

Analysis

Residential Mortgage and Rent Relief During Crises

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Original post [here](#).

Cash flows around the world have dropped dramatically as more governments require non-essential businesses to close and individuals to stay at home in order to fight the COVID-19 pandemic. In a fairly short time, such actions have led to [massive layoffs and job losses](#). In the United States, for example, the country has swung from historically low unemployment levels to historically high numbers of claims for unemployment benefits; similar effects can be observed in other countries. As a consequence, individuals are experiencing, and are expected to continue to experience for some time, difficulty in paying their housing costs. Whether mortgage or rent, housing is usually the largest fixed cost for households and many governments have responded by announcing various packages to provide relief. This post begins by examining the fundamental challenge presented by the need to provide residential expense relief on a grand scale. It then details multiple programmatic interventions utilized in crises past and present. Finally, this post provides some key takeaways to consider when implementing residential expense relief policies.

Statement of the Challenge

National or state-wide residential mortgage and rent relief policies in response to broad financial duress date back as early as the [Great Depression](#). Such policies may provide immediate relief to individuals through instruments like mortgage or rental forbearance or eviction moratoria. Governments may also institute longer-term policies, such as mortgage restructuring or repurchasing.

The need to provide respite to individuals during times of crisis places governments in a delicate position in which they must implement policies that provide financial relief to individuals experiencing difficulties making their mortgage or rental payments while simultaneously maintaining the functional integrity of the mortgage lending and servicing system. Difficulty may arise in balancing these two competing objectives as the individual homeowner's or tenant's interest conflicts with that of the landlord, lender, or mortgage servicer. Thus, to achieve a balance, governments that provide short-term or long-term mortgage or rent relief often also provide flexibility or incentives for landlords, lenders, and servicers administering or participating in such programs. Should a government employ one set of relief without the other, or a method of relief that doesn't fit the problem well, then the debt burdens for homeowners (including landlords) may persist unaddressed, further exacerbating the crisis.

To determine policies that optimally address such a problem regarding mortgage and rental payment, governments must consider the following key questions:

- **Type of Problem:** What is the problem that creates the need for residential relief? When is the problem expected to end?

- **Type of Relief:** What are the best tools to address the problem? Who are the various stakeholders?
- **Underlying Borrower/Renter Circumstances:** What is known about the underlying circumstances of the borrowers or renters?
- **Lender Impact:** Can lenders and their servicers execute the program efficiently? What will the impact of the program be on them? What relief might they need?
- **Existing Structural Issues:** How might differing market incentives or structural issues impede the success of the program?

Residential relief programs may address these considerations in different ways based on the circumstances presented. We will discuss these questions further as we review different intervention strategies below.

Types of Programs

- **Mortgage Forbearance** - allows homeowners to temporarily delay making payments
- **Mortgage Restructuring** - permanent modifications to existing at-risk mortgages
- **Mortgage Purchasing** - outright purchase of at-risk mortgages by a government or agency
- **Renter's Aid** - providing forbearance and rent subsidies to tenants
- **Flexibility in Debt Restructuring** - modifications to accounting and regulatory frameworks to aid lenders in restructuring mortgages

Mortgage Forbearance

If decreased cash flows amongst individuals is the only economic problem they face, forbearance may be a suitable relief strategy, since it grants mortgage holders a short period during which they can defer payment and repay the unpaid balance months later. Because of the nature of the current COVID-19 pandemic, where the cash flow issues are expected to be of limited duration—reversing once the wide-spread government-imposed economic shutdowns are lifted—several countries have used forbearance for short 3-6 month durations. In this instance, the period of forbearance may also be extended as needed. Additionally, in connection with forbearance relief, late payment penalties and foreclosures are usually stayed. Credit reporting may also be stayed so that the individual does not experience a drop in creditworthiness after accepting forbearance.

Governments may implement mortgage forbearance by passing legislation that provides direct legal relief for nonpayment, as the [United States](#) has done in the current COVID-19 outbreak. The CARES Act provides homeowners whose mortgages are federally backed (approximately 80% of those outstanding) the right to request a 180-day forbearance. (See a YPFS blog on the US program [here](#)). Officials in the [United Kingdom](#) have instituted a three-month mortgage holiday, during which borrowers do not have to make any payments. [Ireland](#) has implemented a similar payment moratoria on mortgages, as well as on business and personal loans for individuals. Some countries may institute government-mandated forbearance, but with more limited coverage.

