each mortgage, the current position of the interest only mortgage stock has been profiled.

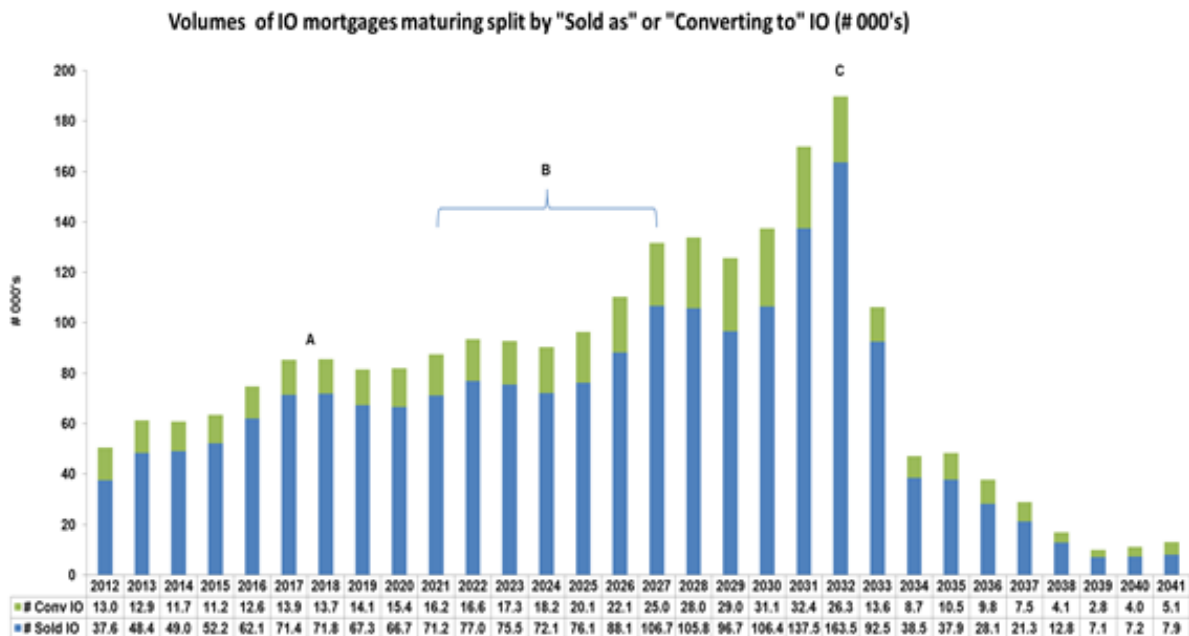
An algorithm has been developed to identify residential interest only mortgages 'sold as' such and those 'converted' to interest only terms (on either a long term or temporary basis) at some point in the account life. The algorithm uses original loan value, loan term, monthly payments, monthly balance changes and monthly arrears position to infer a month by month repayment method, repayment, interest only and part and part. As the algorithm is based upon payment behaviour if a mortgage is contractually on interest only terms but the consumer is over-paying this will be classified as repayment (examples of how the algorithm works are provided in the Appendix).

The key findings of this analysis are:

- As of December 2011, 2.6m residential interest only mortgages represented 29.4% of all residential mortgages (by case volume), with 0.5m part and part mortgages accounting for 5.6%.
- The volumes of residential interest only mortgages stock have fallen by 2.4% over the last 2 years, while the numbers which have been converted to interest only terms at some point in the life of the mortgage i.e. those mortgages sold as repayment but now on interest only terms, has risen by 2.5% over the same period.
- It is estimated 12% of residential interest only mortgages are currently in negative equity (where the outstanding balance of the mortgage is higher than the value of the property).
- London, the South East and South West have high concentrations of 'sold as' residential interest only mortgages, particularly among young professionals in their 20's or early 30's. This group has relatively high unsecured credit commitments which are typically off-set by good incomes.
- 37% of residential interest only mortgages, which were sold as such, are held by a group of older more affluent people. This segment of the population typically has low debt to property values and high value investments.
- Historically low volumes of residential interest only mortgages have been sold in Northern Ireland. However, Northern Ireland has the highest rates of conversions to interest only terms in the UK.

- Conversions to interest only terms during the term of the mortgage occur across all demographics to some extent. The highest income groups, typically with large properties and high value investments, have a higher concentration of this behaviour. They are likely to have equity in the property and alternative repayment vehicles, interest only mortgages offer this group the opportunity to minimise monthly outgoings.
- There is a concentration of interest only mortgages for younger consumers with mid-incomes and high levels of unsecured borrowing. This segment of the UK population are more likely to have been sold an interest only mortgage than have on average converted to interest only terms during the life of the mortgage, levels of equity within the property are low and debt servicing costs leave little ability to afford increased mortgage payments.
- More than 10% of people with residential interest only mortgages have in excess of £25,000 of unsecured borrowing. Of the population with high unsecured borrowing and currently on interest only terms, 21.4% have converted to interest only at some point in the life of the mortgage and 78.6% were sold as interest only.

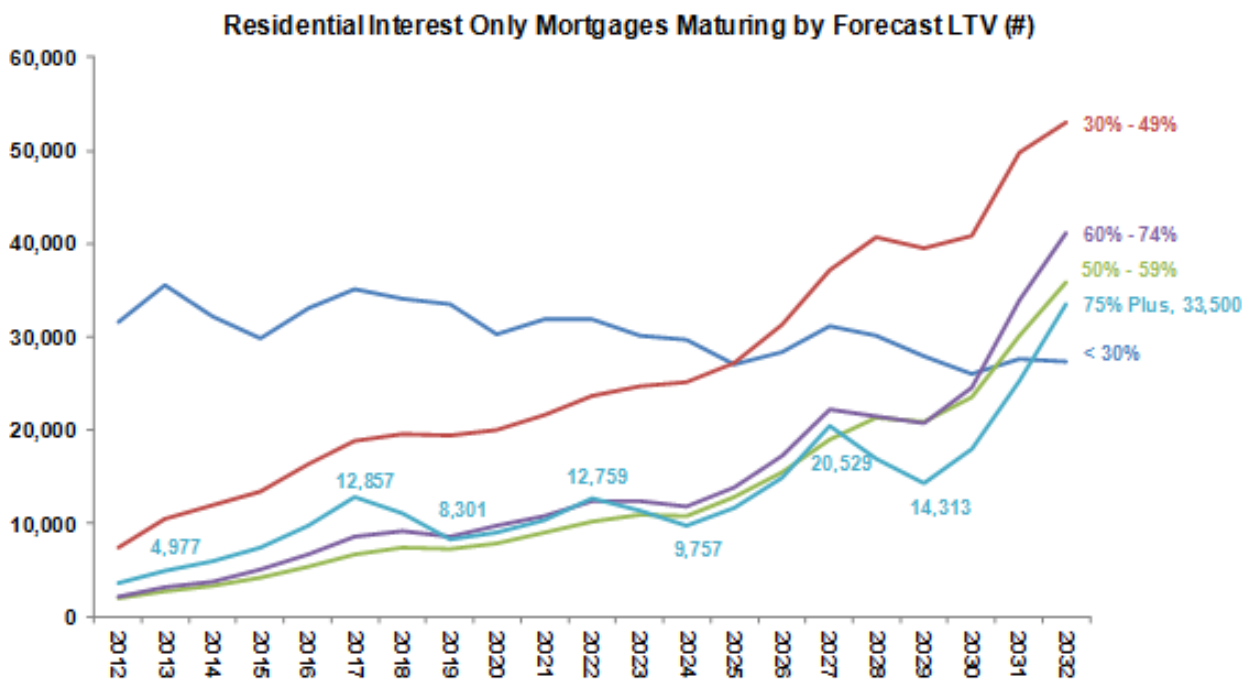
- Based upon the current residential interest only mortgage stock position, the maturity horizon (the points at which the residential interest only mortgages are due to reach the end of term) has been projected.



The residential interest only mortgage maturity horizon has three peak periods:

- 2017/2018 – this peak is a result of endowment mortgages sold in the 1990’s and early 2000’s and is typically comprised of individuals approaching retirement with high incomes, high assets and high levels of forecast equity in the property at the end of the term. Maturing mortgages in this peak are concentrated in the South East and South West.
- 2027/2028 - this peak is a result of interest only mortgages typically sold from 2003 to 2009. Maturity starts in 2022, peaks in 2027/2028 and is characterised by less affluent individuals currently in early to mid life stages. This group has higher income multiples at point of origination, higher rates of ‘converted’ interest only mortgages, lower forecast equity levels and is concentrated in the South West, East, North West, London and the West Midlands.
- 2032 - the final peak is driven by residential interest only mortgages opened from 2005 to 2008 (with higher income multiples and loan to values) and the mortgages converted to interest only terms at some point during the life of the mortgage. There are concentrations of highly indebted individuals with low or negative equity in the property at the point of maturity within this tranche.

- In general the capital balance remaining at the end of the term increases the further into the future the maturity event occurs.
- Over the maturity horizon the volumes of residential interest only mortgages due to mature with a forecast loan to value in excess of 75% are projected to increase from 5,000 in 2013 to 33,500 in 2032 (17.6%). During this period there are peaks in the numbers of mortgages maturing with a greater than 75% loan to value in 2017, 2022 and 2027.



- There are approximately 40,000 residential interest only mortgages due to mature each year between 2017 and 2032 where the consumer will be past 65 when the mortgage reaches the end of term. The majority of these are forecast to have a loan to value of less than 75% at the end of the term.

The body of this report profiles each of these groups of residential interest only mortgages as they currently stand and projects forward a range of consumer positions, some of which may result in a risk of repayment problems at the point at which they are due to mature.

Residential interest only mortgages - market analysis

Profiling Interest Only mortgages

This report considers the 10.6m residential mortgages open within the UK (December 2011 position, excluding Lifetime and Off-set mortgages). The FCA does not regulate Buy-to-Let mortgages, therefore, 1.7m such mortgages have been excluded from this analysis.

Of the 9.0m regulated residential mortgages, 2.6m are on interest only terms, 29.4%. A further 0.5m (5.6%) are on part capital and interest and part interest only terms, the part and part population have not been included within this analysis.

80.3% of mortgages paying the interest only at the present time were originally sold on these terms. These may have been endowment or pension mortgages with an associated investment vehicle or, more recently, an Interest Only mortgage, where the consumer invested independently in some way to provide a method for repaying the capital balance of the mortgage at the end of the term.

Figure 1 shows the decrease in the volumes of Interest Only (IO) mortgages from the beginning of 2011 onwards, year-on-year to December 2011 this represents a 2.2% reduction. This has primarily been driven by fewer residential interest only mortgages being sold in recent years with lenders increasing the deposits required and some withdrawing from the interest only market. Those mortgages which have been converted to interest only terms represent 19.7% of the overall stock.”

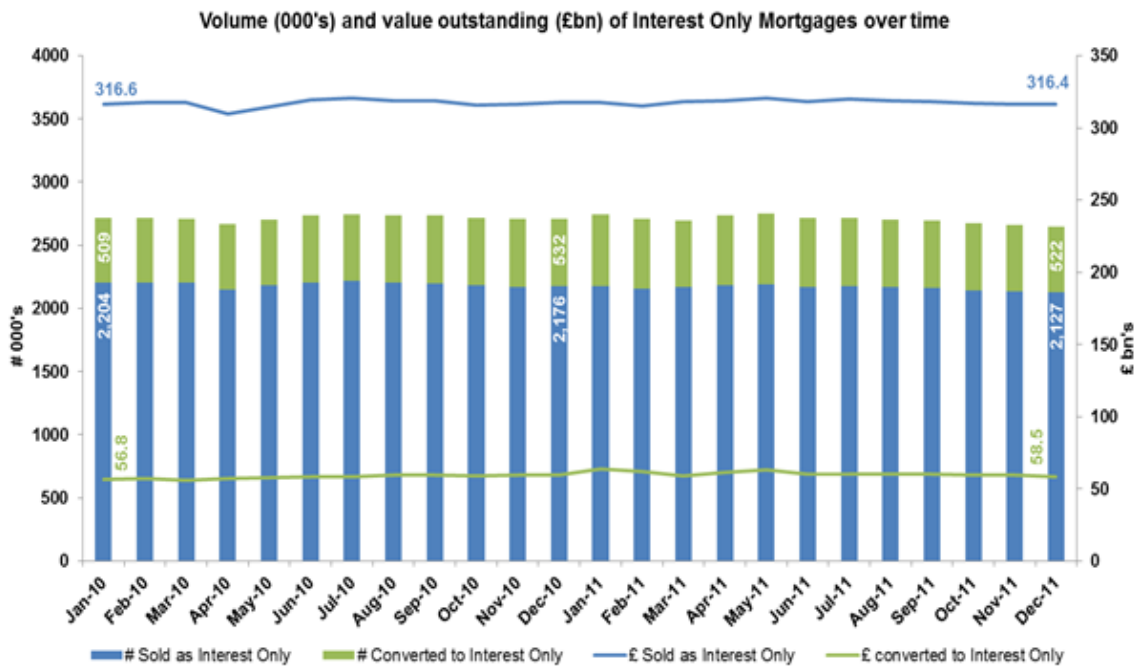


Figure 1: Volume and Value of Residential interest only mortgages trend (Source: Experian)

Whilst the absolute volumes of converted residential interest only mortgages are falling (1.9% reduction year-on-year to December 2011) the proportion they form of all residential mortgages is not reducing overall.

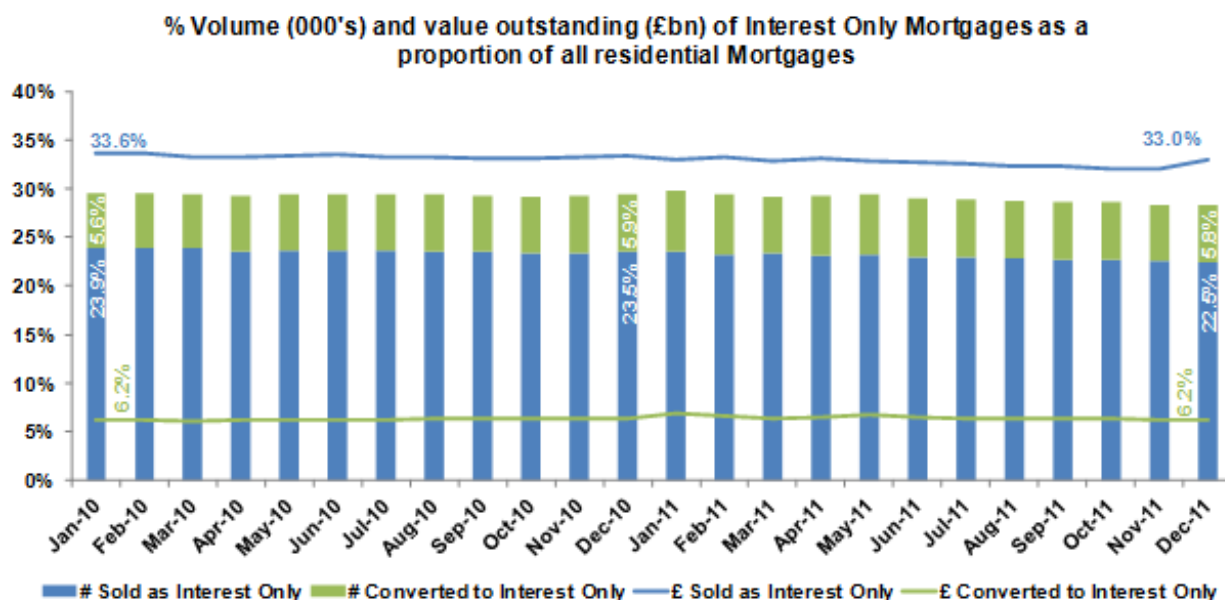


Figure 2: Percentage interest only mortgages, by volume and value, of all residential mortgages trend (Source: Experian)

Regional profile

There are significant geographical concentrations of 'sold as' residential interest only mortgages in the South East, South West and London with higher house prices in relation to incomes resulting in residential interest only mortgages representing a higher proportion of all residential mortgages sold.

