Central Bank of
Trinidad & Tobago

The Residential Mortgage Market in Trinidad and Tobago

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FOREWORD

External communications are an important part of the business of the Central Bank of Trinidad and Tobago. The Bank's outreach initiatives are intended both to enhance its contribution to educating and informing the public generally, as well as to assist markets in understanding the Bank's policy actions and intentions.

In addition to the regular publications of its Research Department, the Bank's Outreach Programme has included lectures and speeches to school children by senior Bank officials, mentoring to undergraduate students and supporting an internship arrangement with the University of the West Indies.

This public education series is also a part of the Programme. Its intention is to provide information on topics and policies that are relevant to the management of the economy of Trinidad and Tobago. The world of business and trade is a fast-paced, ever-changing and challenging one and the tools of knowledge and information must be strategically used to navigate it.

This pamphlet series is geared towards a broad readership. It is likely to be a good source of information for students at the secondary and tertiary levels, professionals and other members of the public who are interested in increasing their knowledge of economics and business.

The pamphlet will be published on a quarterly basis and will cover current and topical issues and explain new economic initiatives. In the series, every effort will be made to present the material in as non-technical a manner as possible while adhering to sound economic analysis and the highest editorial standards.

FOREWORD

To this end, the Bank has invited three well-known economists from the private sector to join the editorial team, firstly to suggest topics that would be of interest to the public and secondly, to advise on ways to reach the target audience. The Bank also intends to invite guest contributors to the series from time to time.

We hope that the series raises the level of public awareness and public discourse on economic issues and contributes to the strengthening of economic policy formation in Trinidad and Tobago.

Ewart S. Williams
Governor

The Residential Mortgage Market

Introduction

This pamphlet analyses the residential mortgage market in Trinidad and Tobago. The analysis is conducted against the background of market practices in more developed markets, particularly in the United States of America (US) and the United Kingdom (UK).The facts suggest that while there has been a significant expansion of mortgage activity in Trinidad and Tobago in the last few years, the local market has been slow to adopt many of the innovations that are standard in these developed economies and in many developing countries. The slow adaptation to changing circumstances has had implications for consumer choice and may well have increased the level of risks inherent in the market.

The risk characteristics of mortgages are subtle and complex. For example, many mortgage applicants find it difficult to assess these risks and very often are not helped by the kind of information and advice they receive from their bankers. In these circumstances, the objective of the pamphlet is to give consumers a better understanding of the functioning of the mortgage market and of some of the issues that ought to be considered when contemplating home ownership and contracting a mortgage.

Two related practices common to the Trinidad and Tobago market tend to work against the consumer. First, unlike what happens in the US, there the tendency is for applicants to do very little comparative shopping for mortgage loans. This may be due to the perception that it is a seller's market and that "being qualified by a lender" is an achievement in itself. Second, even when customers are presented with options, they tend to give enormous weight to the level of initial monthly payments, while considerations of long-term cost and affordability tend to play a lesser role. Hopefully, the type of information presented in this pamphlet will help consumers make more informed judgements, and in so doing, make the best of the limited market opportunities available. Several examples have shown that more informed consumers will inevitably lead to a better functioning of the mortgage market.

In Section I, the pamphlet introduces some important concepts and definitions commonly used in the mortgage industry. Section II outlines the structure of the residential mortgage market in Trinidad and Tobago, while Section III discusses the terms and conditions that could be found in the market, using the offerings of the US and UK markets as benchmarks.

Section IV discusses the role of the public sector in the residential mortgage market, highlighting the innovations that have been introduced in recent years. Section V deals with the evolution of residential mortgage interest rates while Section VI, the final section, provides a discussion of the risks associated with the current housing boom against the background of the economic and financial stress that followed the collapse of oil prices.

The pamphlet includes two Appendices: Appendix A provides estimates of the rapid increase in housing prices over the last few years, while Appendix B outlines some guidelines to consumers to help them through the mortgage application process.

I. Understanding Mortgages

Definitions/Concepts

Mortgages

For most people, their home is their largest single asset. Correspondingly, a mortgage, which is the secured advance of funds for the purchase of a home, is the largest debt incurred in a lifetime. Mortgages allow the borrower to spread the acquisition of this major asset over a long period by paying off for the mortgage in a number of fixed instalments.

Mortgage Term/Cost

The mortgage term or amortization period is the actual number of years that it will take to repay the entire mortgage loan.

The total cost of the mortgage is the sum of interest payments plus the amount of the loan. This cost is impacted by the mortgage term and the interest rate. For a given interest rate, the longer the amortization period, the lower the monthly payments and the higher the cost of the mortgage (See Box 1). Although 25-year amortization periods are common, many homeowners choose shorter amortization periods to lessen the interest expense and the ultimate cost of the mortgage.

Down Payment

A down payment is the money paid to make up the difference between the purchase price and the mortgage amount. It normally ranges from 10-25 percent.