Other countries have implemented similar relief through the private sector. [Hungary](#) stopped short of legislating such relief and instead urged banks to provide forbearance for household payments. In Ireland, during the Global Financial Crisis (GFC), the government emphasized [forbearance by lenders](#) but did not require such policies until 2013. In [the Bahamas](#), the government has arranged for lenders to provide a three-month mortgage forbearance to borrowers who were in good standing prior to the pandemic. In this case, missed payments will accrue interest throughout the forbearance period. Private-sector solutions can provide coverage for substantial numbers of individuals if all major banks participate.

It should be noted, however, that forbearance is a delay, not forgiveness. Individuals are still responsible for the deferred payments, and repayment plans must be negotiated with the respective lender or landlord. As discussed below, governments often provide incentives for the lenders to reach agreements that are manageable to the homeowner and keep them in their homes. Depending on the structure of the country's mortgage system, homeowners may have to negotiate this restructuring with a mortgage servicer who represents the lender; either party may have conflicting incentives that impact the ease of agreement.

Mortgage Restructuring

If the perceived problem is with the fundamental economics of the mortgage rather than a short-term cash flow issue, then longer-term solutions provide opportunities for mortgage restructuring in an effort to avoid delinquencies or foreclosures, and maintain people in their homes. These solutions may also need to be employed if forbearance fails to address the problem effectively, as occurred in Ireland during the GFC (discussed below).

Historically, the manner in which debt restructuring is implemented varies widely. Some programs attempt to restructure loans to provide easier paths to pay off extant mortgages. Other programs simply purchase homes outright from the lender, including any outstanding mortgage balances, leaving original owners of dwellings as tenants who pay rent to the new homeowner. The choice between the two programs may depend on whether or not the mortgages are “underwater”—the case in which the outstanding principal payment is greater than the value of the home. Mortgages that significantly exceed the value of the home may be strong candidates for outright purchase rather than restructuring, as there is a lesser incentive for the homeowner to continue payments. By contrast, restructurings or modification programs are aimed at reworking the mortgage on the assumption that the homeowner will continue to occupy the home and pay the mortgage. However, as discussed below, the methods and objectives sometimes overlap.

The [Home Affordable Mortgage Program](#) (HAMP) instituted by the United States during the GFC, when many mortgages exceeded home values due to a broad market correction, encouraged privately negotiated modifications by incentivizing mortgage lenders and servicers to participate in the program with cash payments and by providing a required modification framework. The required framework expressly reduced all mortgage payments to [31% of an individual's monthly income](#), relying first on a reduction of interest rate for five years, followed by a reduction of principal payments to reach this target. The program thus established an industry standard for modifications which sought to avoid foreclosures. The [Homeowners Support Mortgage Scheme](#) (HSM) in the United Kingdom took a different approach to creating a modification framework. That scheme allowed homeowners to defer up to 70% of their interest payments for two years, with 80% of the deferred interest payments guaranteed by the government for banks participating in the scheme.

Also during the GFC, [Ireland utilized split mortgages](#), a novel restructuring option that split mortgage debt into two pieces: one piece warehoused for later payment, and one piece that the borrower makes payments on until their financial situation improves.

Some restructuring options do not rely on changing the terms of an existing mortgage. During the Great Depression in the United States, a style of lending called “equity of redemption” allowed debtors to re-attain their foreclosed properties if outstanding mortgage debt was paid off within a certain time period after foreclosure. Many states [extended the equity of redemption period](#) to provide relief for mortgage owners.

Mortgage Purchasing

In comparison to private-sector modification programs, government-funded mortgage repurchase programs purchase loans and then offer favorable refinancing if the homeowner can afford it. During the Great Depression, the [Home Owners Loan Corporation](#) in the United States purchased [mortgages directly from lenders and issued new mortgages to the borrowers](#), refinancing many on much more favorable terms.

In some cases, if homeowners could not afford to refinance, they were permitted to stay in their homes as tenants. During the GFC, Scotland created the [Homeowner Support Fund](#), under which a local council purchased distressed houses at 90 percent of their value and then rented them to the former homeowners, allowing families to remain in their homes.