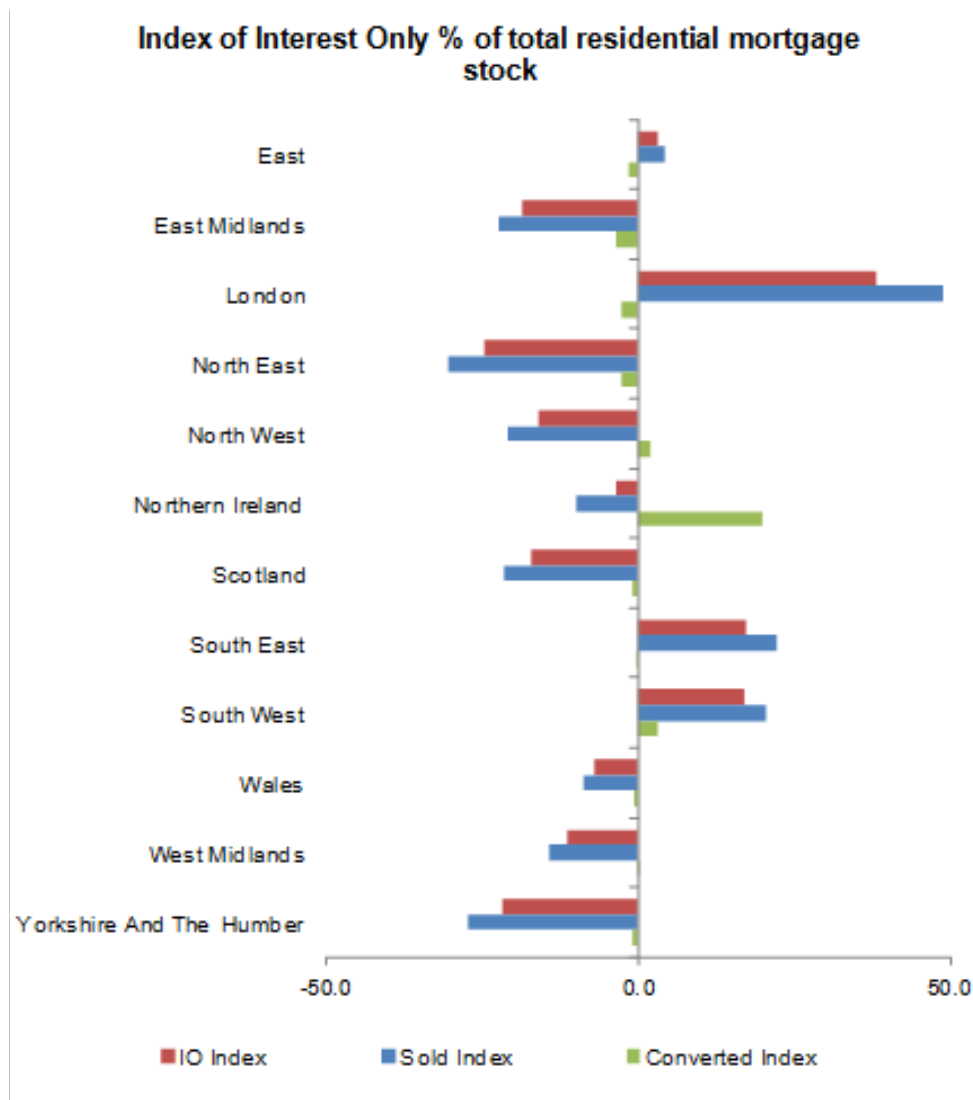


Figure 3: Residential interest only mortgages % of all mortgages, index by region, as defined by Government Office Regional classification (Source: Experian)

The recent economic conditions within Northern Ireland have given rise to a significantly increased proportion of mortgages converting to interest only terms.

Figure 3 shows the relative index of the residential interest only mortgages as a percentage of all residential mortgages in the region compared to the UK market overall. This has been split into 'sold as' i.e. originated as an interest only mortgage and 'converted' to. For example, London has a 50% higher penetration of 'sold as' residential interest only mortgages than the UK as a whole but a 5% lower representation in the 'converted' population.

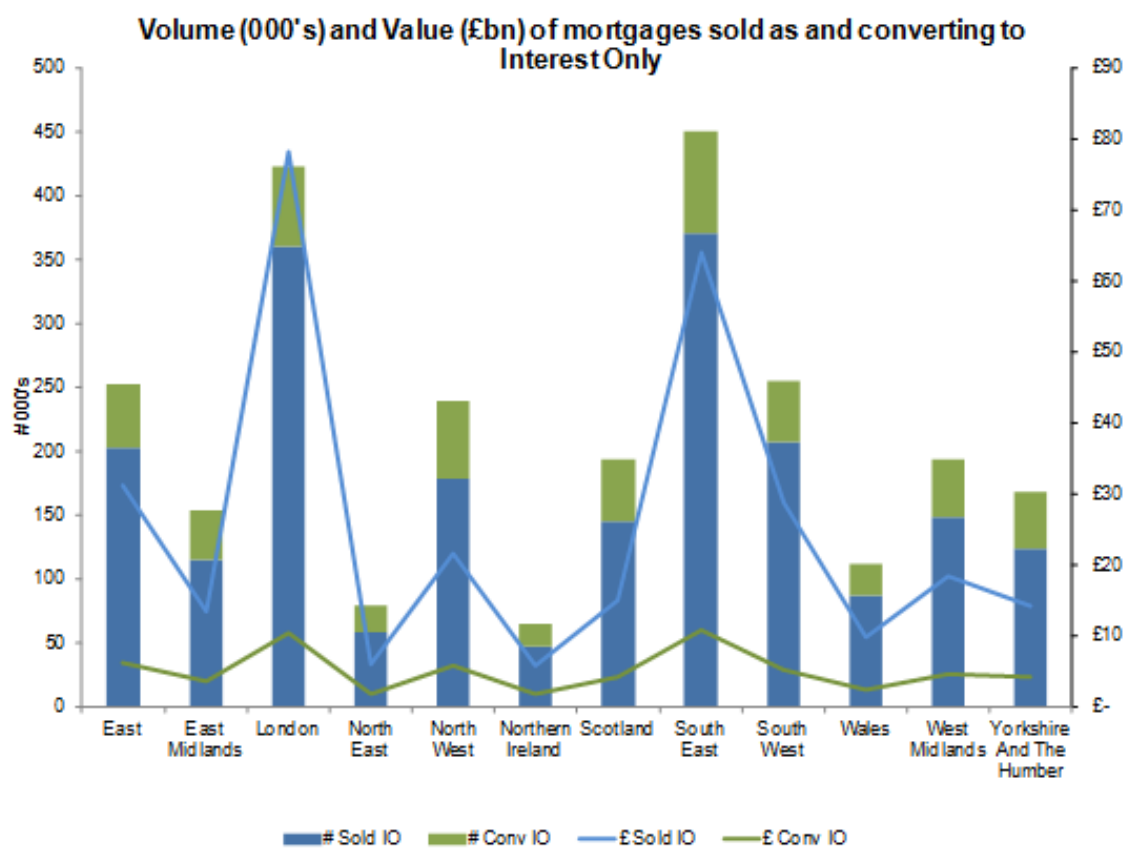


Figure 4: Residential interest only mortgages profile by region (Source: Experian)

Demographic profile

The socio-demographic profile of people with residential interest only mortgages has been examined through the use of Experian's Financial Strategy Segments. This classifies the UK population by life stage and affluence and segments it into 14 groups (for further information regarding the segmentation please refer to the Appendix).

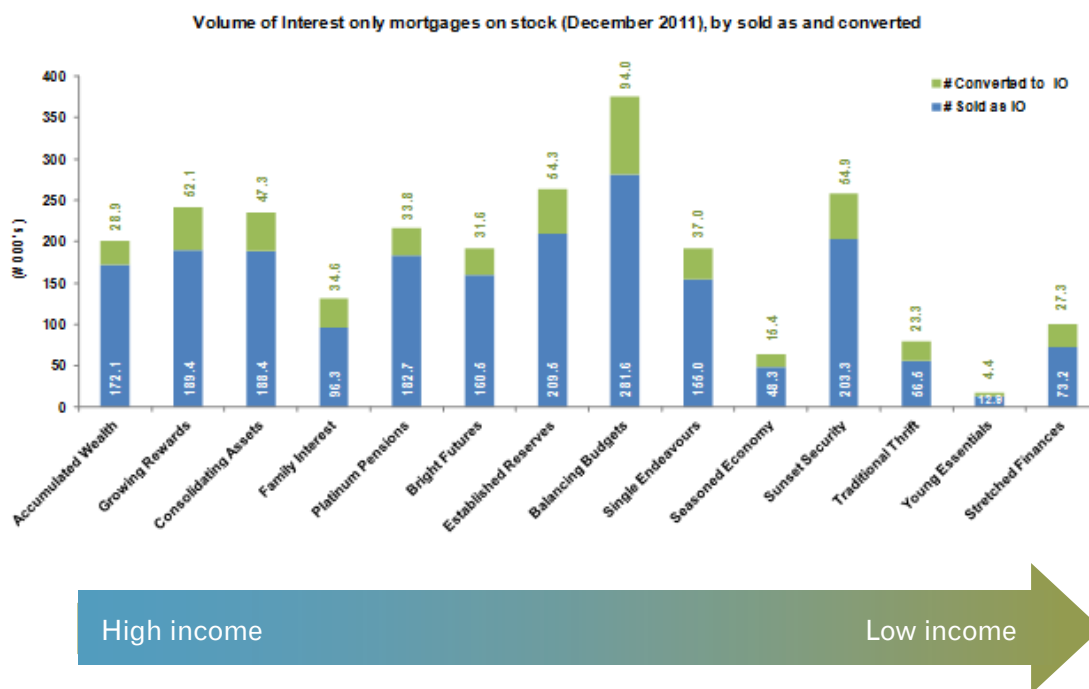


Figure 5: Residential interest only mortgages volumes by Financial Strategy Segment (Source: Experian)

Figure 5 shows the highest volumes of residential interest only mortgages occur within the Balancing Budgets, Established Reserves and Sunset Security segments:

- **Balancing Budgets** segment is comprised of families in their middle years with average incomes and limited savings. They typically reside in affordable terraces and semi-detached houses and careful budgeting means they are searching for good value deals.
- **Established Reserves** are typically in their late 50's or early 60's with good salaries or in early retirement and in comfortable homes. They have respectable savings and reducing financial commitments, although some may still be supporting adult children.
- **Sunset Security** groups retired singles and couple with modest pension income living in average value semi-detached houses or bungalows. They tend to have moderate savings and are cautious investors.

Figure 6 shows that Accumulated Wealth, Platinum Pensions and Bright Futures are most over-represented in residential interest only mortgages (interest only as a percentage of all residential mortgages compared to the UK average).

All three segments are dominated by interest only mortgages which were sold as such.

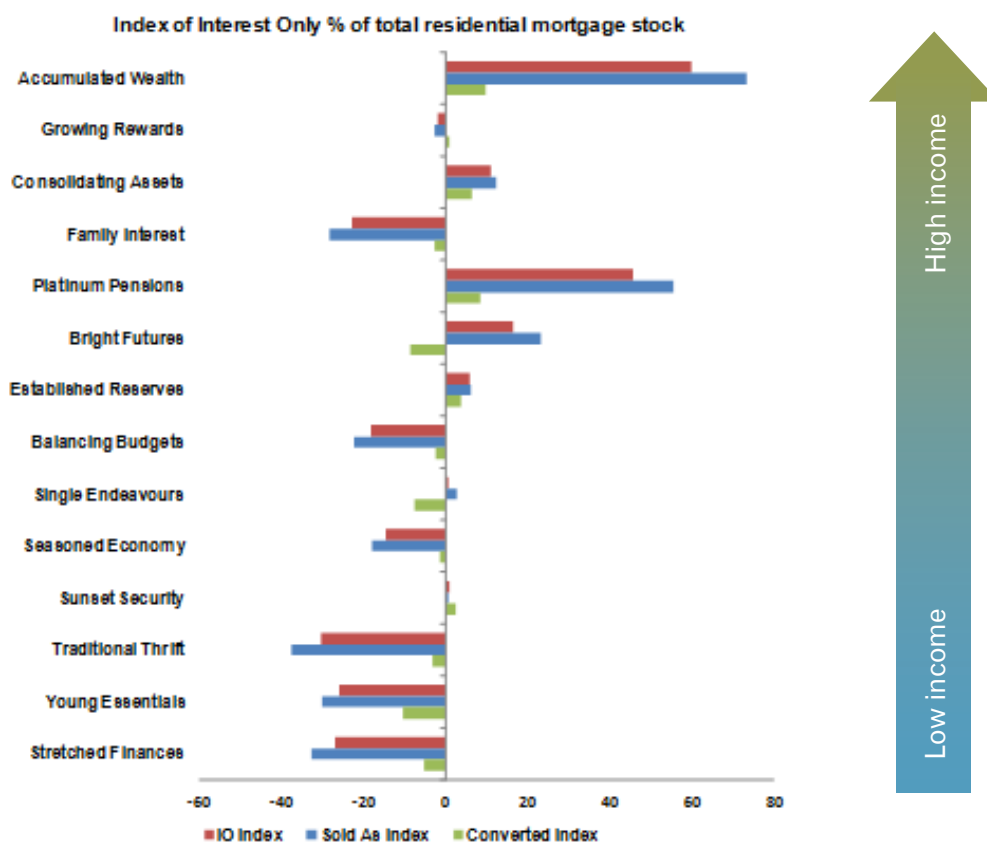


Figure 6: Residential interest only mortgages % of all mortgages, index by FSS (Source: Experian)

The **Bright Future** segment represents young professionals, typically graduates in their 20's or early 30's and highly concentrated in London. As such an interest only mortgage would allow this segment to get onto the property ladder with high house prices and mid-level incomes, albeit with high earning potential as they grow older.

Accumulated Wealth and **Platinum Pensions** represent the most affluent segments of the population in their mid to later years with large properties and high value investments. The people in these two segments typically have both equity in the property and alternative repayment vehicles to allow the capital balance to be paid at the end of term. Residential interest only mortgages offer them the opportunity to minimise monthly outgoings. Accumulated Wealth consumers have a sophisticated approach to their finances, many have equity ISA's and they often move money around to find the best returns.

Both Accumulated Wealth and Platinum Pensions are also over represented in the converted to Interest Only terms population. **Consolidating Assets** also exhibit the same relationship but to a lesser degree. This group contains families in their 40's and early 50's with growing equity within their detached or semi-detached family homes, they are adding to their savings regularly and have made a good start to investments.

Equity position

Within each region (Figure 9) and demographic segment (Figure 10) there are residential interest only mortgages currently in negative equity.

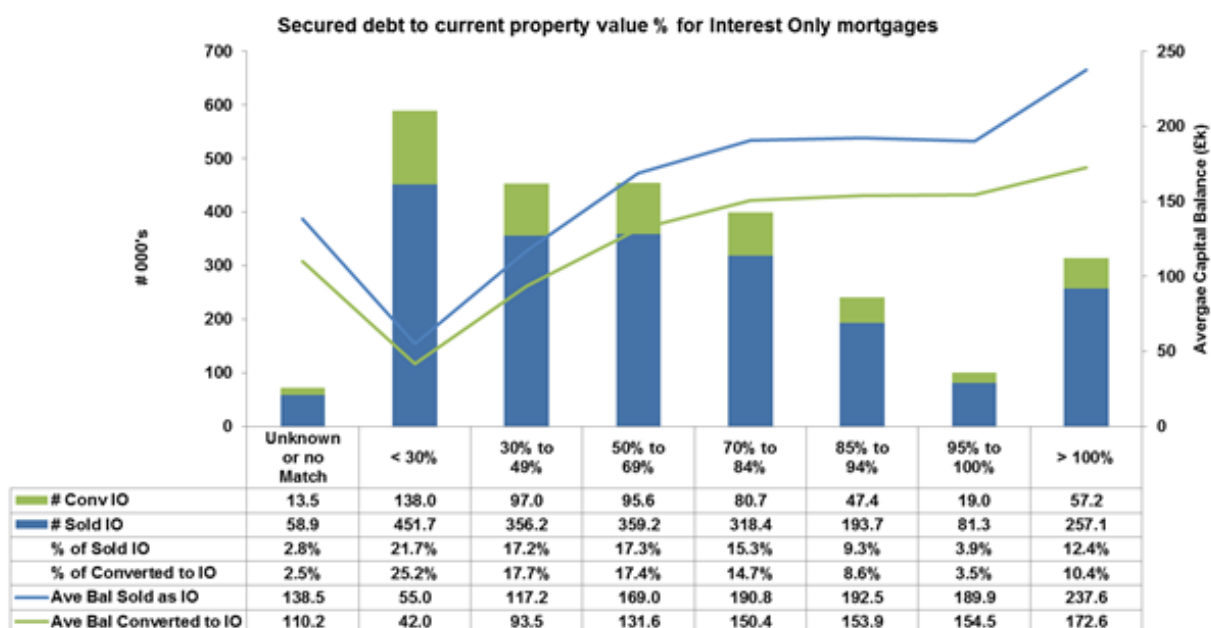


Figure 7: Secured debt to current property value % for Residential interest only mortgages (Source: Experian)

Comparing the capital balance of the mortgage with the property value (taken from Experian's National Property Database) as at December 2011, 12.0 % of all residential interest only mortgages are presently in negative equity. Of those that were sold as interest only, 12.4% have a loan to value in excess of 100% and for those converted to interest only, 10.4%.

A further 13% of residential interest only mortgages have a secured debt to property value percentage of 85%-100%.

With higher proportions of residential interest only mortgages sold in London and the South East, (see figure 4) Figure 9 shows there are high concentrations of interest only mortgage with low levels of equity.

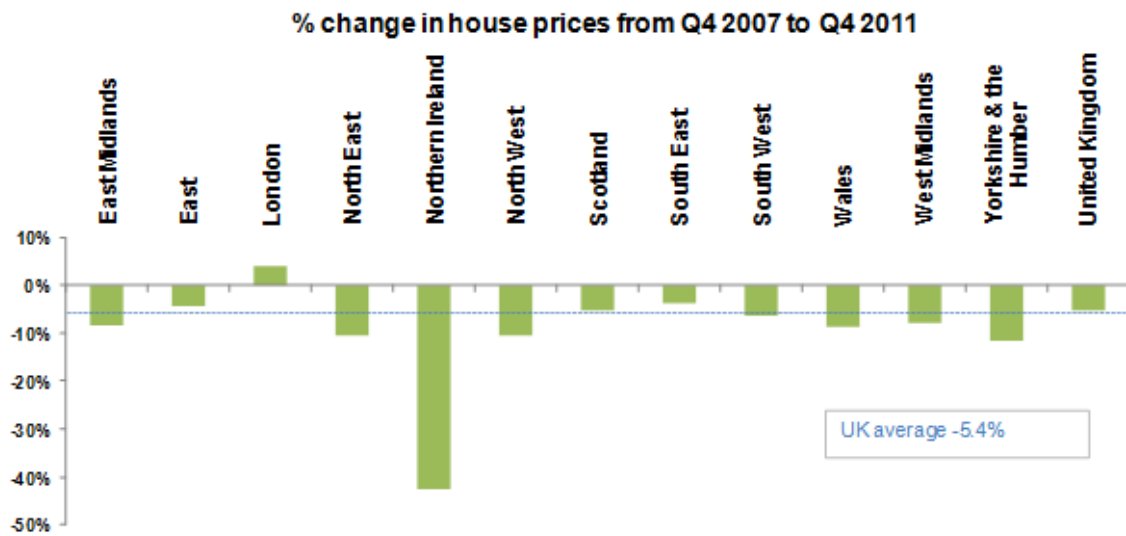


Figure 8: All properties house price index (2008 = 100) by government office region (Source: DCLG)

Despite house prices largely holding at Q4 2007 levels (Figure 8), Figure 9 shows there are relatively high proportions of the residential mortgage stock in the high loan to value ranges (85% plus loan to value) on interest only terms.