Box I
Sample Mortgage Computation

The sample mortgage calculation illustrates how the interest rate and the term of the mortgage affect monthly mortgage payments as well as the overall cost of the mortgage. For a 20-year mortgage valued at TT$450,000 with an 8.0 per cent interest rate, the monthly mortgage payment amounts to TT$3,764 while the overall cost of the mortgage to the borrower amounts to TT$903,355. Although lengthening the term of the mortgage to 30 years would result in a lower monthly mortgage payment (TT$3,302), the overall cost of the mortgage to the borrower would also increase by TT$285,343 to TT$1,188,698. An increase in the rate of interest on the 30-year mortgage from 8.0 per cent to 8.75 per cent also raises the overall cost of the mortgage to the borrower by TT$85,756 to TT$1,274,454.

SAMPLE MORTGAGE PAYMENTS

DURATION OF MORTGAGE (YEARS)	20	25	30	20	25	30
Mortgage Interest Rate (Fixed-Interest Rate Mortgage)	8.00 % per annum			8.75 % per annum		
Size of Loan	$450,000	$450,000	$450,000	$450,000	$450,000	$450,000
Total Mortgage payments	$903,355	$1,041,951	$1,188,698	$954,407	$1,109,893	$1,274,454
Of which:						
Total Interest	$453,355	$591,951	$738,698	$504,407	$659,893	$824,454
Total Principal	$450,000	$450,000	$450,000	$450,000	$450,000	$450,000
Total Monthly Payment	$3,764	$3,473	$3,302	$3,977	$3,700	$3,540

Box 2
THE EFFECTS OF CHANGES IN THE INTEREST RATE ON A VARIABLE-INTEREST RATE MORTGAGE

FIXED-INTEREST RATE MORTGAGE				
SCENARIO 1 Duration of Mortgage (25 years) Size of Mortgage $450,000	**First 5 years**	**Next 5 years**	**Next 5 years**	**Remaining 10 years**
Interest Rate	8.0	8.0	8.0	8.0
Monthly Instalment	$3,473	$3,473	$3,473	$3,473
VARIABLE-INTEREST RATE MORTGAGE				
SCENARIO 2 Duration of Mortgage (25 years) Size of Mortgage $450,000	**First 5 years**	**Next 5 years**	**Next 5 years**	**Remaining 10 years**
Interest Rate increasing over time	8.0	8.25	8.50	8.75
Monthly Instalment	$3,473	$3,538	$3,592	$3,630
VARIABLE-INTEREST RATE MORTGAGE				
SCENARIO 3 Duration of Mortgage (25 years) Size of Mortgage $450,000	**First 5 years**	**Next 5 years**	**Next 5 years**	**Remaining 10 years**
Interest Rate decreasing over time	8.75	8.50	8.25	8.0
Monthly Instalment	$3,699	$3,633	$3,592	$3,542

INTEREST RATE OPTIONS

Fixed-Interest Rate Mortgage

The **Fixed-Interest Rate Mortgage**: under this option the borrower is assured of the negotiated interest rate for the entire life of the loan. This is generally considered to be a desirable option for consumers as it implies a set payment schedule (See Box 2). However, to the extent that under certain economic conditions, interest rates could decline over the long term, a fixed-interest rate mortgage could involve higher payments over the life of the loan than a variable-interest rate option. Supporters of the fixed-interest rate option argue that if interest rates decline, borrowers could refinance the mortgage at the lower interest rate. However, refinancing has a cost and thus the interest rate differential needs to be large enough to justify refinancing.

Variable-Interest Rate Mortgage

A **Variable (or Adjustable)-Interest Rate Mortgage** has an interest rate which is fixed for relatively short periods and adjusted in line with market interest rates. The timing of adjustments and the benchmark to which the adjustments are linked are normally specified in the mortgage contract. If the mortgage is contracted when interest rates are at a high point and if rates decline steadily thereafter, the variable interest rate option could yield significant savings, compared with a fixed-interest rate mortgage, contracted at the same time.

Some adjustable rate mortgages start at a lower than market interest rate which is increased over time. The lower initial payment allows younger home-owners to get started, expecting to have the mortgage payment increase over time as their incomes increase. In many cases, the potential increase in interest payments under a variable-interest rate option is contained by capping the extent to which the applicable interest rate could rise over specific periods and over the entire life of the loan.

Mortgage Payment Schedule

Mortgage payments are normally made in monthly instalments. Under either a fixed or variable-interest rate option, monthly mortgage instalments are structured such that the early instalments cover more interest than principal. This means that the reduction in the loan balance is slow initially but accelerates towards the end of the mortgage term (See Box 3).

Box 3
Distribution of Interest and Principal Payments for a 25-year Fixed-interest Rate Residential Mortgage

	MORTGAGE LOAN OF TT$450,000		
	8.0 PER CENT		
YEAR BAND	INTEREST PAYMENT $	PRINCIPAL $	TOTAL $
1 to 5	173,623	34,767	208,390
6 to 10	156,592	51,797	208,390
11 to 15	131,219	77,170	208,390
16 to 20	93,417	114,972	208,390
21 to 25	37,098	171,291	208,390
Total	**591,948**	**450,000**	**1,041,951**

On the other hand, if interest rates increase over the life of the loan, then interest payments may be higher than under the fixed rate option.