Also during the GFC, the United Kingdom implemented a two-part scheme, called the [Mortgage Rescue Scheme](#), designed to help vulnerable homeowners stay in their houses. Local councils had the ability to purchase a home at market rate and offer a short-term tenancy to those already living in the home at 80% of market rent. The scheme also allowed local councils to make a “shared equity” loan to the household to help it maintain the mortgage by temporarily paying a reduced amount. The scheme was ultimately criticized for miscalculating demand and completing too many [costly purchase rescues](#); a more balanced usage of the two schemes had been forecasted.

Examples of restructuring or modification frameworks have yet to emerge in the current COVID-19 crisis. However, if the crisis persists, the need for such relief may arise as the prolonged effects of unemployment and economic downturn impair owners’ ability to maintain their mortgages.

Renter’s Aid

Renters may also face reduced cash flows as unemployment rises during economic crises. Similar to mortgage forbearance, governments may provide rent forbearance to renters, where they are granted a short period during which they may defer payment and repay the unpaid balance months later. Renters also may be protected from late-payment penalties and negative marks on their credit report as a result of utilizing the forbearance benefit. The risks associated with a tenant who takes a rental forbearance differ from those of a homeowner or mortgagor. Rental contracts are short-term commitments and do not carry the possibility of equity. In contrast, a mortgage creates an incentive for the borrower to remain in the home. There may be a greater risk that tenants, especially tenants who have difficulty returning to work or other basic financial difficulties, may not be able to repay the forbearance amount, creating a problem for landlords and their own ability to pay related mortgages and expenses.

Governments may implement rent forbearance by passing legislation that provides direct legal relief for nonpayment, as the [United States](#) has done in the current COVID-19 outbreak. The CARES Act provides a rental moratorium and suspends evictions for the duration of mortgage forbearance for properties that are financed by federally backed multi-family mortgages. (See a YPFS blog on the program [here.](#)) [Greece](#) has provided relief using a different method; businesses and individuals directly impacted by the pandemic will be permitted to pay only 60% of their rent for the months of April and May. Both methods increase the flexible cash-flow for renters who choose to take advantage of the benefit and illustrate the differing breadth that such relief can take.

Governments may also implement rental subsidies, aimed at reducing rental costs rather than deferring them. Government subsidies provide the additional benefit of guaranteeing payments to landlords and lenders who may not receive payments if renters are unable to repay outstanding rent after the forbearance period. Some rent subsidies are a direct government payment to landlords. In [British Columbia](#), government-funded rent relief of CAD\$500 per person per month for up to three months is intended to help tenants impacted by the COVID-19 pandemic continue to pay their rent. Related provisions prohibit evictions and rent increases during this period; also, the government has asked banks to work with landlords who may experience a drop in rents. [Malta](#) has also established a new Private Rent Housing Benefit Scheme, through which individuals unemployed due to the COVID-19 outbreak will receive governmental rent subsidies.

Governments may also reduce housing costs that are not typically included in rent. [Bahrain](#) will cover electricity and water payments for three months; [Ukraine](#) has prevented the disconnection of utilities for customers late on utility payments.

Flexibility in Providing Debt Restructuring

When economic shocks demand large-scale residential mortgage relief, lenders face barriers to efficiently carrying out government mandates. These include liquidity issues due to slowed cash flows; an increase in loans classified as “troubled debt,” due to restructurings that reduced principal or interest payments; and other increased administrative costs associated with high volumes of activity.

To provide flexibility for lenders who provide mortgage forbearance, governments may seek to ease the application of accounting principles. For example, restructuring loans to reduce principal or interest payments is typically classified as troubled debt. A government may specify that restructurings in compliance with its mandate will be excluded from this classification. This policy enables lenders to restructure more loans without taking massive losses on their balance sheets.

In response to the COVID-19 outbreak, the [United States](#) provided that mortgages that benefit from forbearance will not be categorized as troubled debt. [Peru](#)’s Superintendence of Banks notified financial institutions that any modifications to loan terms due to the COVID-19 crisis would not change the classification of the loans.

The government may also provide relief to lenders’ cash flows. In the [United Kingdom](#), in response to the GFC, the government guaranteed the interest-only payments of borrowers in exchange for lender participation in the mortgage forbearance program. In response to COVID-

19, [Canada](#) has promised to purchase CAD\$150 billion in loans from banks to free up their capital.