Figure 9: Secured debt to property value 85%+ by region (Source: Experian)

Some of the regions where house prices have fallen by more than the UK average since the peak in Q4 2007 (North West, North East, East, East Midlands, Wales, West Midlands and Yorkshire and Humber) also show significant pockets of the overall mortgage stock on interest only terms and low levels of equity, in particular the North West, East and West Midlands.

The primary exception to this is Northern Ireland where despite the largest falls in average house prices, lower overall volumes of residential interest only mortgages have been sold resulting in low volumes and low penetration into the residential mortgage stock of high loan to value interest only mortgages.

In terms of the demographic profile, the segments Accumulated Wealth and Platinum Pensions, with the highest penetration of interest mortgages (largely sold as interest only), do not have high proportions with low or negative equity. Family Interest, Bright Futures, Balancing Budgets, Single Endeavours, Young Essentials and Stretched Finances all have in excess of 4% of the total residential mortgage stock on interest only terms with a debt to property value greater than 85%.

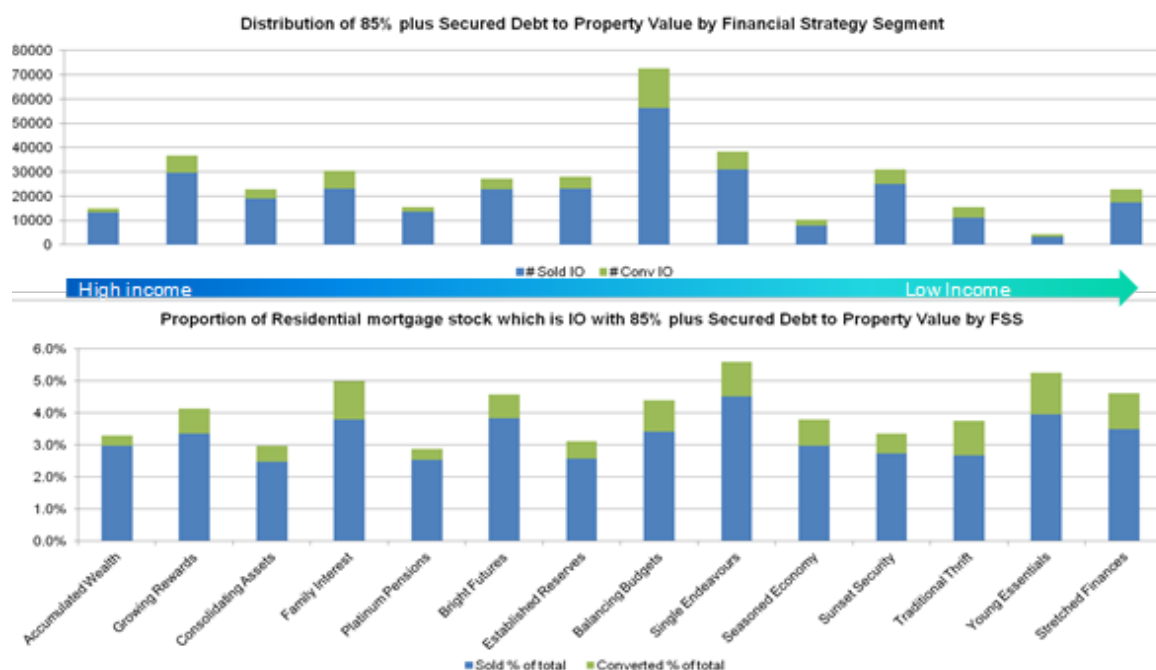


Figure 10: Secured debt to current property value 85%+ by FSS for Residential interest only mortgages (Source: Experian)

Bright Futures is over-represented in 'sold as' interest only mortgages (Figure 6), however, there is a concentration in low equity residential interest only mortgages where a conversion has occurred.

The other segments with concentrations of low equity interest only mortgages, particularly those which have converted to interest only since they were opened, are in the early to mid life stages and mid to low-affluence ranges:

Mid Affluence: Family Interest (families in late 20's to early 40's, young and school age children, salaries a little above average with two incomes, little or no savings or investments), **Balancing Budgets** (families in their middle years with average incomes and limited savings)

Low affluence: Young Essentials (singles in their 20's, low financial stability, some single parents, low incomes and a high proportion not working), **Single Endeavours** (singles and shared occupancy, in 20's and early 30's, regular use of overdrafts, low financial commitments, below average incomes and low if any savings) and **Stretched Finances** (middle aged adults with simple finances, on limited incomes, lower skilled jobs, low level of employment and often on benefits).

Levels of Unsecured borrowing

Approximately 10% of interest only mortgage holders have unsecured borrowings in excess of £25,000. Of this population 21.4% have converted and 78.6% were sold as interest only. Where as 15.9% of the group with unsecured borrowing of less than £5,000 have converted and 84.1% were sold as interest only.

12.8% of the converted interest only mortgage population have unsecured credit commitments in excess of £25,000, compared to 10.2% of the sold as interest only population.

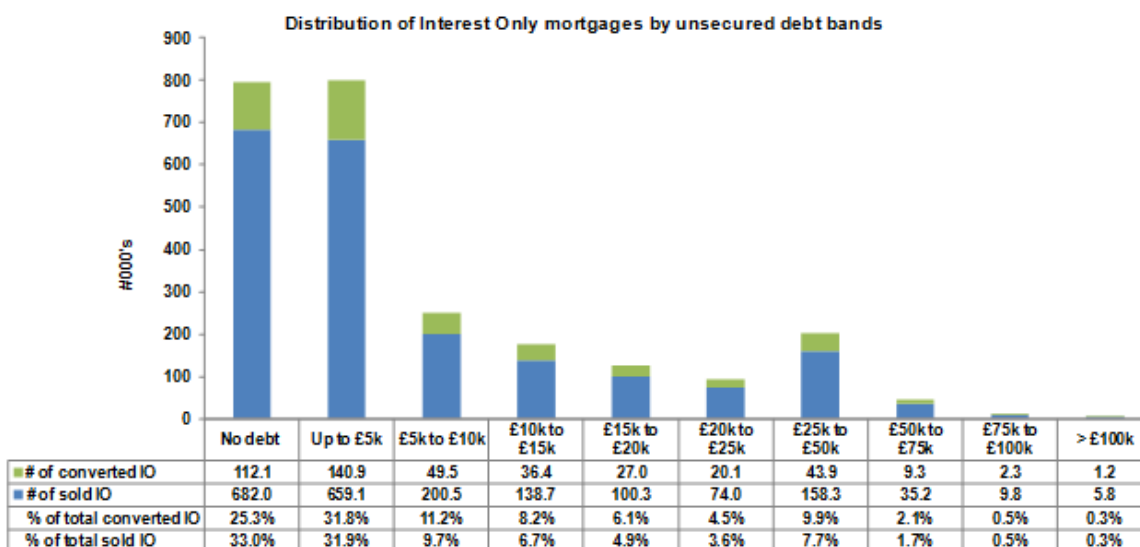


Figure 11: Distribution of Residential interest only mortgages by unsecured debt (Source: Experian)

However, over half of consumers with a interest only mortgage have either no unsecured borrowing or less than £5,000 outstanding on unsecured credit commitments.

Figure 12 shows London and the South East accounts for 36% of the population with high levels of unsecured borrowing, whilst the segments of Accumulated Wealth and Platinum Pensions contribute 17% (see Figure 13). Typically the mortgages were sold as interest only, with higher income levels off-setting the level of borrowing, hence levels of affordability are maintained.

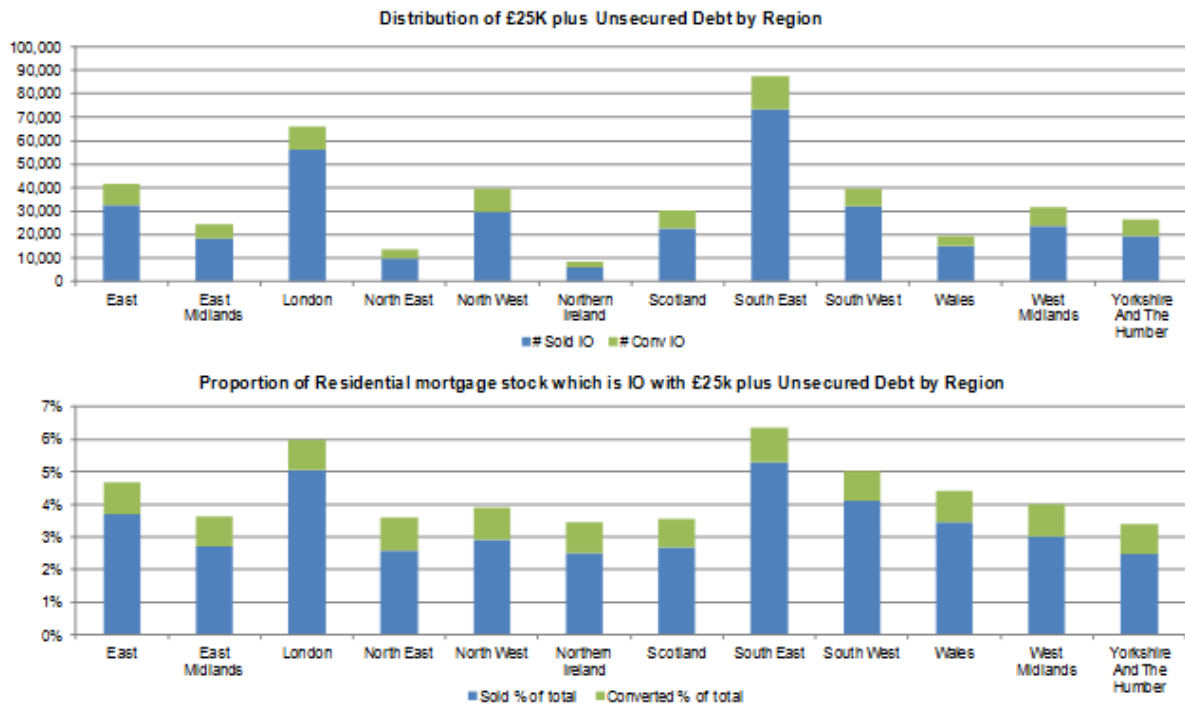


Figure 12: Distribution of Residential interest only mortgages holders with greater than £25k in unsecured debt by region (Source: Experian)

There are high concentrations of the group carrying high levels of unsecured borrowing in the East, South West and Wales and within the Bright Futures segment, where incomes are in the mid ranges and there are higher levels of negative equity.

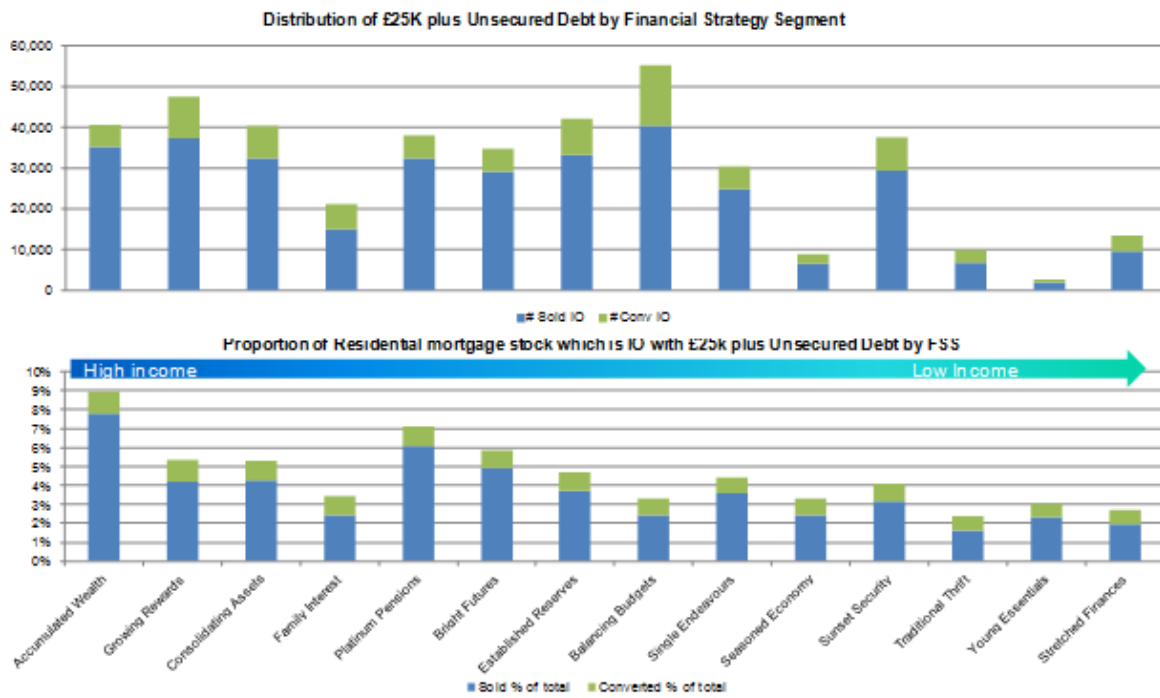


Figure 13: Distribution of Residential interest only mortgage holders with more than £25k in unsecured debt by Financial Strategy Segment (Source: Experian)

In conclusion, there are 468,000 residential interest only mortgage holders who are carrying high levels of unsecured debt across all regions and demographics. Of these 21.4% have converted to interest only, compared to 17.2% of residential interest only mortgages with less than £25k in unsecured debt.

Conversion to interest only terms during the life of the mortgage

Throughout the recessionary period, from late 2007 through to March 2011, the percentage of residential mortgages on repayment terms (or part and part) converting to full interest only terms rose from 3.7% in June 2009 to 4.6% in Dec 2011, an increase of over 22%.

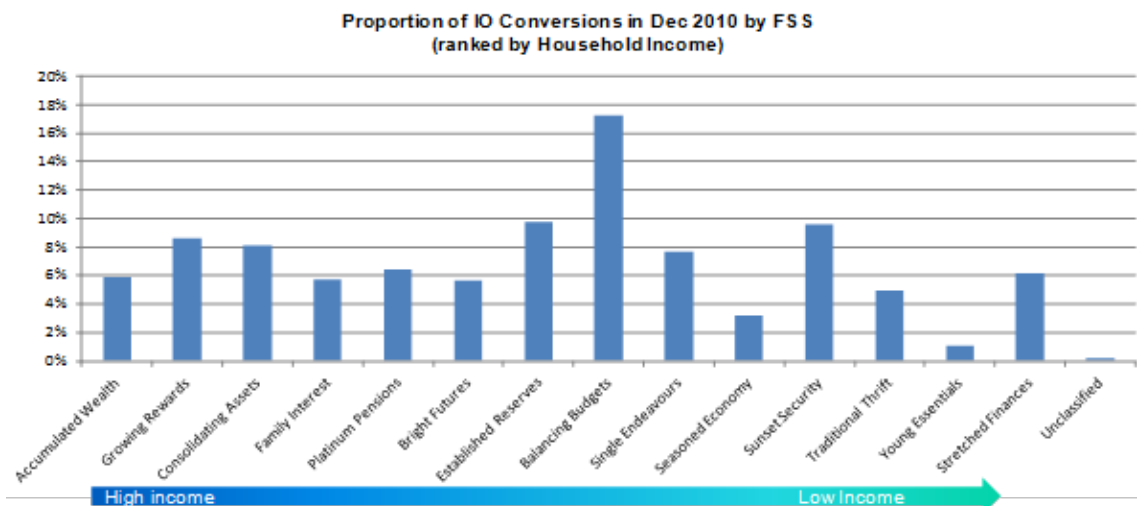


Figure 14: Distribution of residential mortgages converted to interest only in Dec 2010 by Financial Strategy Segment (Source: Experian)

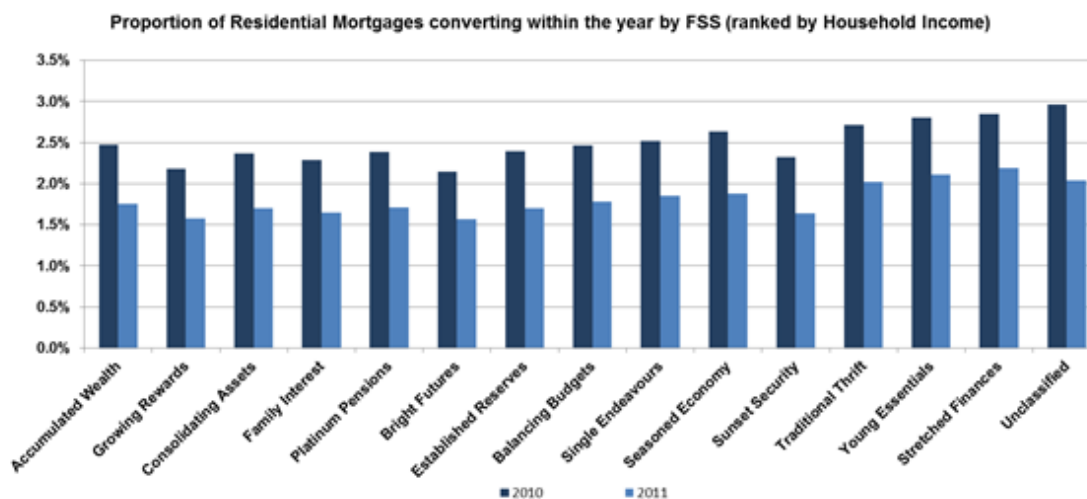


Figure 15: Proportion of residential mortgages converted to interest only in 2010 and 2011 by Financial Strategy Segment (Source: Experian)

The consumers converting to interest only terms during the term of the mortgage at some point during 2010 and 2011 were distributed across all the demographic groups.