Mortgage Types

A **Conventional Mortgage** is a term usually given to a fixed-interest rate, 25-30 year term arrangement with a minimum 25 per cent down payment.

A **Balloon Mortgage** has low monthly payments which cover only interest. The assumption is that the principal is paid in a lump sum at the end of the mortgage term. This option could be attractive to homeowners who expect to sell after a short time to benefit from capital gains.

A **Reverse Mortgage** allows individuals to receive payments from a lender against the equity in their homes. Under this arrangement, the lender takes over the property upon the owner's death. Reverse mortgages will appeal to senior citizens who have a home but are having difficulty meeting monthly payments such as living and medical expenses.

Prepayment, assumability and portability options:

Prepayment privileges, assumability and **portability** are three popular options found in mature mortgage markets.

The ability to prepay a mortgage is one of the most important features to a mortgage buyer. The prepayment could come through lump sum discrete payments or through accelerated payments, for example weekly or bi-weekly instead of monthly instalments. The interest savings to be derived from prepayment privileges can be significant (See Table 1).

TABLE 1
INTEREST SAVINGS FROM PREPAYMENTS AND SHORTER TERM OF MORTGAGE LOAN

Loan Amount	TT$450,000	
Interest Rate	8.25%	
Original Payment Amount	TT$3,548	
Original Loan Term	300 months (25 years)	
	Without Shorter Term (300 months)	**With Shorter Term (240 months)**
Prepayment	NIL	$3,568 annually
Total Interest Paid	$614,404	$471,422
Interest Saved	NIL	$142,982

Some lenders allow purchasers of residential properties to **assume the mortgage** attached to the property being purchased. This could be a significant benefit in a rising interest rate environment when the original mortgage was at lower interest rates. In the case of **mortgage portability,** the purchaser of a residential property is allowed to transfer the remaining portion of the mortgage on the property being sold to a property being purchased.

Primary/Secondary Mortgages

Primary mortgage lenders deal directly with the public. They originate loans, i.e. they lend money directly to the borrower. Primary mortgage lenders (the banks, the mortgage companies and savings and loans associations) fund mortgages by mobilizing deposits and issuing mortgage bonds.

Primary mortgage lenders then sell the mortgage notes (in packages, not one at a time) to investors in the secondary market to replenish their cash reserves so they can initiate more mortgages. The largest buyers of mortgages in the U.S. are the Federal National Mortgage Association ("Fannie Mae") and the Government National Mortgage Association ("Ginnie Mae"). A variety of private financial institutions such as banks, life insurance companies and private investors also buy portfolios of mortgage. In Trinidad and Tobago, the Home Mortgage Bank is the main player in the secondary mortgage market.

II. Structure of the Residential Mortgage Market in Trinidad and Tobago

The mortgage market in Trinidad and Tobago has expanded significantly in value terms but remains remarkably under-developed compared with the main industrialized countries or even many emerging market countries. In the United States of America, the United Kingdom and in other developed countries, the mortgage market is typically comprised of a whole range of institutions that are largely dependent on long-term funding sources (mortgage securities). Also, with intense competition for mortgage business, institutions are in constant search for innovative ways to meet evolving market needs.

In Trinidad and Tobago, with the sharp increase in personal incomes, housing demand has surged over the last decade. This, combined with a significant expansion in government housing programmes, has led to a rapid increase in construction costs and property values. Correspondingly, mortgage loans outstanding on the books of private and public institutions have more than doubled over the decade. Somewhat surprisingly, however, private mortgage-lending institutions have been reluctant to tap the market for long-term savings through bond issuance. Moreover, among the traditional mortgage institutions, there has been limited product innovation to expand the range of options available to consumers.

Structure of the Residential Mortgage Industry

The primary mortgage market in Trinidad and Tobago comprises **the commercial banks, the trust and mortgage institutions, merchant banks and the insurance companies** (See Table 2)**.**

In addition to these private sector institutions, mortgage financing is provided by two specialized agencies: **the Trinidad and Tobago Mortgage Finance Company Limited (TTMF)** and the **Home Mortgage Bank (HMB)**, as well as some pension funds and at least one credit union.

Most of the trust companies and merchant banks are affiliated to commercial banks. Some **insurance companies** provide mortgage lending to policy holders through their mortgage administration departments. However, the Insurance Act limits investments by insurance companies in mortgages to 20 per cent of total assets.