In developing economies, it may be necessary to restructure loans denominated in foreign currencies. For example, leading up to the GFC, it was common in many countries in central and eastern Europe for mortgages to be denominated in Swiss francs. As the Swiss franc strongly appreciated after the crisis, many of these loans became non-performing. In response, the governments of [Hungary](#) and other countries allowed foreign-denominated mortgages to be redenominated in local currency or even a third currency, providing relief to borrowers from the pressure of increasing exchange rates on mortgage payments. In the COVID-19 crisis, [Sri Lanka](#) has broadly allowed banks to recover loans in Rupees as a last resort, when recovery of loans in a foreign currency appears remote.

Key Takeaways

Fit the solution to the problem.

When considering whether to provide aid to residents or tenants of a mortgaged property, the nature and expected duration of the problem will be a key question. Mortgage and rent forbearance programs provide short-term solutions to address cash-flow shortfalls for mortgage owners or renters. They can provide quick relief to individuals having trouble paying their bills because of unemployment or other cash-related issues until circumstances change.

However, forbearance may not adequately address problems with the fundamental economics of a mortgage, as generally existed during the GFC. Then, longer-term solutions are needed to provide opportunities for mortgage restructuring or purchasing in an effort to avoid delinquencies or foreclosures, and keep people in their homes.

Forbearance relief may create secondary problems once the forbearance period ends.

Forbearance is not forgiveness, but this may be fundamentally misunderstood by some individuals, or just disregarded when faced with a balloon payment or larger monthly payments needed to make-up the forbearance amount. Others, just may be financially unable to make up the payments. For homeowners, history has shown that there is no guarantee that restructured loans will not default. But every crisis is different. If the COVID-19 crisis ends sooner and there is no dislocation in the housing market, the effects should be much different than experienced in the GFC under the HAMP program restructurings, when significant defaults on restructured loans with [underwater mortgages but also prolonged unemployment were cited as major factors](#) of the prolonged foreclosure crisis.

There is a similar risk that renters will fail to repay forbearance amounts. Some tenants may have underlying financial difficulties not related to the immediate crisis. Governments should consider that they may be confronted with a mass problem of unpaid forbearance rent and thus, possibly increased evictions and or bankruptcies once the forbearance period ends.

In total, governments should consider the possibility of such secondary impacts and how they might be addressed should they occur. Additional fiscal assistance may be needed.

Some residential relief programs may create moral hazard.

There is some evidence that forbearance policies create moral hazard. In other words, homeowners may take advantage of the opportunity to not pay their mortgage even if they are

capable of doing so. In Greece, during the Sovereign Debt Crisis, many homeowners received the benefit of a [foreclosure moratorium](#). It is estimated that as many as [37% of the homeowners](#) utilizing the moratorium to delay payments did so strategically rather than because of need.

Understand the underlying circumstances of homeowners and renters.

For both homeowners and renters who take advantage of forbearance benefits, factors that contribute to the ability and willingness to repay center around issues of income, unemployment, debt load, and credit worthiness. If the assistance provided does not take into consideration the full financial profile of the borrower, then the mortgage assistance program may not succeed in stabilizing the borrower's situation.

Such was the case in Ireland in the aftermath of the GFC. The country's initial response relied on broad implementation of [short-term mortgage forbearance](#), which did not account for the broader underlying problem of excessive mortgage debt that had arisen during the GFC (by 2009, the ratio of mortgage debt to GDP was 92%). With a significant number of mortgages underwater and increased unemployment, many homeowners participated in forbearance but were ill-equipped to resume payments when their forbearance periods ended. The government ultimately encouraged large-scale permanent mortgage restructuring to keep homeowners in their homes, rather than temporarily restructuring for forbearance needs.

Similarly, in the United Kingdom, a miscalculation of the desirability of two options under the [Mortgage Rescue Scheme](#) resulted in budgetary underallocation and undermined the efficacy of the program. Although the shared equity option provided a cheaper alternative for the government, it was far less popular than the mortgage purchase option. More homeowners than expected chose to have their council purchase their mortgages and rent the home back to them than the number of homeowners who chose to take a shared equity loan to help them manage mortgage payments. The first option was significantly more expensive and therefore, the number of homeowners assisted was less than planned, while the cost of assistance received by each was significantly greater than expected. The scheme points out the pitfalls of providing an open choice to the homeowner when trying to also serve as many people as possible. A modification to the plan, such as limiting the budget allocated to each option, could have maintained choice but also better positioned the government to achieve its service objectives.