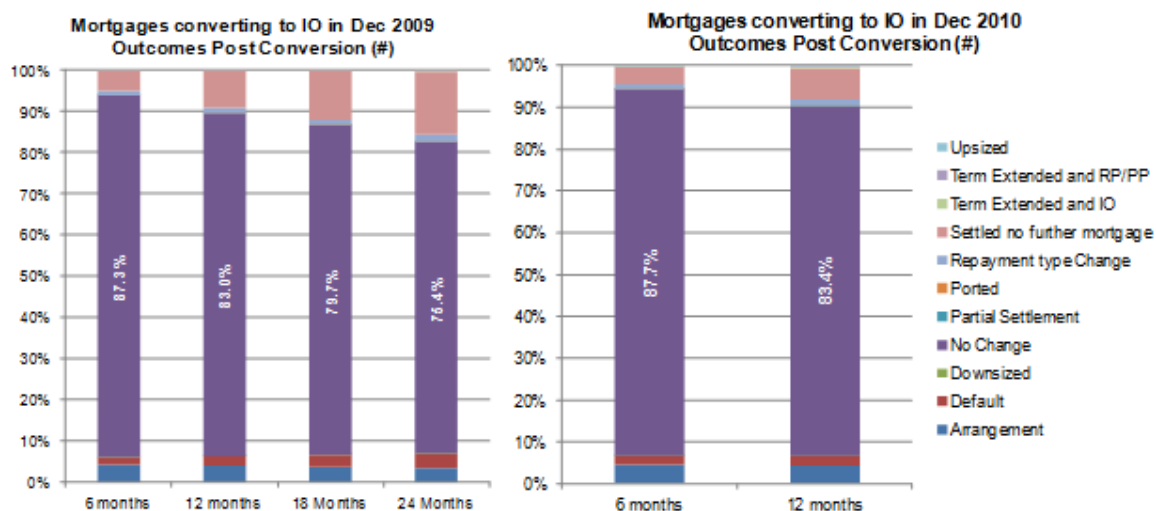


Figure 16: Outcomes post conversion to interest only repayment terms after 6-24 months (Source: Experian)

Once converted 87% remained on interest only repayments after 6 months and 83% after 12 months. In many cases an arrangement is made to reduce the monthly payments as the consumer is unable to afford all their commitments, economic conditions and household disposable incomes have not improved greatly over the last 2 years, as a result 75% of those conversions to interest only terms made 2 years ago remain on interest only terms.

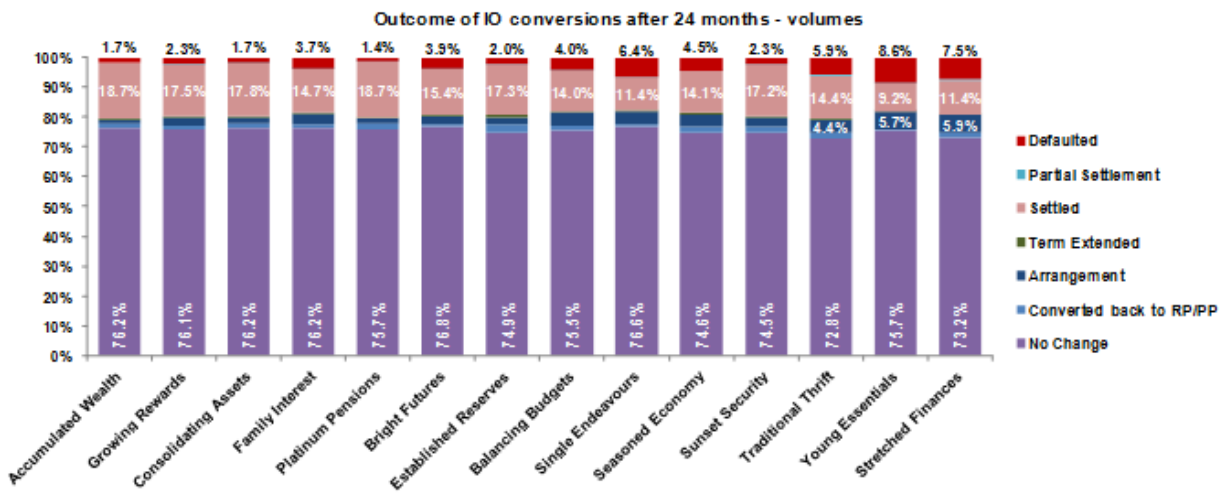


Figure 17: Outcomes 24 months after conversion to interest only repayments terms by Financial Strategy Segments (Source: Experian)

The proportions of mortgages remaining on interest only terms 24 months after converting are between 73%-77% across all the demographic groups. The higher the average income for the group, the higher the settlement rate (the mortgage has been closed and the balance paid in full) 24 months after conversion to interest only terms. In the lowest two income groups, Young Essentials and Stretched Finances, the proportions of cases subsequently on an arrangement for forbearances purposes or where repossession proceedings have commenced are 14.3% and 13.4% respectively.

Maturity horizon for Interest Only Mortgages

Having gained an understanding of the profile and concentrations of the current stock of residential interest only mortgages, we have extrapolated what this means over time as these mortgages reach maturity.

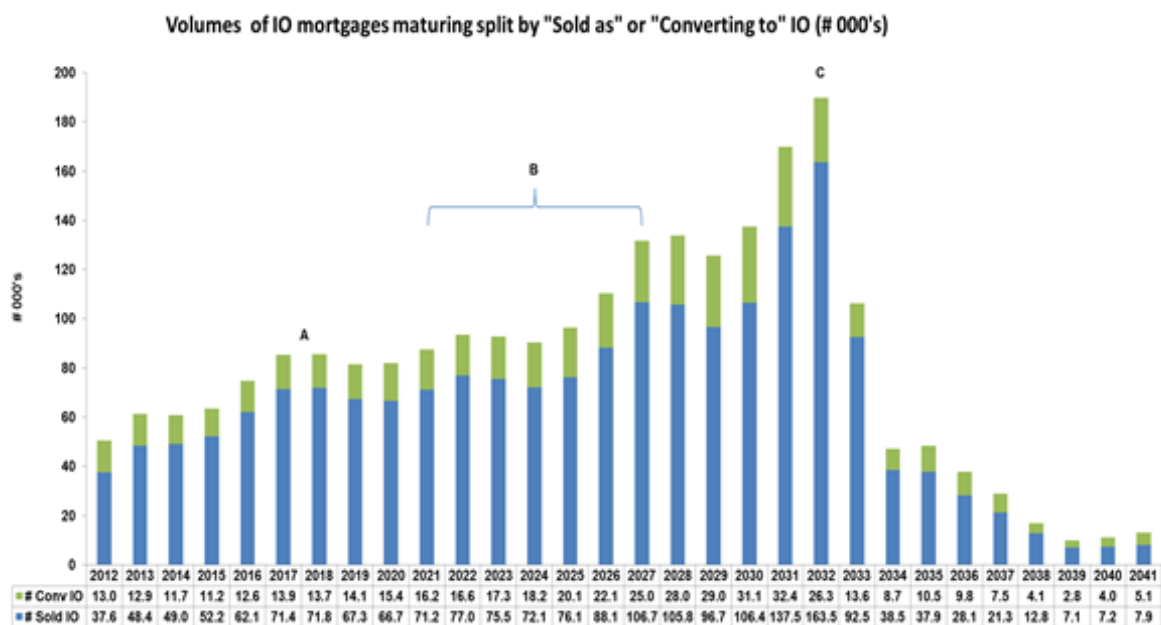


Figure 18a: The maturity horizon of residential interest only mortgages split by sold as and converted by volume (Source: Experian)

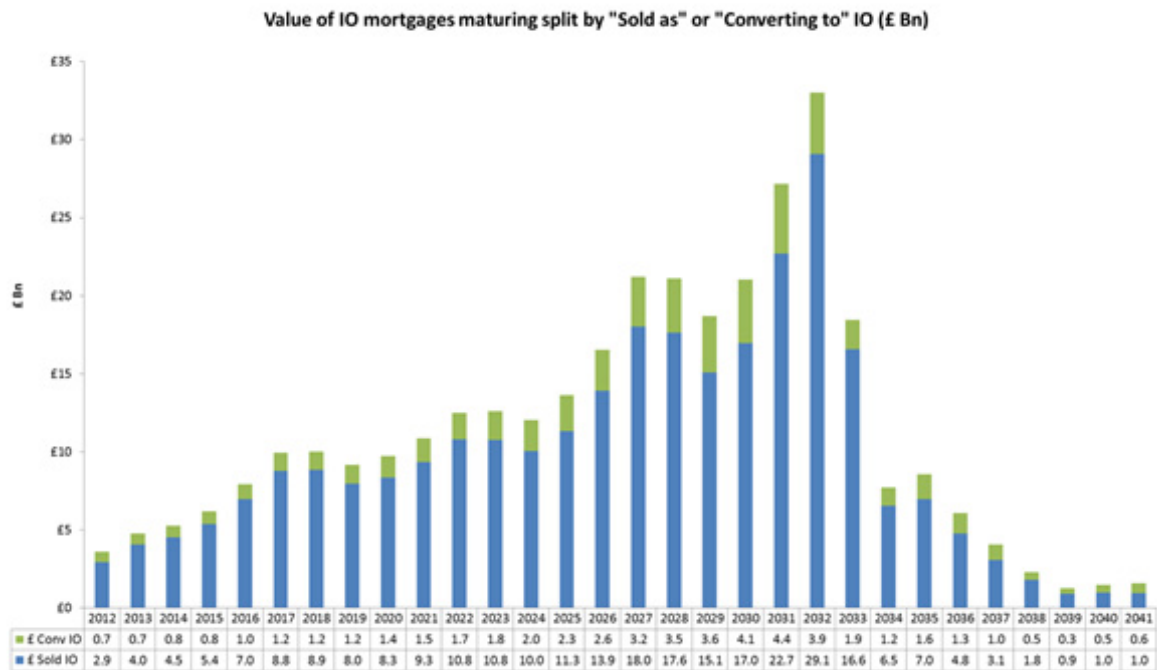


Figure 18b: The maturity horizon of residential interest only mortgages split by sold as and converted by value (Source: Experian)

Figure 18 shows the distribution of residential interest only mortgages reaching the end of their term over the next 30 years. The peaks in the maturity horizon are related to the phases of interest only sales and conversions.

Peak A in 2017/2018 is predominantly comprised of endowment mortgages sold in the mid to late 1990's. From 2022 volumes of residential interest only mortgages reaching maturity gradually rises to another peak B in 2027/2028 relating to mortgages typically sold from 2001 to 2009. Peak C is a result of mortgages opened from 2005 to 2008 and the mortgages converted to interest only terms at some point during the life of the mortgage.

With the average mortgage term being about 21 years, the maturity horizon tails off past 2032. However, this is likely to extend with new lending under interest only terms continuing through 2012 and into 2013 and further conversions to interest only.

Maturity by capital balance

In general the capital balance remaining at the end of the term increases the further in the future the maturity horizon extends. Each peak within the maturity horizon has particular characteristics.

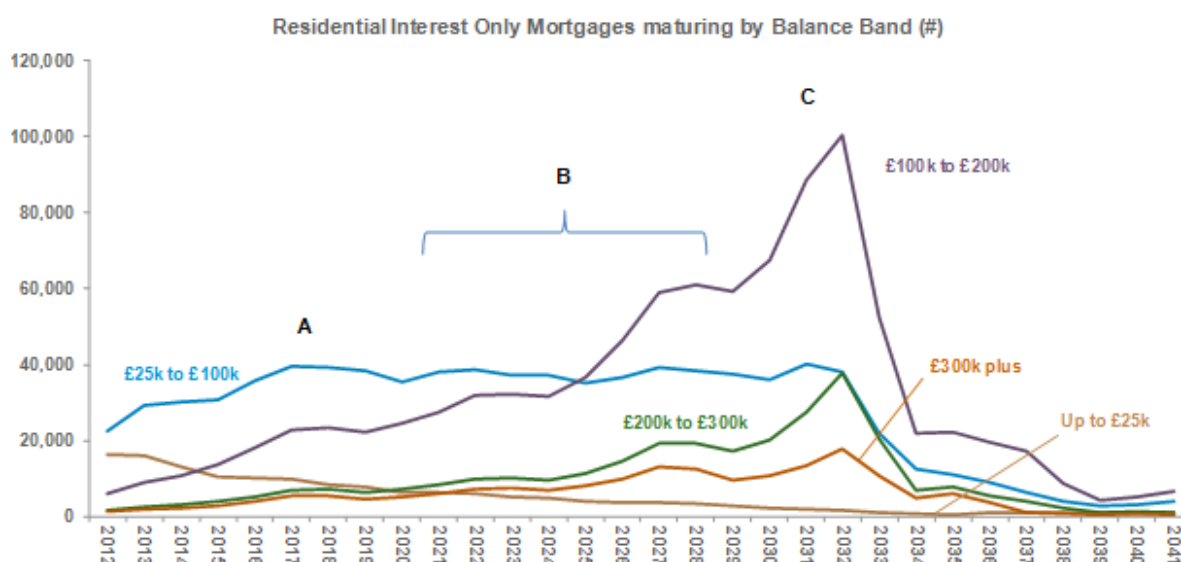


Figure 19: Residential interest only mortgages maturity horizon by capital balance (Source: Experian)

Peak A is dominated by mortgages with lower capital balances, £25k-£100k with some contribution from the £100k-£200k balance population. Peaks B and C are driven more by higher capital balances.

The Peak A population (£25-200k capital balances, maturing 2012-2020) results from originations focussed around 2001 to 2011, 12% of this population were opened prior to 2000.

Peak 'A': Distribution of IO residential mortgages by Application Vintage maturing 2012-2020 and capital balance £25K - £200K

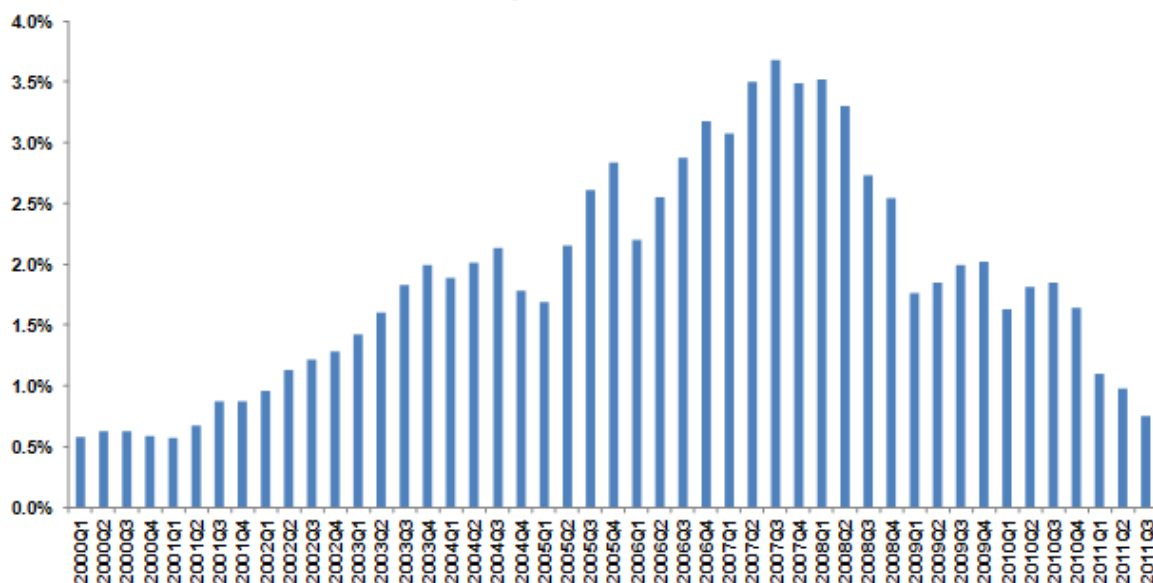


Figure 20: Residential interest only mortgages maturity horizon, peak A population by opening vintage (Source: Experian)

The majority were sold as interest only (Figure 19) and so the original loan values are largely in the same range as the capital balances (from £30k to £230k). This population of residential interest only mortgages were originally accepted with income multiples predominantly up to 3.5 (21% with an income multiple in excess 3.5).