Table 2
Major Mortgage Lending Institutions in Trinidad and Tobago

COMMERCIAL BANKS	OTHER FINANCIAL INSTITUTIONS
Scotiabank Trinidad and Tobago Limited	Home Mortgage Bank Limited
RBTT Bank Limited	Trinidad and Tobago Mortgage Finance Company Limited
Republic Bank Limited	Guardian Life Insurance Limited
Citibank (Trinidad and Tobago) Limited	Maritime Financial Limited
First Citizens Bank Limited	Sagicor Limited
Intercommercial Bank Limited	CL Permanent
	Eastern Credit Union Society

Pension funds also invest in mortgages, but with similar limitations as the insurance companies. Most pension plans make mortgage loans directly to their membership through employee home assistance plans. However, most pension plan mortgage investments are made through funds administered by trust companies.

Some **credit unions** have begun to provide mortgage financing to their members; however, the involvement of credit unions in the mortgage market is still very limited.

TTMF has been in operation since 1961. It was originally a partnership between the Government of Trinidad and Tobago and the Colonial Development Corporation of the United Kingdom. Today, it is jointly owned by the Government and the National Insurance Board. TTMF's original mission is to make residential mortgage financing available to low- and middle-income households. Consistent with this mission, TTMF is a major provider of mortgage financing for government-constructed housing. TTMF has however, broadened its activities and now also makes large mortgage loans for private housing. TTMF does not accept deposits and its activities are financed through the issuance of long-term bonds and more recently, through a long-term loan from the Inter-American Development Bank.

The **Home Mortgage Bank (HMB**) is the only institution operating in the secondary mortgage market. HMB was established by an Act of Parliament to provide liquidity to the mortgage market by buying mortgages from primary lenders. HMB gets most of its financing through the issue of bonds. HMB is a public/private partnership with its main shareholders being Colonial Life Insurance Co. (Trinidad) Limited (43.8 per cent), Republic Bank Limited (24 per cent), the Central Bank of Trinidad and Tobago (12.5 per cent), the National Insurance Board (7.5 per cent) and Scotiabank Trinidad and Tobago Limited (6 per cent).

Private sector institutions have provided the bulk of mortgage financing in Trinidad and Tobago. The private sector's share in total mortgage financing rose from 66 per cent in 1995 to 77 per cent in 2005 (See Table 9).

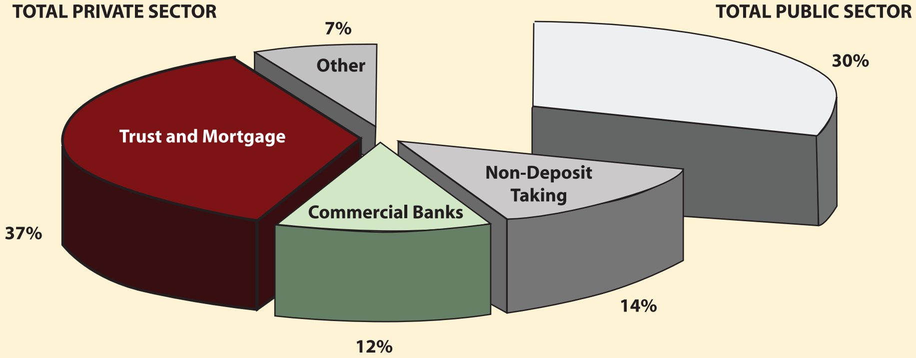
For several years, the primary mortgage market was dominated by the trust and mortgage institutions which, in 2003, accounted for 47 per cent of total mortgage loans extended by the private institutions. These institutions, most of which, as noted earlier, are affiliated with the commercial banks, were a natural source of long-term mortgage financing since their funding came from longer-term deposits. In fact, since for most of the period the banks faced significantly higher reserve requirements than the trust companies[1], it was in their interest to channel both long-term deposits and the mortgage loans through their affiliated institutions.

During the period 1995- 2003, the **trust and mortgage companies** accounted for 37 per cent of total mortgage credit outstanding, followed by the **commercial banks** at 12 per cent, and the **insurance companies** which had a 9 per cent share of the market. **Pension funds** held an average market share of 4.5 per cent over the period (See Table 9).

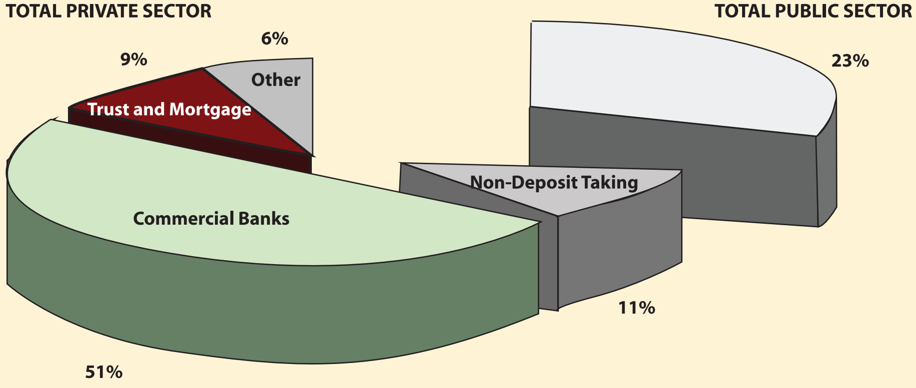
There have been two major structural changes in the mortgage market since 2003. First, with the reduction in the reserve requirements on commercial banks' prescribed liabilities from 18 per cent in 2003 to 11 per cent in 2004, the financial incentive for banks to channel long-term funding and mortgage activity to their trust companies declined. Added to this, with intense competition in the mortgage market, banks have moved to rationalize loan administration in order to achieve

[1] And of 1997, the reserve requirement of the commercial banks was 24 per cent compared with 9 per cent for the non-banks.