In particular, the choice to reduce payments rather than the principal of a loan [may not be effective if a borrower's equity is very negative](#). Some argue instead that [programs should focus on ameliorating the immediate consequences of job losses](#) to help borrowers maintain liquidity in the long term.

Lender experience and incentives may affect a program's efficiency and participation rate.

Lenders may struggle with implementation [due to a lack of experience in renegotiating loans](#). In financial environments where a majority of lenders do not regularly restructure debts, the implementation of various loan restructuring policies may take longer than expected. Such was the case with the US Home Affordable Modification Program (HAMP) during the GFC. The experience also highlighted the importance of the government understanding the way the industry is structured and incentivized.

Attempts to correct currency mismatch in loans may not reduce lenders' risks.

In some cases, restructuring foreign-denominated debts to local or third-country currencies can provide the necessary leeway for lenders to properly implement government policies. However, it's unclear that changes to currency denomination [reduce risk](#) for lenders overall. They may reduce currency mismatch in the original currency but create another in the new currency. Such exchanges may also be [difficult to administer](#).

Conflicting policies may hamper the success of residential relief programs.

As discussed above, because of the nature of housing, it is useful to combine forbearance policies with restructuring incentives and foreclosure and eviction moratoria. However, when existing or newly implemented rules do not properly allocate risk among housing market participants, they can hamper efficient enforcement of housing policies aimed at providing residential mortgage relief for both borrowers and tenants.

Protections that overshadow borrowers from the risk of default (or renters from eviction) may affect the ability to enforce residential mortgage relief policies. In the case of Ireland during the GFC, homeowners slipped into default on mortgages for years, as a result of the country's [strong homeowner protections](#) that created a one-sided mortgage forbearance regime. This was facilitated by a repossession law that [effectively made foreclosures impossible](#) and left mortgage lenders with little recourse. By December 2012, about [12% of Irish mortgages were late by more than 90 days](#). In this case, homeowners were incentivized to stop paying mortgages when there were few options to permanently restructure debts with mortgage servicers, exacerbating the mortgage debt problem for both homeowners and lenders.

Structural issues may undermine utilization of residential relief programs.

The degree of separation between mortgage owner and homeowner can lead to difficulties in the enforcement of mortgage aid programs. In the United States, before the GFC, the popularity of securitization of mortgages meant that mortgages would often be sold and resold, creating several degrees of separation between mortgage owners and homeowners. This distance between lender and borrower, as well as the complexity of claims on a mortgage created by securitization, often led to [litigation](#) negatively impacting the effectiveness of relief programs.

Additionally, due to the separation between mortgage servicer and mortgage owner, differing compensation incentives hampered efficient mortgage restructuring. This incentive mismatch manifested under HAMP, where [28% of modified loans defaulted again](#), including half of the loans modified at the height of the financial crisis. While the program required restructuring of loans in a way that supported homeowners—specifically through the introduction of mandatory terms to reduce monthly payments to [31% of the individual's monthly income](#)—the program permitted mortgage servicers to determine which borrowers could restructure. Because the servicer was compensated by the unpaid principal balance of performing loans, servicers had the incentive to reduce interest payments and instead opt for [adding unpaid loan balances to the outstanding principal of the loan](#), which was not effective in ensuring the long-term performance of the loan. As a result, many servicers were incentivized to [deny restructuring to eligible borrowers](#), reducing participation in the program dramatically.

In the case of the HSM in the United Kingdom, also during the GFC, the additional onerous requirements placed on lenders in terms of documentation and reporting lead to only [32 borrowers participating in the program](#). Additionally, few lenders provided forbearance through the HSM program directly, instead opting to offer their own forms of forbearance. However, it

was concluded that through such intervention, the government was able to influence most lenders' forbearance policies, leading to indirect aid for even those not participating in the program.

For more specific information about specific types of programs and their usage in the most recent crisis, see [Mortgage Forbearance and Eviction Moratoria in Response to the COVID-19 Outbreak](#) and [Expanding Debt Restructuring Options for Mortgage Lenders in Response to the COVID-19 Outbreak](#).