Peak 'A': Distribution of IO residential mortgages by Income Multiple at origination, maturing 2012-2020 and capital balance £25K - £200K

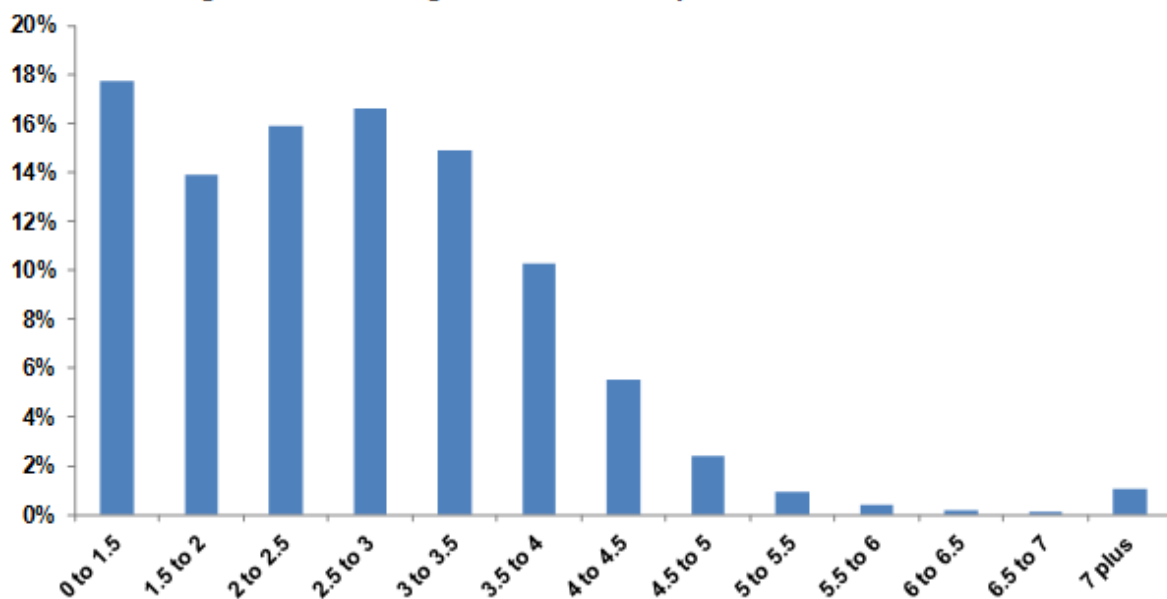


Figure 21: Residential interest only mortgages maturity horizon, peak A population by income multiple at origination (Source: Experian, Product Sales Data)

Peak B mortgage originations (> £100k capital balances, maturing 2021-2029) are much more concentrated in the period from 2005 to 2008.

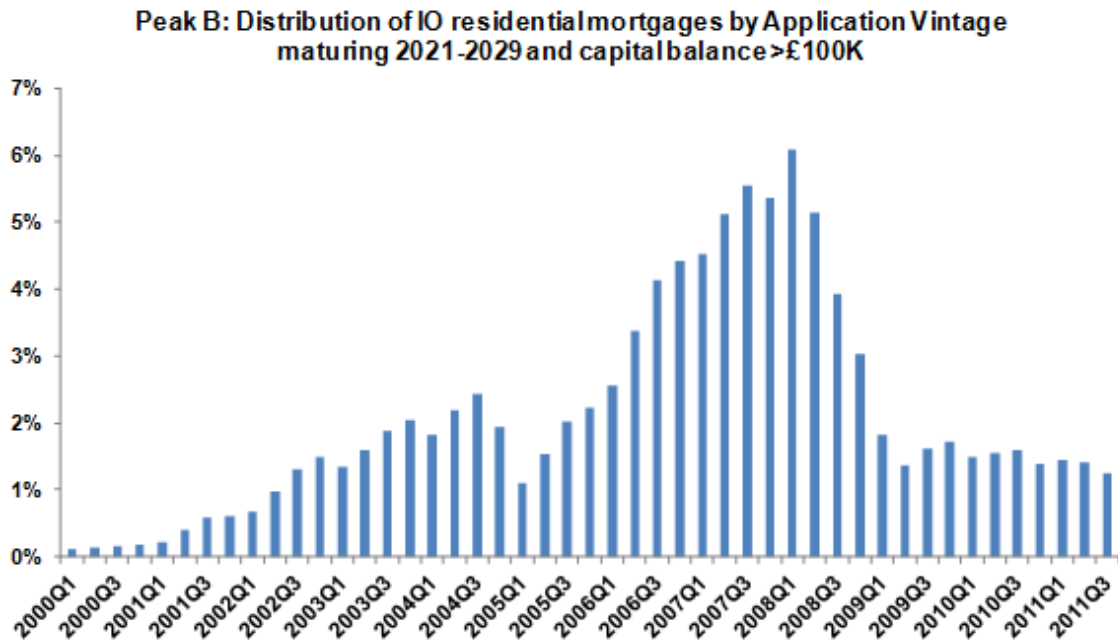


Figure 22: Residential interest only mortgages maturity horizon, peak B population by opening vintage (Source: Experian)

The peak B population of mortgages were originally accepted on income multiples predominantly in the range 2.5 to 4.5 (26.8% with an income multiple of 3.5 to 4.5 and a further 10.5% in excess of 4.5).

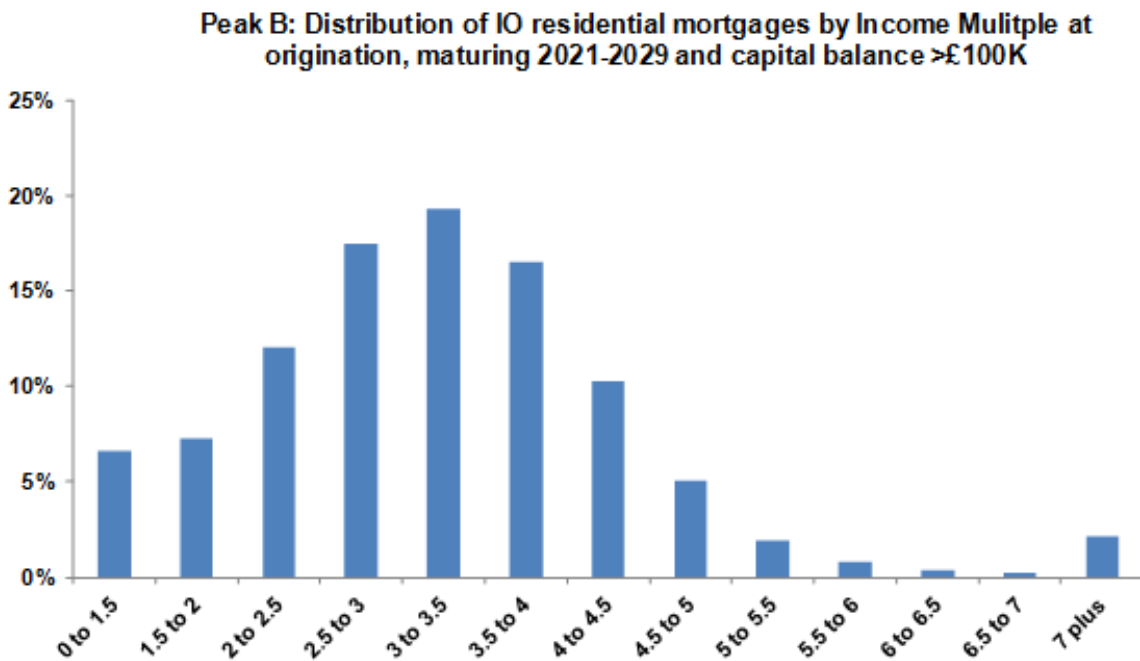


Figure 23: Residential interest only mortgages maturity horizon, peak B population by income multiple at origination (Source: Experian, Product Sales Data)

Of interest only mortgages maturing in peak B 32.6% had an original loan to value less than 60% and a further 50% in the 60%-95% range.

Peak B: Distribution of IO residential mortgages by Loan to Value at origination, maturing 2021-2029 and capital balance >£100K

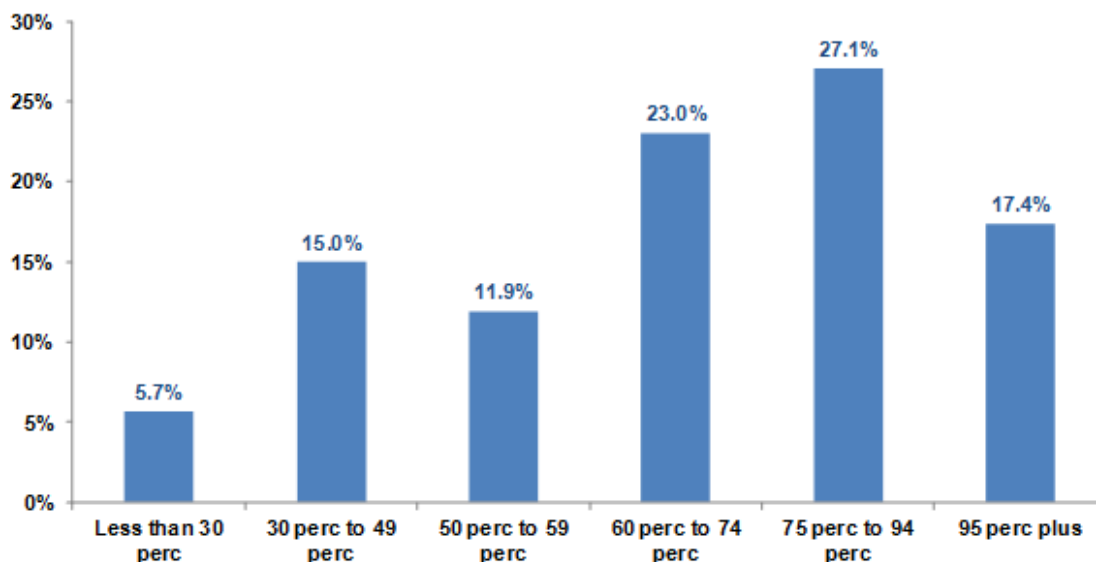


Figure 24: Residential interest only mortgages maturity horizon, peak B population by loan to value at origination (Source: Experian, Product Sales Data)

The Peak C population of maturing mortgages (> £100k capital balances, maturing 2030-2034) originations are even more focussed from 2005 to 2008.

Peak 'C': Distribution of IO residential mortgages by Application Vintage maturing 2030-2034 and capital balance >£100K

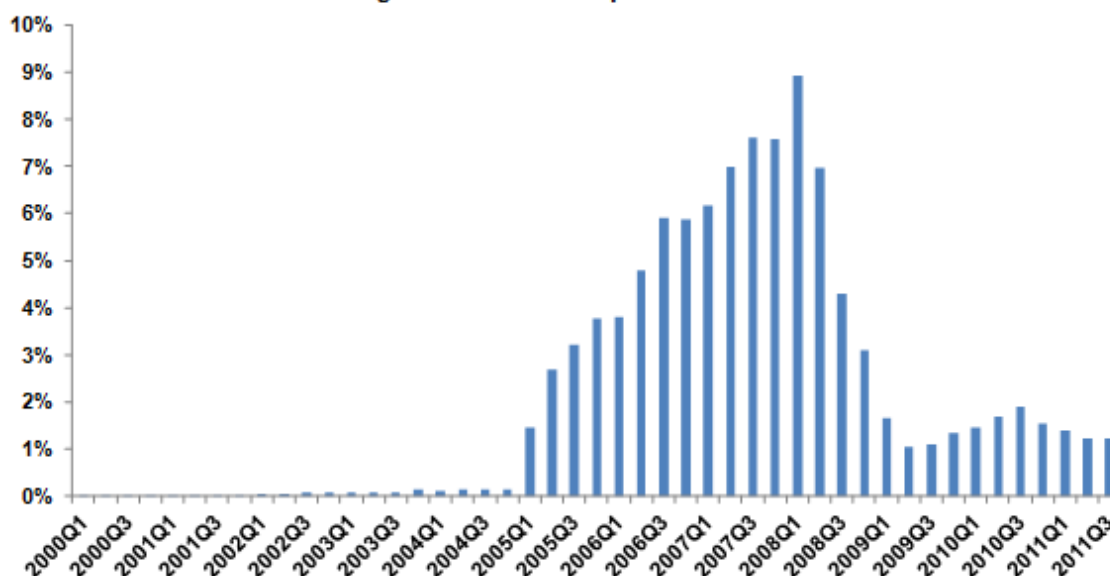


Figure 25: Residential interest only mortgages maturity horizon, peak C population by opening vintage (Source: Experian)

Peak C maturing mortgages also have a very similar income multiple profiles to the peak B population.

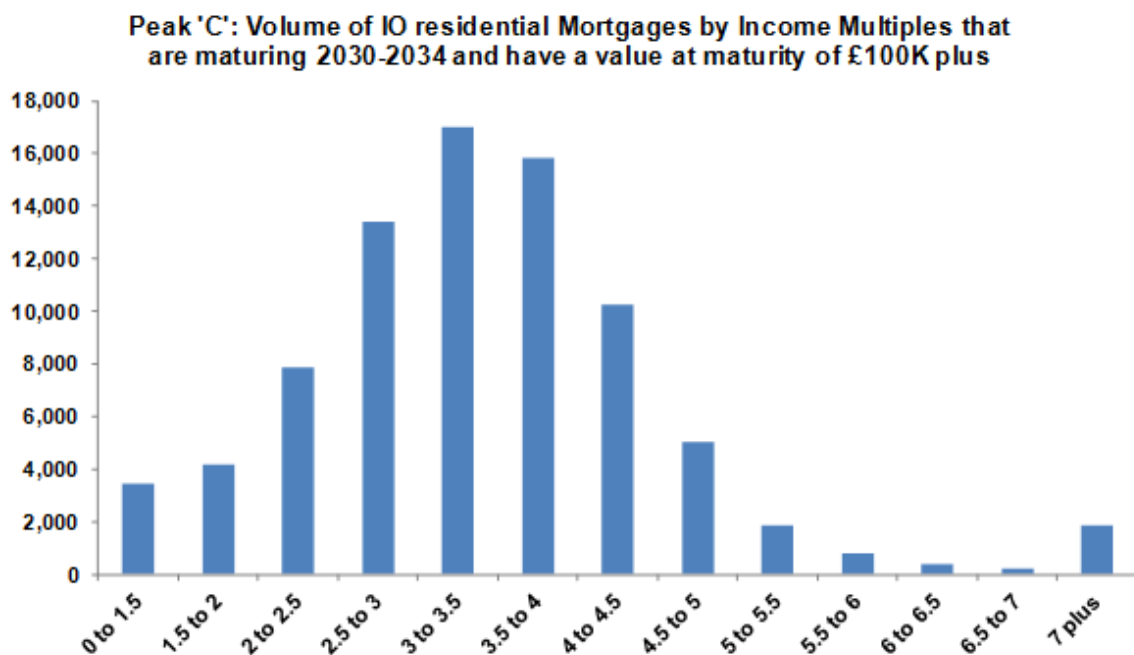


Figure 26: Residential interest only mortgages maturity horizon, peak C population by income multiple at origination (Source: Experian, Product Sales Data)

Maturity by forecast equity position

By combining the current property value with regional house price forecasts up to 2032 (see Appendix for details of the forecasting methodology) an estimate of the property value at the point of maturity can be made. By combining the forecast property value with the capital balance at the end of term the forecast equity position or loan to value at maturity is derived.

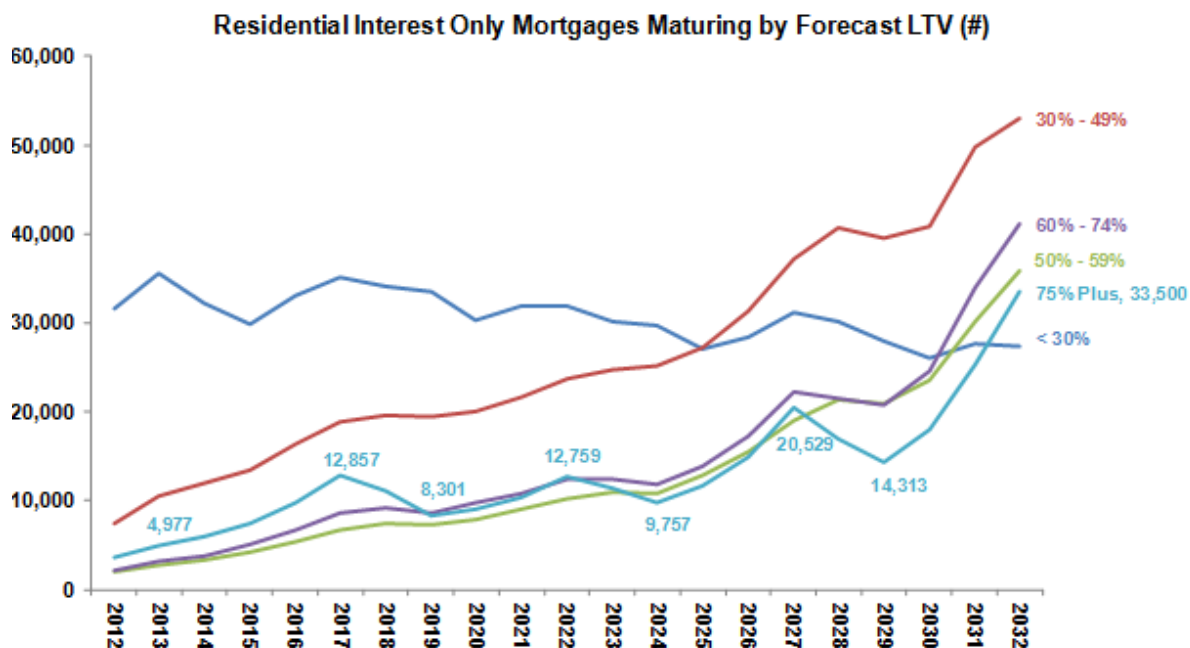


Figure 27: Residential interest only mortgages maturity horizon by forecast loan to value at maturity. (Source: Experian, Department for Communities & Local Government (DCLG))

The volumes of residential interest only mortgages due to mature with a forecast loan to value in excess of 75% are projected to increase from nearly 5,000 in 2013 to 12,000 in 2017 (peak A). From 2018 to 2024, an average of 10,300 interest only mortgages a year are predicted to mature with less than 25% equity in the property.