Chart 1
Proportion of real estate mortgages held by financial institutions (Average 1995-2003)



Proportion of Real Estate Mortgages Held By Financial Institutions (End of 2005)



efficiency gains. Accordingly, most of the mortgage accounts of the affiliated trust companies, along with new loan originations, were transferred to the parent banks. Trust companies now focus on trustee operations and investment management.

Second, with a significant increase in bank liquidity, banks needing to look for investment opportunities began to hold on to their mortgage loans rather than sell them in the secondary market. Table 3 illustrates the recent slowdown in the growth of secondary market activity and the switch to primary market activity by HMB since 2004.

TABLE 3
PRIMARY AND SECONDARY MARKET ACTIVITY FOR THE HOME MORTGAGE BANK LIMITED
/TT$M/

YEAR	PRIMARY MARKET	SECONDARY MARKET[1]
1996	-	699.0
1997	-	814.0 (16.5)
1998	-	903.0 (10.9)
1999	-	1,047.0 (15.9)
2000	-	1,160.0 (10.8)
2001	-	1,300.0 (12.1)
2002	-	1,406.0 (8.2)
2003	-	1,764.0 (25.5)
2004	65.2	1,885.0 (6.8)
2005	96.5	2,027.0 (7.5)

Source: Home Mortgage Bank Limited Annual Reports
[1]The figures in brackets( ) represent percentage changes.

III. Terms and Conditions in the Local Residential Mortgage Market

The Mortgage Term

The **typical mortgage term** available for residential mortgages in Trinidad and Tobago is 25 years, though occasionally 30-year mortgages are available. The maximum term is limited by the stipulation that the mortgage becomes due at the borrower's retirement age or when he/she reaches the age of 60 (or 65) years. As discussed later, the Government has moved to ease this restriction in respect of public sector housing.

Fixed or Variable-Interest Rates

As mentioned earlier, in the US and the UK, there are clear options between fixed and variable-interest rate mortgages. In a standard fixed-interest rate mortgage, the interest rate remains unchanged throughout the life of the loan while in a variable-rate mortgage, the interest rate changes based on pre-determined criteria.

In Trinidad and Tobago, most mortgages are deemed to be extended on a variable-interest rate basis since the contract allows the lender to vary the interest rate with three to six months' notice. In practice, however, the rate is adjusted rather infrequently. In the face of a steady reduction of interest rates from late 2004 through most of 2005, some commercial banks exercised the option to reduce rates on existing mortgages. Later, in response to the rise in the 'Repo' rate, some mortgage rates were increased during 2006.

Eligibility

Mortgage institutions take account of several criteria in deciding an applicant's eligibility for a mortgage loan. The most important of these are (i) t**he indebtedness of the borrower**, defined as the ratio of the borrower's monthly debt service payments to his gross income (ii) **the instalment ratio**, which is the ratio of debt service of the mortgage debt to income and (iii) **the repayment risk**, which is contained, in part, by the ratio of the size of the loan to the assessed value of the property. Information on the **applicant's credit history** is also factored into the decision to grant the loan. Tolerance limits for the instalment/income ratio vary from a maximum of 30 per cent to 35 per cent while the maximum for the total debt service ratio is 40 per cent. The loan-to-value ratio accepted by most lending institutions usually ranges from 75-80 per cent. In exceptional circumstances, a few lenders go as high as 95 per cent (see Table 4). The Insurance Act limits loan-value ratios for insurance companies to 75 per cent.

TABLE 4
KEY MORTGAGE CREDIT EVALUATION RATIOS

	INSTALMENT INCOME RATIO	TOTAL DEBT SERVICE/ INCOME RATIO	LOAN-TO-VALUE RATIO
Commercial Banks	30-35	40	75-80
Trust and Mortgage	30-35	40	75-80
Insurance Companies	30-35	40	75-80
Home Mortgage Bank	30-35	40	75-80
T.T.M.F.	33 1/3	40	Up to 95

Fees and Closing Costs

Lenders safeguard their security by insisting that the property which is the subject of the mortgage, is fully insured on a replacement-cost basis. Of course, the insurance also safeguards the asset of the borrower. The initial and annual insurance premiums are for the account of the borrower. Lenders also require life insurance on the life of the borrower so that the loan is covered in the event of the borrower's death.