The 20,500 mortgages forecast to mature in 2027 with less than 25% equity represent 14.0% of the overall number of mortgages maturing in the year. By 2032 this has risen to 17.6%.

The volumes forecast to mature with a loan to value greater than 95% then rise gradually to 9,500 in 2027 – peak B (representing 7.1% of the interest only mortgages due to mature in the year). The volumes reduce once more to 6,300 in 2029 followed by a further peak in 2032 of 11,200 (5.7% of maturing interest only mortgages in peak C).

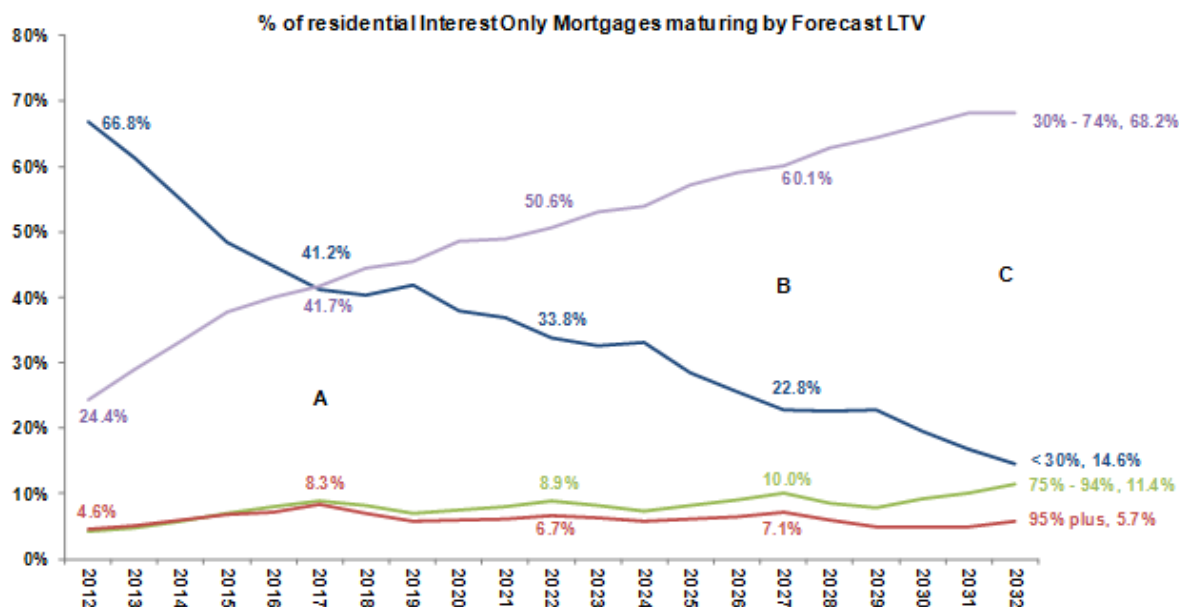


Figure 28: Residential interest only mortgages maturity horizon % distribution by forecast loan to value at maturity. (Source: Experian, (DCLG))

In peak A the majority of residential interest only mortgage maturing are forecast to do so with a loan to value of 30% or less. From 2017 onwards mortgages with a loan to value of 30% - 74% form the majority of the maturing population. The proportions with a loan to value in this range increase the further the maturity horizon extends. There are typically limited options for downsizing available to this group.

Maturity by demographic group

Figure 29 shows the contribution of different demographic segments to the maturity horizon. The segments of Accumulated Wealth and Platinum Pensions, which are characterised by high concentrations of interest only mortgages, high value assets, lower capital balances and concentrated in the South East and South West, make a significant contribution to peak A.

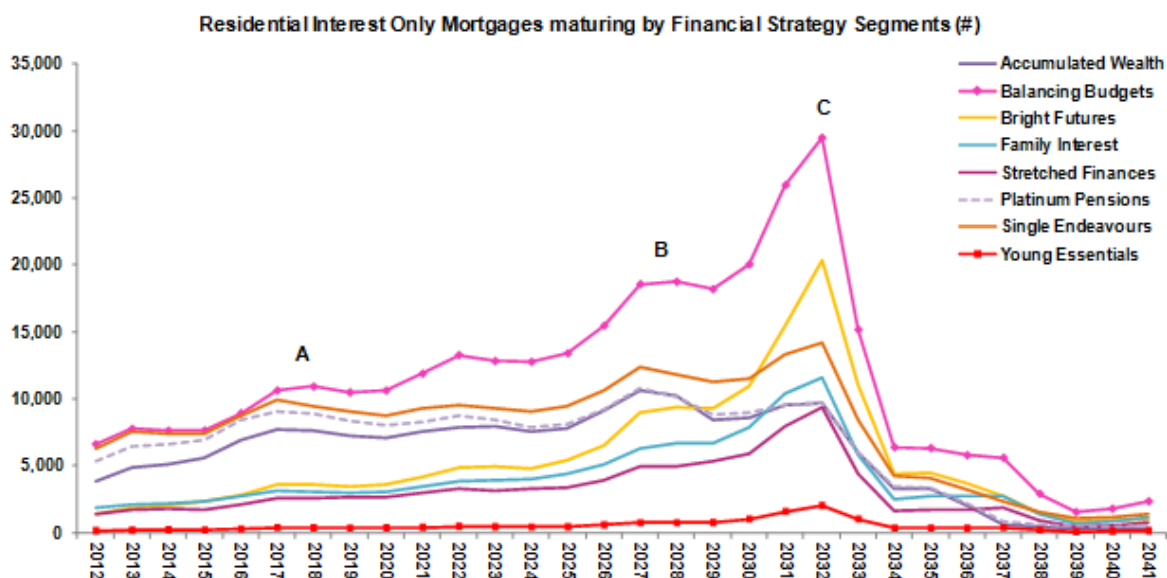


Figure 29: Residential interest only mortgages maturity horizon by Financial Strategy Segment. (Source: Experian)

Balancing Budgets (families in their middle years with average incomes and limited savings) and Single Endeavours (singles and shared occupancy, in 20's and early 30's, regular use of overdrafts, low financial commitments, below average incomes and low if any savings) are the other two segments which form the majority of mortgages maturing in peak A.

The less affluent, early to mid life-stage segments highlighted earlier, with higher conversion rates and lower equity levels, drive peak B. With the greatest concentration of residential mortgages in the Balancing Budgets segment, this population dominates the later maturity peaks (B and C). Bright Futures is also a high contributor to peaks B and C.

Maturity by levels of unsecured borrowing

Consumers with unsecured borrowing of more than £25k are concentrated in peaks B and C. This concentration coincides with the mortgages originated with higher income multiples and higher loan to values and the greater proportion of mortgages forecast to mature with higher loan to value percentages.

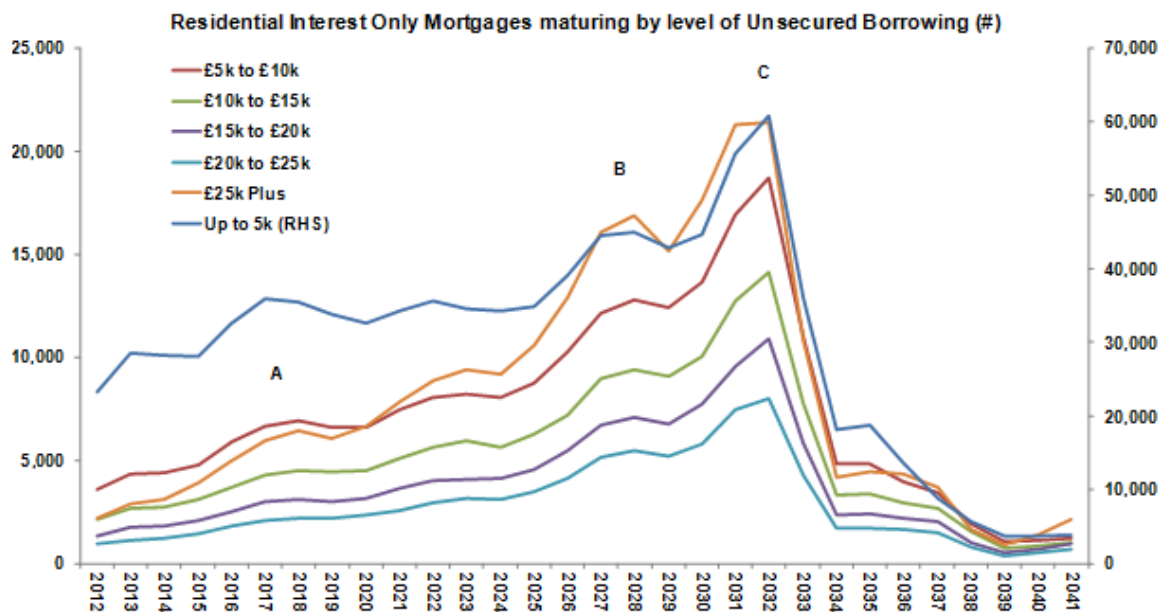


Figure 30: Residential interest only mortgages maturity horizon by level of unsecured borrowing in December 2011. (Source: Experian)

Maturity by region

The regions with the highest concentrations of residential interest only mortgages maturing are London, the South West, East, North West and the West Midlands.

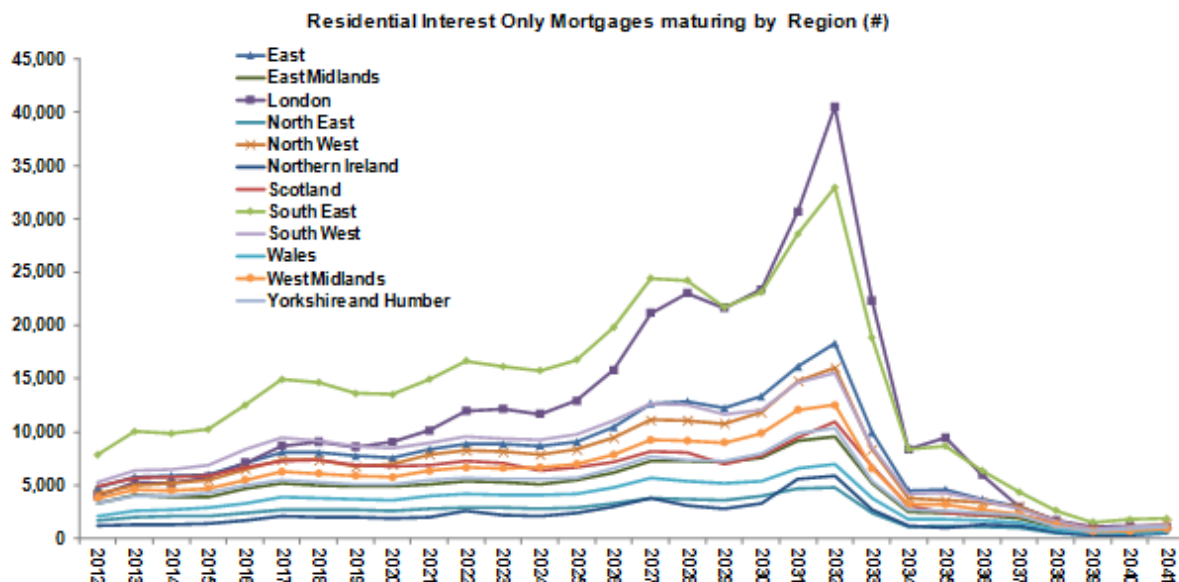


Figure 31: Residential interest only mortgages maturity horizon by region. (Source: Experian)

Of these regions with high concentrations, the North West and West Midlands have particularly high numbers of mortgages maturing with a loan to value in excess of 75%.

Residential Interest Only Mortgages maturing by Region (selected) and Forecast LTV > 75%

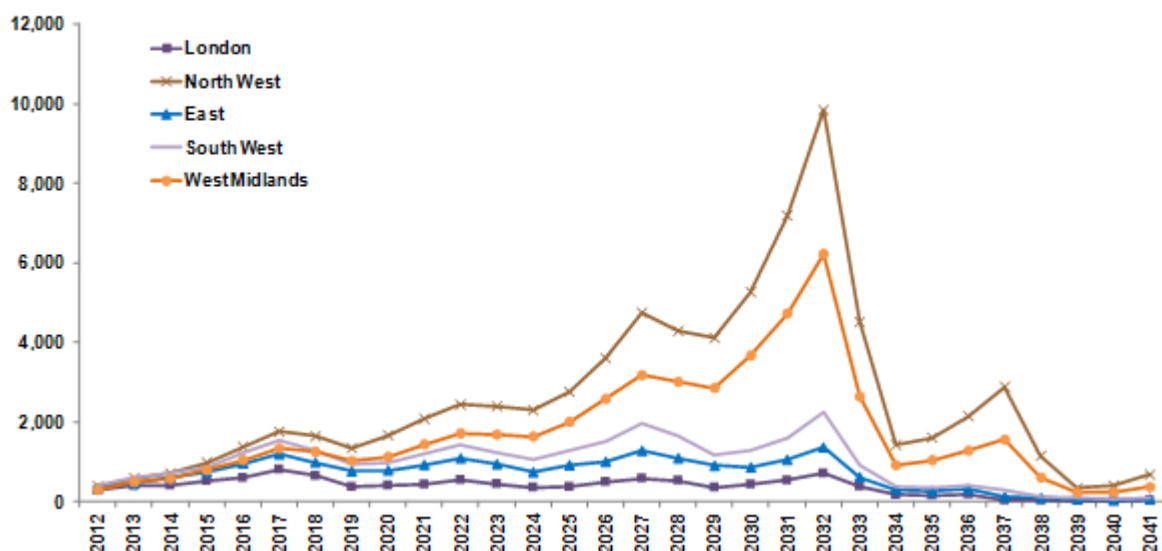


Figure 32: Residential interest only mortgages maturity horizon by region (selected) and forecast loan to value more than 75%. (Source: Experian)

Age of consumer at end of term

There are approximately 40,000 residential interest only mortgages due to mature each year from 2017 to 2032 where the consumer will be past the age of 65 when the mortgage reaches its term. The numbers rise sharply up to 2017 to reach this level.

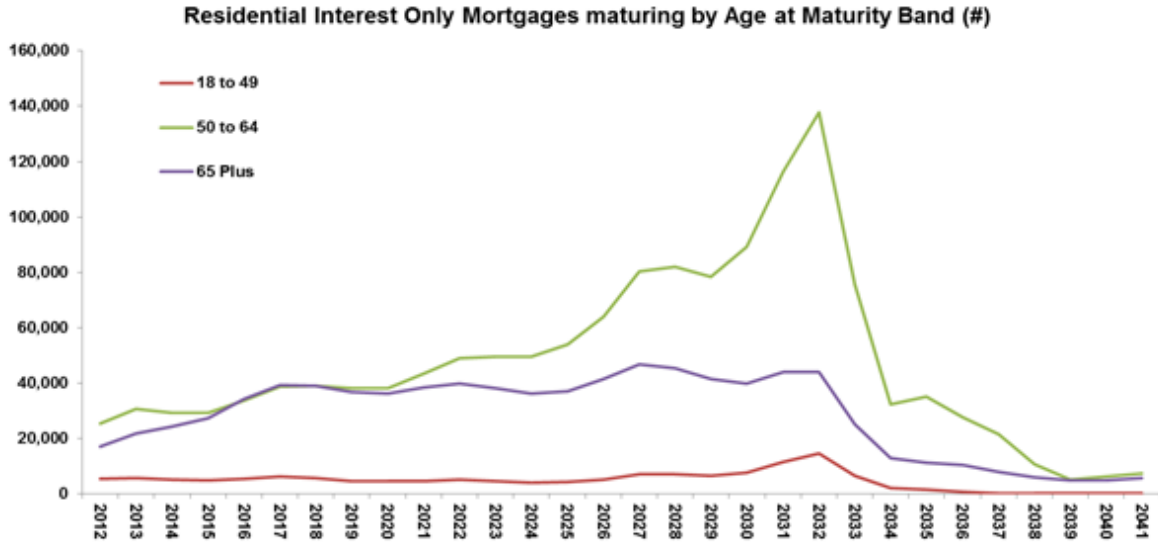


Figure 33: Residential interest only mortgages maturity horizon by age of consumer at maturity. (Source: Experian)

The majority of 65-69 at maturity age group are forecast to have a loan to value of less than 75% at the point of maturity.