There are a number of one-time costs involved in securing a mortgage, which must be borne by the borrower. These include the **application fee**, the **title search fee**, the **commitment fee**, the **stamp duty on the Deed of Conveyance** (which allows the transfer of the property to the new owner), **the stamp duty on the Deed of Mortgage** and **legal fees**. Application and title search fees tend to differ among lending institutions. In the case of the application fee, these range between TT$500 – TT$1,000, while the title search fees depend on the type of property and the complexity of the search. For a mortgage of $450,000, total fees could exceed 1 per cent of the value of the mortgage.

Prepayment Penalties

Some mortgage lenders tend to discourage payments made in excess of the scheduled principal repayments by imposing a prepayment penalty. These prepayment penalties could be as high as three to six months interest payments. In the face of intense competition in the mortgage market, some lenders are now waiving the prepayment fees, if given three months' notice by the customer. A prepayment plan that is being offered by at least one mortgage lender provides for 13 instead of 12 instalments per year. As noted earlier, this prepayment scheme will result in savings on interest payments of about 23 per cent.

IV. The Public Sector and the Residential Mortgage Market

Trinidad and Tobago Mortgage Finance Co. Ltd.

The sole public sector mortgage institution, TTMF, is the principal source of financing for the recent significant expansion of the public sector housing programme. Since 2003/2004, the Government has constructed just over 8,200 single and multi-family units. The housing programme is geared towards low and middle-income groups and involves a sizeable interest rate subsidy administered through the TTMF.

The latest variant of the programme announced in the last budget targets families with a maximum household income of $8,000 per month and covers mortgage loans up to $500,000 with the following conditions:

- 100 per cent financing;
- A fixed-interest rate mortgage of 2 per cent to be reviewed every five years;
- An amortization term of 25 years which could be extended to 30 years.

The contract contains a unique "transferability" feature whereby, at the death of the mortgagor prior to the maturity of the loan, the mortgage liability may be transferred to his/her estate.

Home Mortgage Bank

As noted earlier, the Home Mortgage Bank has entered the primary mortgage market in the face of the slowdown of the secondary market. In an effort to build its market share, HMB has introduced several new options. These include:

- For existing properties, a choice of a variable-interest rate of 8 per cent or a fixed-interest rate of 8.5 per cent, which becomes variable upon the expiration of the tenth year;
- Waiver of insurance premium;
- 95 per cent financing (compared with a maximum of 90 per cent for other lenders);
- No penalties for early repayment.

Housing Development Corporation

The Government has also introduced a number of innovative approaches to assist in financing home-ownership for low and middle-income groups. One such approach provides for a **Rent-to-Own Programme**, targeted at individuals who, initially, are financially unable to service a mortgage. It allows these persons to enter into an agreement to rent for a period of five years with the option to purchase. At the end of the five-year period, two-thirds of the rental payments would be applied as a deposit towards the purchase of the property and the rental tenancy would be converted to a mortgage.

The Housing Development Corporation has replaced the National Housing Authority but with an expanded mandate. In addition to its main responsibility for housing development, the HDC's mandate will allow the corporation to:

- Assist new homeowners to assume mortgages on the purchase of certain government-constructed residential units;
- Arrange portable mortgages, which involve the transfer of existing loan balances and any benefits accrued, to a new home, with or without additional financing.
- Facilitate the assignment of mortgages, i.e. the transfer of the mortgage obligation to the purchaser of an existing residential unit in a government housing project.

These additional provisions had not been put into operation at the time of writing this pamphlet.

V. The Evolution of Residential Mortgage Interest Rates

Traditionally, an important anchor of the residential mortgage market has been the **Approved Mortgage Company Programme**, in which most lenders participate. The Programme, whose legal basis is the Housing Act and the accompanying Housing Regulations, seeks to facilitate home acquisition by low- and middle-income households by offering preferential interest rates on mortgage loans. The programme, introduced in the 1970s, provides for subsidized rates for mortgage loans, up to certain limits, for households that meet the qualifying income criteria. In addition to a subsidized interest rate set by the Government, the borrower received full tax exemption for interest payments on the mortgage loan. The benefit for the lender was the tax exemption on the interest costs and expenses incurred in raising the funds for the programme.

The maximum loan sizes and preferential interest rates applicable to loans under the Approved Mortgage Company Programme were changed on several occasions since the programme was initiated in 1976. The last change, effected in 2002, set the level of qualifying loans and interest rates as follows:

Table 5
Mortgage Interest Rate Charged Under the Approved Mortgage Company Programme

Mortgage Value	Interest Rate
Up to 200,000	6%
$200,001 - $250,000	6.5%
$251,001 - $300,000	7.0%
$300,001 - $350,000	7.5%
$350,000 - $450,000	8.0%

Loans in excess of $450,000 were contracted at negotiated rates starting at the base of 8 per cent (see Table 5).

Prior to the amendment to the income tax legislation in 2005, mortgage interest payments on loans outside the Approved Mortgage Company Programme were tax exempt up to a maximum of $18,000 per year. The Amendment increased the level of personal allowances for income tax purposes from $25,000 to $60,000. At the same time, it eliminated all deductions for interest payments on mortgage loans. It also eliminated the mortgage tax concessions given to the mortgage lenders under the programme. These actions effectively eliminated the attraction of the programme for lenders. Thus, while in 2001, loans under the Approved Mortgage Company Programme accounted for around 25-30 per cent of total loans from private mortgage institutions, in the last three years private lenders have made few loans under the programme. On the other hand, TTMF has expanded its participation in the programme such that close to 80 per cent of its mortgage portfolio now covers loans under the programme.

The recent evolution of mortgage interest rates in Trinidad and Tobago could be gleaned from an examination of the data on new mortgage loans extended by the commercial banks since 2003 (See Table 6).

In the first quarter of 2004, about **96 per cent** of new mortgage loans extended by the commercial banks were contracted at rates between 8 and 9 per cent. As the ‘Repo’ rate started its steady decline in 2004, so too did mortgage rates and by the last quarter of 2004, 36 per cent of new mortgage loans were being contracted at rates between 7 and 8 per cent and **60 per cent** in the range of 8-9 per cent. Led by the 'Repo' rate, interest rates started to increase in the fourth quarter of 2005 and the share of new mortgage loans contracted at rates between 8.1 and 9 per cent increased to 65 per cent.

Table 6
Commercial Banks: New Residential Mortgage Loans

INTEREST RATE BAND	OCT04-DEC04		OCT05-DEC05		JUL06-SEP06	
	Value TT$	Per cent	Value TT$	Per cent	Value TT$	Per cent
Under 7%	12,793	0.0	84,934	0.0	14,825	0.0
7.1%-8%	47,265,436	36.5	63,820,100	34.6	31,438,043	11.6
8.1%-9%	78,235,302	60.4	119,079,126	64.6	236,888,762	87.6
Over 9.1%	3,934,546	3.1	1,354,784	0.7	88,518	0.0
TOTAL	**129,448,077**	100.0	**184,338,944**	100.0	**270,365,658**	100.0

Source: Central Bank of Trinidad and Tobago

The tightening of monetary policy which continued throughout 2006 further affected the cost of mortgage loans. Accordingly, by the third quarter of 2006, only 12 per cent of new loans were contracted at rates between 7.1 and 8 per cent while 88 per cent of loans were contracted at rates between 8.1 and 9 per cent (See Table 6).

The Home Mortgage Bank (HMB) began originating mortgage loans in 2004 at a rate of 9 per cent which was fixed for five years. With the decline in interest rates, which took effect in late 2004, the HMB reduced its rate to 8 per cent variable or 8.5 per cent fixed for ten years. There have been no changes in this rate since December 2004.

VI. The Residential Mortgage Market and the Macro-economy

Developments in the real estate market are influenced by, and in turn, can have a major impact on, the financial system and the macro-economy. For example, construction spending has a direct impact on economic activity and employment. Increases in housing prices directly affect personal wealth which could influence consumption spending. Persistently strong increases in housing prices are invariably followed by reversals which could pose a threat to the stability of the financial system, especially where real estate loans make up a significant portion of the loan portfolio of financial institutions.

The latter situation occurred in the 1980s following the first oil shock. The surge in oil prices in the mid-1970s led to a rapid increase in personal incomes, which was unfortunately accompanied by expansionary fiscal and monetary policies. Fiscal expansion included an increase in expenditure on subsidized housing while on the monetary side, there was a significant expansion of credit by some newly established finance houses and by three indigenous commercial banks. One of the banks, the Workers Bank, over-extended itself in housing finance through an innovative scheme called the VARINSTALL Plan (See Box 4).

Box 4
WORKERS' BANK OF TRINIDAD AND TOBAGO LIMITED VARINSTALL FINANCING SCHEMES

In the late 1970s and early 1980s, the Workers' Bank sought to establish a market niche in real estate financing. To build market share, it introduced a novel mortgage financing scheme which it branded the "VARINSTALL MORTGAGE". Three variants of the Varinstall mortgage were marketed by the bank.

A Graduated Instalment Mortgage Finance Plan (VARINSTALL MARK I): provided for loan amortization with the initial deferment of the repayment of principal, the initial part payment of interest, and a variable amortization instalment that increased over the term of the mortgage loan on the basis of a pre-determined escalation index of 3.5 per cent which compounded annually.

A Base Rate Mortgage Finance Plan (VARINSTALL MARK II): provided for monthly instalments at a base rate which was lower than the actual lending rate during an initial amortization period, thereby making the monthly mortgage payments required during the initial mortgage period lower than the payment under Varinstall configurations originally introduced.

A Variable Interest Rate Mortgage Finance Plan (VARINSTALL MARK III): provided for loan amortization using interest rates which were changed at annual intervals over the unexpired term of the mortgage, on the basis of the prime lending rate prevailing in the banking system.