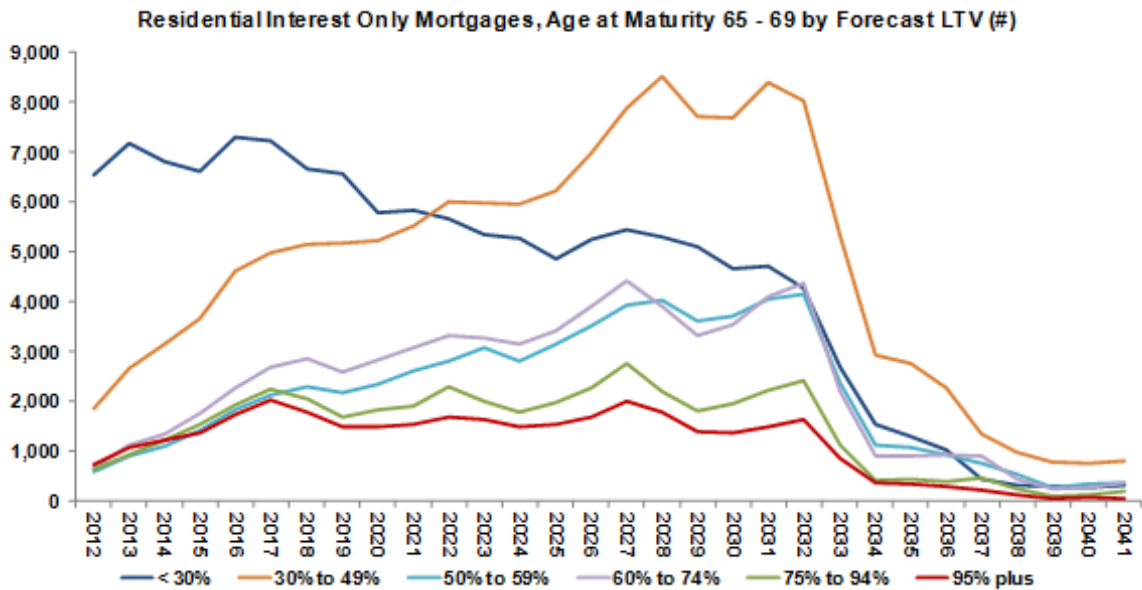


Figure 34: Residential interest only mortgages maturity horizon, age at maturity 65-69 by forecast LTV. (Source: Experian, DCLG)

The majority of 70+ at maturity age group is forecast to have a loan to value of less than 50% at the point of maturity.

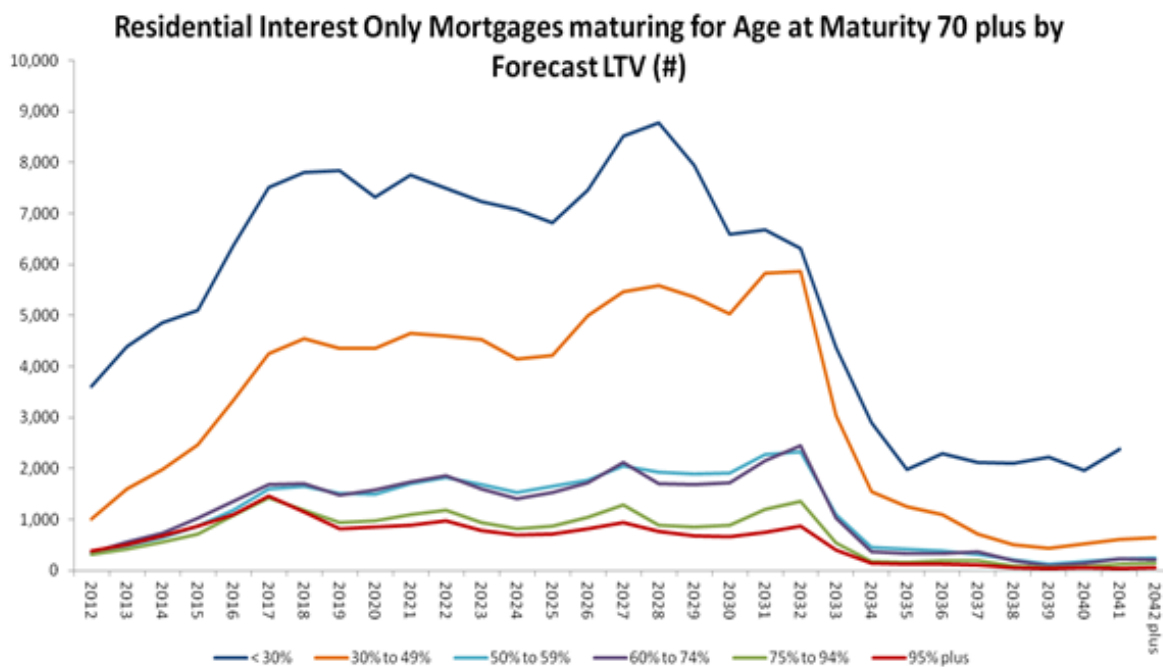


Figure 35: Residential interest only mortgages maturity horizon, age at maturity 65-69 by forecast LTV. (Source: Experian, DCLG)

Post-maturity analysis of residential interest only mortgages

The final element of this analysis is to understand how consumers who have recently reached the end of their interest only mortgage term are managing this event. A proportion of interest only consumers will settle the mortgage in the year leading up to the end of term these cases are not included in the following analysis.

Two cohorts of residential interest only mortgages which reached the end of the loan term have been tracked and a range of outcomes monitored. The first for residential interest only mortgages maturing in March 2010 and the other in December 2010. The range of outcomes studied is:

- **Upsized** – interest only mortgage closed and another mortgage opened within the subsequent 3 months for a value at least £20,000 greater than the interest only mortgage balance
- **Ported** – interest only mortgage closed and another mortgage opened within the subsequent 3 months for a value with +/- £20,000 of the interest only mortgage balance
- **Downsized** – interest only mortgage closed and another mortgage opened within the subsequent 3 months for a value at least £20,000 less than the interest only mortgage balance
- **Settled no further mortgage** – interest only mortgage closed and no further mortgage opened within the subsequent 3 months
- **Term extended and RP/PP** - The term of the mortgage has been formally extended (e.g. repayment period changed from 25 years to 30 years) and the repayment method has changed from interest only to capital and interest (RP) or part and part (PP)
- **Term extended and IO** - The term of the mortgage has been formally extended (e.g. repayment period changed from 25 years to 30 years within account management systems) and the repayment method has remained interest only
- **Repayment type changed** - The term of the mortgage has not been formally extended (e.g. remains at 25 years within systems) and the repayment method has changed from interest only to capital and interest or part and part
- **No Change – UTD** - The term of the mortgage has not been formally extended and the repayment method remains interest only. All monthly payments are currently up to date.
- **No Change – Delinquent** - The term of the mortgage has not been formally extended and the repayment method remains interest only. One or more monthly payments in arrears.
- **Arrangement** - The term of the mortgage has not been formally extended and the repayment method remains interest only. The lender has entered into a temporary arrangement for revised monthly payment amounts with the consumer.
- **Partial Settlement** – the lender has accepted a partial settlement of the value of the loan, this typically relates to individual insolvency
- **Default** – the lender has charged-off the full value of the loan. This typically at the point at which repossession proceedings are started.

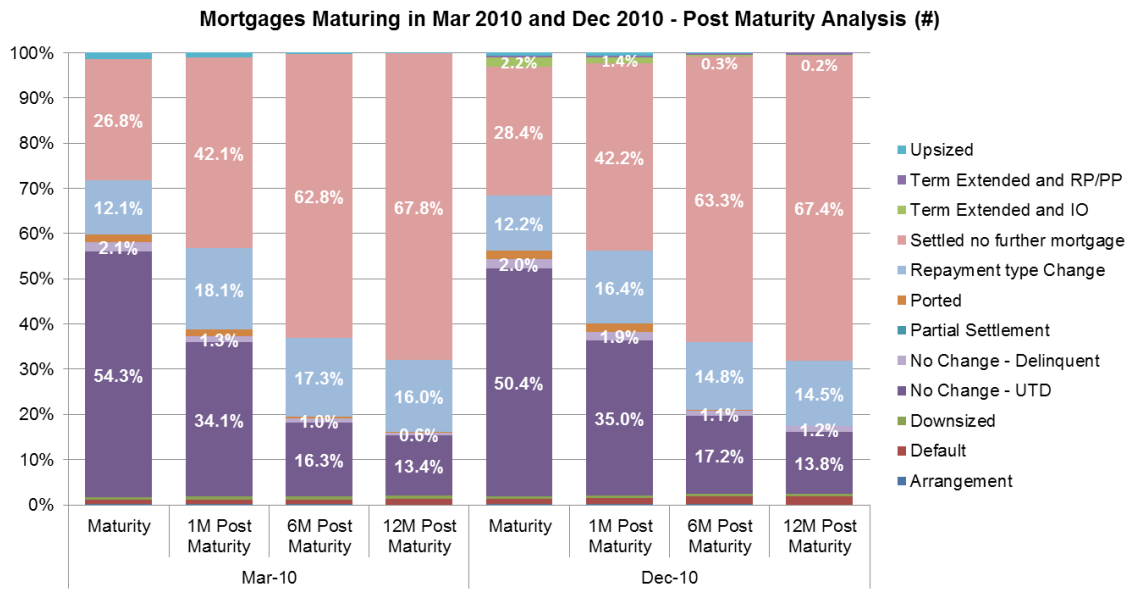


Figure 36: Post maturity analysis for residential interest only mortgages recently reaching the end of term. (Source: Experian)

Figure 36 shows what happened to two cohorts of residential interest only mortgages maturing, in March 2010 and December 2010 respectively, during the 12 months following the end of the loan term. Each outcome in Figure 36 provides a snap-shot of the position at each point after the end of the term. For the first cohort 67.8% of consumers paid off the interest only mortgage in full after 12 months, for the second cohort 67.4%. The overwhelming majority of consumers repaying the balance have done so within six months of the end of the term (6 month post-maturity in Figure 36).

Approximately 15% (16% in March 2011 reducing to 14.5% in December 2011) convert to repayment terms with the same lender, essentially continuing past the formal term to pay off the capital balance (Repayment type change in Figure 36). A further 13% exhibited no change and were up to date with monthly payments i.e. they continued paying the interest only payment amount past the end of the formal term.

There is little difference in the outcomes between 6 months post maturity and 12 months post maturity, indicating that if the consumer is not able to repay in full immediately, a longer term solution is put in place in the 6 months following the end of the term.

The greater the age of the person past retirement age at the point of the maturity the more likely it is that only the interest element will continue to be paid off ongoing.

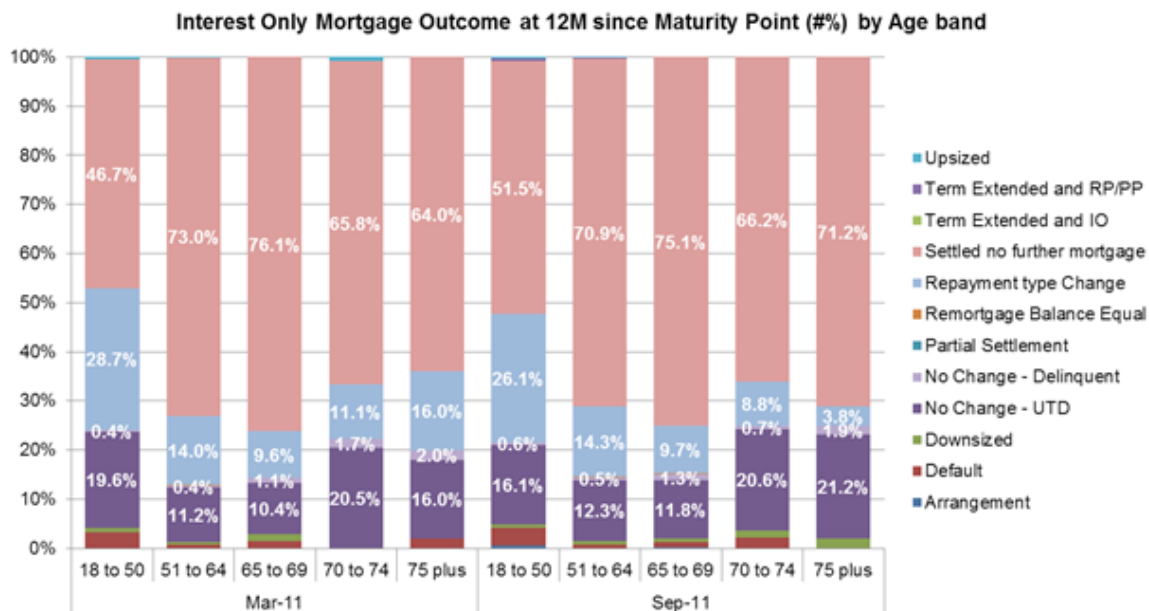


Figure 37: Post maturity analysis for residential interest only mortgages recently reaching the end of term by age at maturity. (Source: Experian)

Figure 38 shows there has been an increase in the proportions of interest only mortgages maturing where the borrower is aged 65 or over, from 15.3% in March 2010 to 18.3% in December 2011.

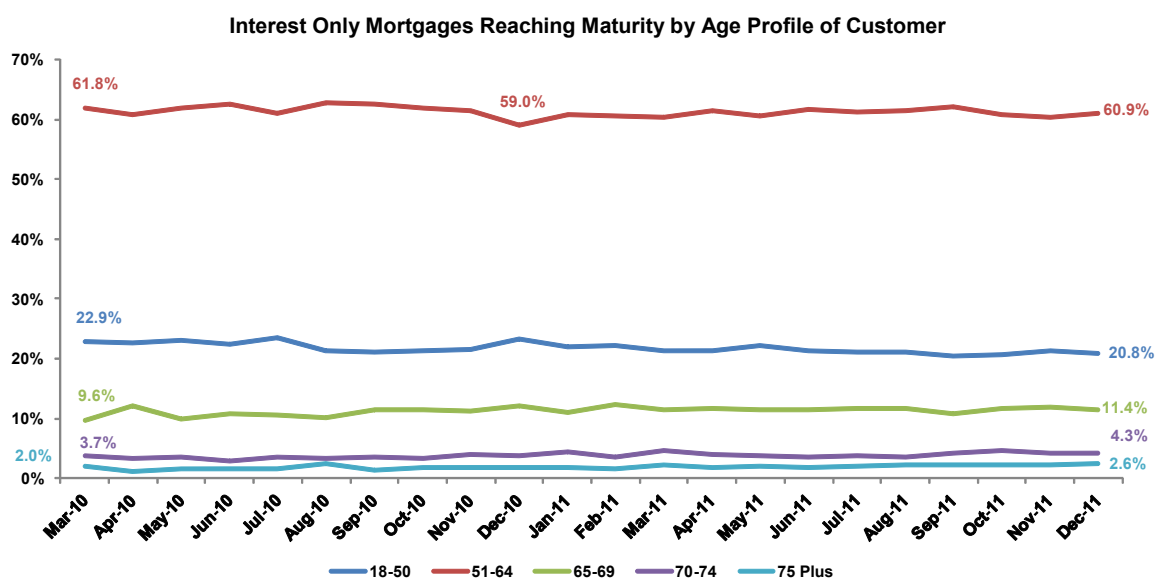


Figure 38: Post maturity analysis for residential interest only mortgages recently reaching the end of term by age at maturity. (Source: Experian)

The movement towards an over 65 population maturing has been driven by an increase in the proportions of the Platinum Pensions and Sunset Security Financial Strategy Segments.

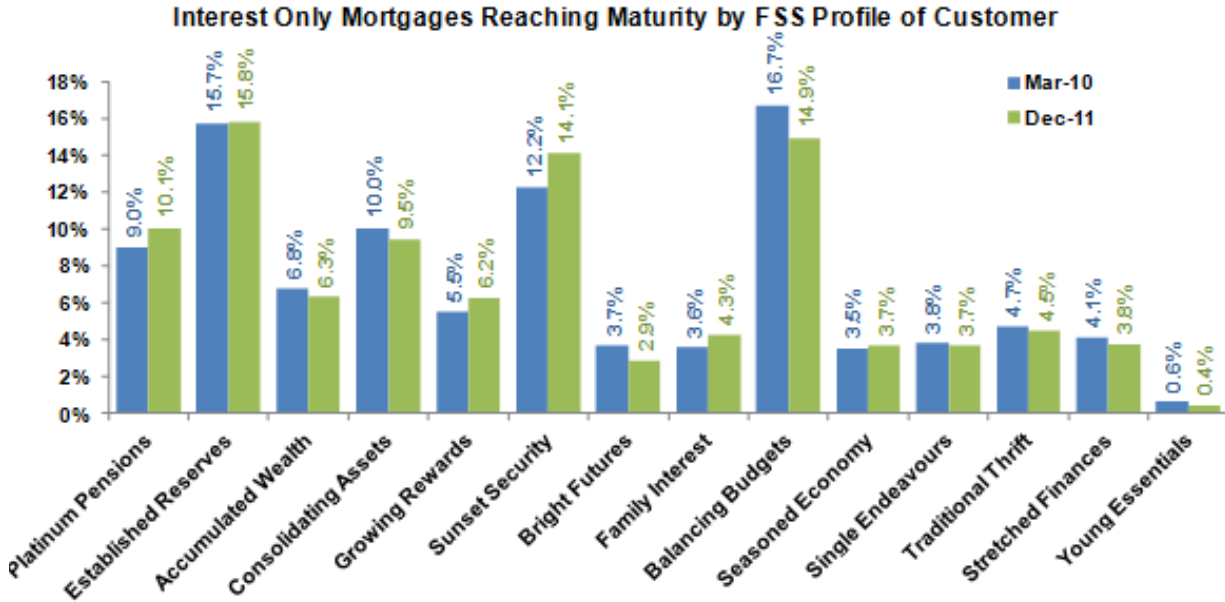


Figure 39: Post maturity analysis for residential interest only mortgages recently reaching the end of term by Financial Strategy Segment. (Source: Experian)

There have also been increases in the early to mid-life stage, mid to high affluence groups of Growing Rewards and Family Interest. Figure 40 shows that over the same period the proportions of interest only mortgage maturing with an loan to value in excess of 85% has risen from 1.9% in March 2010 to 3.6% in December 2011.

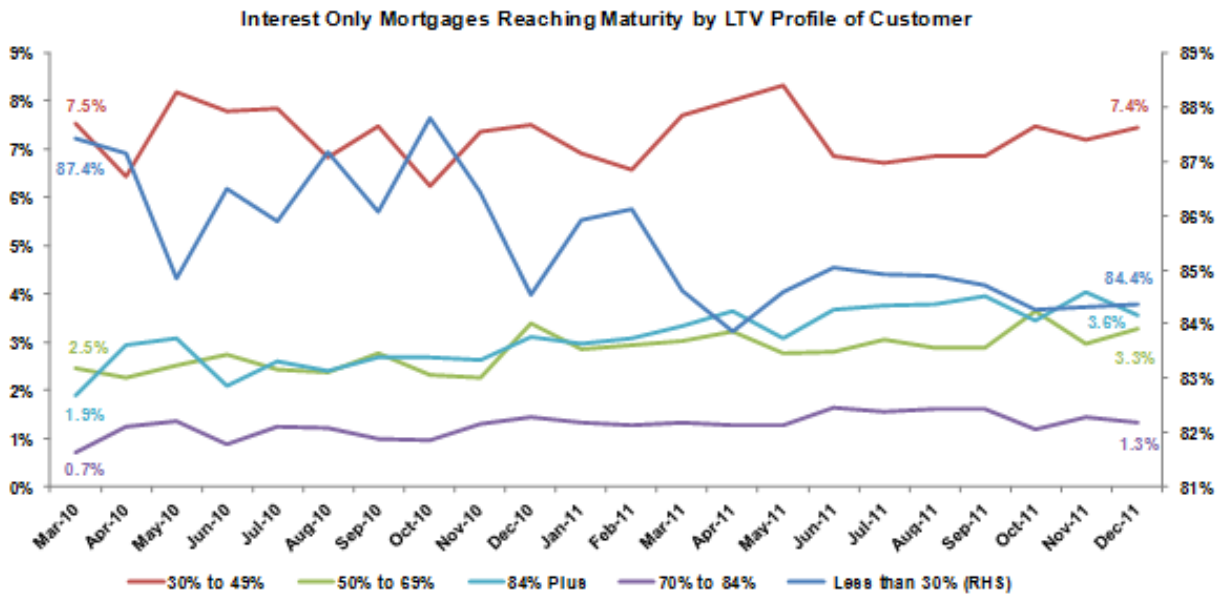


Figure 40: Post maturity analysis for residential interest only mortgages recently reaching the end of term by Loan to Value. (Source: Experian)

Appendices

Identification of Buy-to-Let Mortgages

Buy-to-Let mortgages are not regulated by the Financial Services Authority and are excluded from this analysis. Only residential mortgages are included. For the purposes of this analysis Buy-to-Let mortgages have been identified through the Product Sales Data and an algorithm developed by Experian and excluded.

Where Product Sales Data is available at the point of origination of the mortgage, the Residential / Buy-to-Let classification provided by the lender to the FCA has been used. Where this is not available (mortgages originated prior to 2005, 2.48mn mortgages representing 27.58% of the population), Experian has used an algorithm to identify potential Buy-to-let mortgages.

Both Lifetime mortgages and Off-set mortgages have been excluded from this analysis.

Residential interest only mortgages algorithm approach

The repayment terms of a mortgage are provided on the Product Sales Data at the point of origination but are not updated subsequently. Therefore, this analysis hinged upon the ability to identify changes in repayment terms throughout the life of the mortgage.

Based upon the monthly submissions from the lenders for each mortgage, Experian developed an algorithm to derive the amortisation schedule for the loan. This determined whether the current monthly payment amount, if continued to the end of the mortgage term, would be sufficient to repay the capital balance in addition to the interest element.

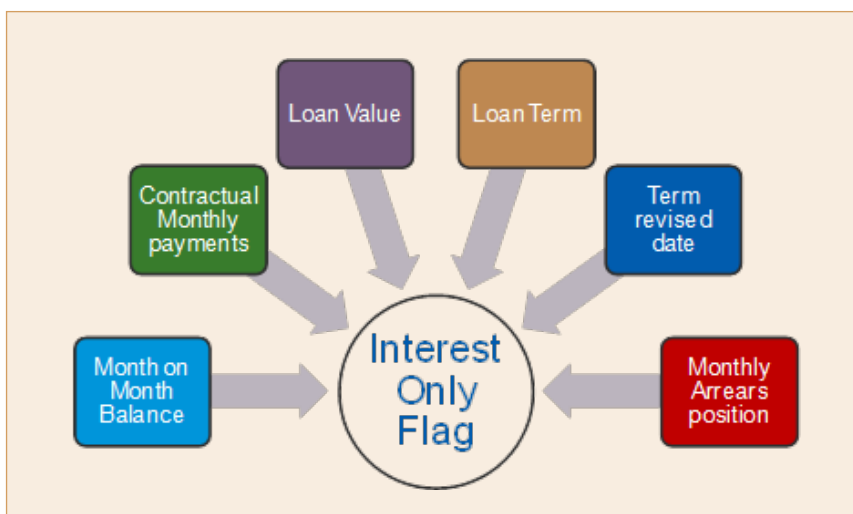


Figure 41: The components of the Interest Only algorithm (Source: Experian)

By adopting this approach the repayment type is determined month on month by considering the actual payment behaviour. Therefore, if a mortgage is contractually on interest only terms but the consumer is consistently over-paying or making lump sum payments, it may be classified as a repayment mortgage and not interest only.

Validation of the Interest Only algorithm

To ensure the algorithm provides an accurate view of the repayment terms of a mortgage over time a series of validation exercises were performed by the FCA and Experian with the co-operation of a number of lenders.

Validation Source	Mortgage Repayment Type from source	Experian Interest Only algorithm accuracy
Product Sales Data at point of origination	Interest Only	91.0%
	Capital Repayment	97.1%
	Part + Part	31.1%
	Overall Accuracy	91.9%
Lender portfolio 1	Interest Only	92.0%
	Capital Repayment	96.0%
	Part + Part	45.9%
	Overall Accuracy	89.1%
Lender portfolio 2	Interest Only	97.5%
	Capital Repayment	96.4%
	Overall Accuracy	97.4%
Lender portfolio 3	Interest Only	96.0%
	Capital Repayment	99.1%
	Part + Part	56.7%
	Overall Accuracy	95.5%

The part and part repayment type has been identified by considering the monthly payment amount as a percentage of amortisation schedule payment i.e. the payment amount that would be required to pay off the interest and capital balance by the end of the term. To obtain the optimal accuracy rate in identify interest only and repayment terms Experian has classified a payment to amortisation schedule payment percentage of < 25% to be interest only and > 87.5% to be repayment. This results in a proportion of part and part repayment types to be misclassified, hence the lower accuracy rates.

When validating the algorithm examples were investigated where the Experian Flag differed from the Product Sales Data and/or lender flags.

The example below shows a scenario where the repayment type changes to interest only for a period of 12 months, the monthly payment amount changes to the interest element and the capital balance is no longer paid down. The algorithm is able to identify the period of interest only terms and also determine the point at which the mortgage reverts to a capital and interest basis.

Month on Book	Amortisation Schedule Payment	Original Balance	Monthly Balance	Balance Change Amount	Monthly Payment Amount	Experian Flag	Lender Flag	PSD Flag
0	0	£97,626	£97,626	0	572		RP	RP
1	386.66	£97,626	£97,521	-105	351		RP	RP
2	375.13	£97,626	£97,393	-128	351		RP	RP
3	369.43	£97,626	£97,257	-136	351	RP	RP	RP
4	289.96	£97,626	£97,128	-129	217	PP	RP	RP
5	369.43	£97,626	£97,125	-3	217	PP	RP	RP
6	369.43	£97,626	£97,129	4	217	IO	RP	RP
7	369.43	£97,626	£97,133	4	217	IO	RP	RP
8	358.19	£97,626	£97,116	-17	217	IO	RP	RP
9	369.43	£97,626	£97,120	4	217	IO	RP	RP
10	369.43	£97,626	£97,117	-3	217	IO	RP	RP
11	369.43	£97,626	£97,121	4	217	IO	RP	RP
12	369.43	£97,626	£97,118	-3	217	IO	RP	RP
13	369.43	£97,626	£97,123	5	217	IO	RP	RP
14	369.43	£97,626	£97,127	4	217	IO	RP	RP
15	369.43	£97,626	£97,124	-3	217	IO	RP	RP
16	369.43	£97,626	£97,128	4	217	IO	RP	RP
17	479	£97,626	£97,125	-3	378	IO	RP	RP
18	369.43	£97,626	£96,968	-157	378	IO	RP	RP
19	369.43	£97,626	£96,811	-157	378	RP	RP	RP
20	358.19	£97,626	£96,632	-179	378	RP	RP	RP
21	369.43	£97,626	£96,474	-158	378	RP		RP

Data sources

This analysis has used a number of data sources which were combined to support the analysis.

The Product Sales Data (PSD), held by the FCA for all regulated mortgages, provides information on the lending and repayment terms at the point of origination of the loan. It does not show any subsequent changes during the lifetime of the mortgage and is only available from 2005 onwards.

The PSD data has been matched to the data held by Experian. This provides information on more than 95% of all mortgages originating from 1994 onwards and is updated monthly allowing changes to repayment terms to be tracked throughout the life of the loan. The information is held at a person level, rather than an individual mortgage account level, thereby providing a full understanding of consumers overall credit commitments.

Whilst the Product Sales Data provides the Loan-to-Value percentage at the point the mortgage was first opened, house prices have fluctuated significantly over the years and these changes have differed by geography. Therefore, the current equity position for each open Interest Only mortgage has been overlaid using the property valuation from Experian's National Property Database in combination with the loan value outstanding at the current point in time.

98% of the residential mortgages population matches to the National Property Database, however, in 38% of the cases there have been insufficient housing transactions in the recent past of similar property types within the postcode area. Therefore, a reliable property valuation has not been possible to determine. Due to the potential inaccuracies which may be introduced by using postcode averages, for example, where 1 bedroom flats and four bedroom detached houses are on the same road, loan-to-value analysis has been provided only in the cases where an accurate property valuation is possible.

Throughout the analysis herein 'Region' refers to the ONS definition of regions (formerly Government Office Regions), for details of the geographical classification please refer to:

<http://www.ons.gov.uk/ons/guide-method/geography/beginner-s-guide/administrative/england/government-office-regions/index.html>

House Price Forecasts

To obtain an estimate of the equity position of each mortgage at the point of maturity (the end of the formal repayment term) the current property valuation from the National Property Database has been projected forward (up to 2032) using Regional House Price forecasts provided by Experian's Economic forecasting team.

Regional house price forecasts are a standard output from our UK macroeconomic and regional forecasting services and are produced within our large-scale multi-equation forecasting models which are built around extended versions of the National Institute for Economic & Social Research NiGEM model. Regional house price forecasts are built upon the historical series of the Department for Communities & Local Government (DCLG) regional house price indices (RHPI) for all properties.

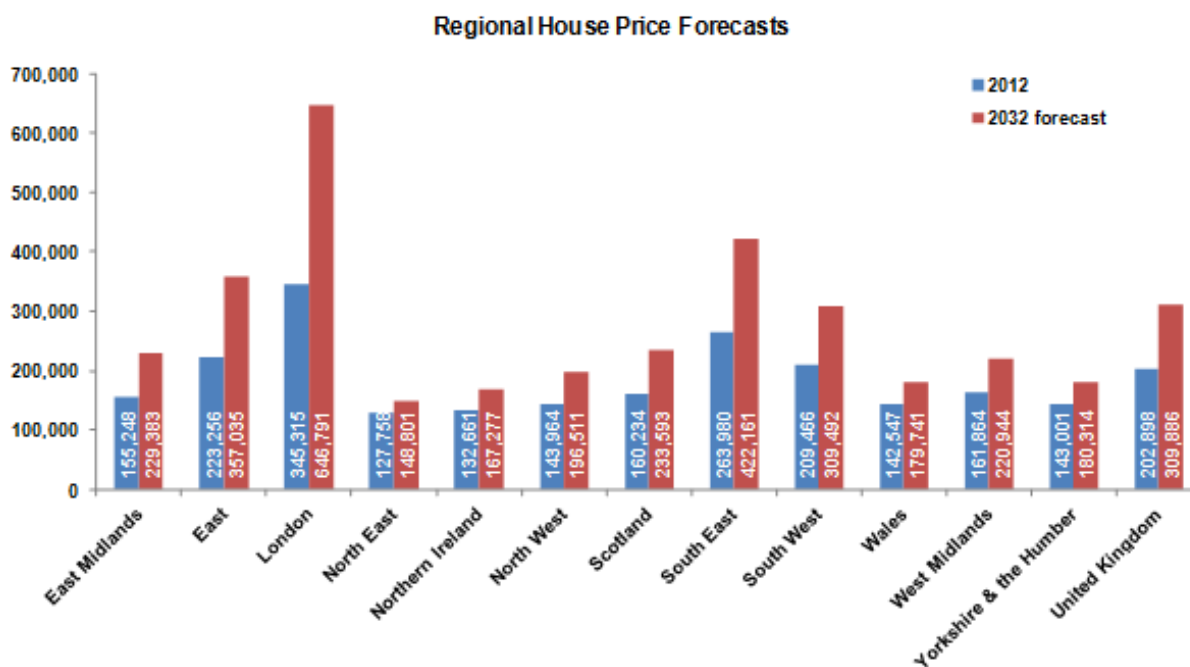


Figure 42: Regional House Price Forecasts, % change applied to average house price for the region (Source: DCLG& Experian)

Financial Strategy Segments

To provide further insight into the socio-demographic profile of consumers with Interest Only Mortgages, Experian has applied its Financial Strategy Segment (FSS) classification to the analysis. The classification segments the total population of the UK into 82 individual behavioural types. These are then aggregated to 50 household types and 14 household groups.

The segmentation has been built from a wide range of data:

- Experian ConsumerView
- YouGov Financial Omnibus survey (annual)
- YouGov Debt Tracker (quarterly)
- YouGov Household Economic Activity Tracker (monthly)
- YouGov Platinum Survey (monthly)
- British Population Survey
- Experian Economic group research
- Experian Hitwise online data

FSS provides a comprehensive portrait of individuals and their financial behaviour across all adults and households in the UK. It includes insight on the types of financial product or service consumed, and segments behaviour on the basis of a person or household's net worth, equity, investments, indebtedness, credit risk, attitudes and preferred transactional channel. For a detailed description of each Financial Strategy Segment please refer to: <http://mmguides/asp/fss2011/html/visualisation.htm?011121>

A simplified view of the Financial Strategy Segments is a combination of affluence and life stage:

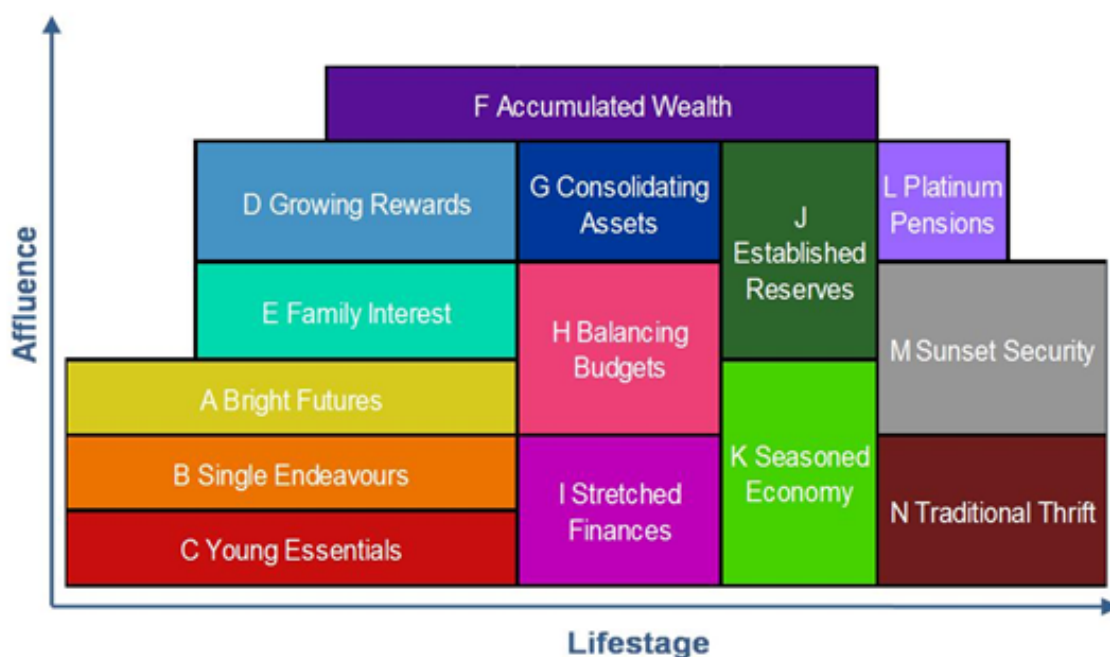


Figure 43: Financial Strategy Segments (Source: Experian)

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