BOX 4 CONT'D

The Varinstall mortgage, like any other product, had certain benefits and risks. On the benefit side, the lower instalments that were required under the plan encouraged a wider section of the population to consider home ownership in a market where access to residential mortgages by middle-income professional and other workers was far less open than at the present time. This led the bank to become one of the largest mortgage lenders in the economy in a relatively short period of time and to establish for itself, a market niche in the commercial banking sector in which it was extremely difficult for a small, new indigenous bank to gain market share in competition with well established foreign branch banks.

The product had additional risks beyond those normally faced by any credit product. The provisions for escalation of the instalments were essentially based on the assumption that property values as well as incomes would continue to rise annually. The onset of recessionary conditions in the economy in the latter half of the 1980s severely affected property values as well as personal incomes and created unusual stresses for the product.

Moreover, poor management practices leading to poor selection of borrowers, a high concentration of "bridging loans" (advanced for home construction) in the commercial lending portfolio, and the development of a mortgage portfolio that consisted primarily of second (the first mortgages were typically held by the National Insurance Board) rather than first mortgages, exacerbated the underlying risks for the institution.

During the recession, the Bank eventually faced severe problems of loan default (as at April 1989 about 90 per cent of the entire mortgage portfolio

Box 4 cont'd

and a considerable part of the commercial loan portfolio that was also in the real estate sector, was in arrears) and this led to chronic liquidity problems for the Bank, resulting in its technical insolvency and the ultimate intervention of the Central Bank in April 1989. The Bank was closed, restructured and re-opened in May 1989 as Workers' Bank (1989) Limited.

The slump in oil prices precipitated acute balance of payments difficulties and prompted the introduction of an adjustment programme which included a cut in public sector salaries. The resulting recession and high interest rates produced a slump in property values which affected the balance sheets of the three indigenous banks. The decline in property values meant that the sale value of the banks' collateral was considerably below that of the mortgage credits extended. At the same time, unemployment and the reduction in personal incomes led to a significant increase in mortgage delinquencies. These factors contributed to the collapse of four finance houses as well as the Workers' Bank.

Rapid economic growth, led by buoyant energy prices, has again led to a boom in the real estate market (See Tables 7 and 9). The question that arises in this context is whether there is a high probability of financial stress as a result of exposure to the real estate market.

There are two main vulnerabilities in the present mortgage market. The first is the excessive dependence on short-term deposits for funding mortgages. In the commercial banks, this creates a serious mis-match between long-term assets and short-term liabilities. This risk is compounded by the recent tendency of commercial banks to hold on to their mortgage loans rather than sell them in the secondary market. The second vulnerability is that the prolonged rapid rise in housing prices is outstripping the growth of incomes. Under these circumstances, the ratio of mortgage loans outstanding to income has been increasing. This raises the possibility that in the event of an oil shock that impacts personal incomes, some debtors could have difficulty meeting their mortgage obligations.

Of course, there have been several changes over the last decade which should serve to make the financial system more resilient than it was during the first oil shock.

Firstly, the evidence suggests that greater prudence in the operations of the financial institutions, combined with improvements in regulatory and supervisory practices, has reduced the potential risks of financial stress caused by a collapse in the mortgage market. For example, mortgage loans as a proportion of total loans of the financial system now stand at 15.5 per cent compared with an average of around 40 per cent in the period 1985-88. In general, banks' prudential indicators (such as regulatory capital, provisions and non-performing loans) are significantly more robust now than they were in the 1980s. Non-performing loans, for example, are now about 2.5 - 3.0 per cent of total loans compared with 33 per cent at the end of 1988.

Secondly, competition in the mortgage financing market has forced banks to hold the lid on mortgage interest rates. Thus mortgage interest rates now average between 8 and 9 per cent. This compares with rates averaging 12 - 13 per cent in the mid-to-late 1980s. The lower mortgage rates are being cross-subsidized by higher rates on some business loans. At the same time, excess liquidity is serving to restrain increases in deposit rates, helping to maintain banks' interest margins.

The potential risks of financial stress induced by setbacks in the mortgage market have been further reduced by the upgrading of financial legislation and the strengthening of financial practices. As regards the latter, bank supervisors now pay special attention to banks' management of risks associated with mortgage lending. Stress testing, which has become an important tool in the Central Bank's supervisory arsenal, now suggests that the banking system is well-equipped to withstand reductions in property values of up to 30 per cent.

APPENDICES

Appendix A
Residential Housing Prices

Official data for residential real estate prices are not available. The Central Bank has, however, attempted to estimate residential housing prices using data supplied by the Association of Real Estate Agents (AREA) and private sector valuators. The data supplied by the Association of Real Estate Agents cover sales transactions in specific areas and therefore may not fully reflect changes in house prices throughout the country. Missing values were computed using a combination of market information as well as statistical interpolation methods. Table 7 contains provisional estimates of median residential housing prices adjusted for extreme values on both the upper and lower ends of the market. The results show that following a sharp decline during the latter part of the 1980s, residential house prices have rebounded (See Chart 2), increasing on average by 13 per cent per annum between 1992 and 2006. Furthermore, the median price of a typical three-bedroom residential property has more than doubled over the last eight years (between 1999 and 2006).

Chart 2

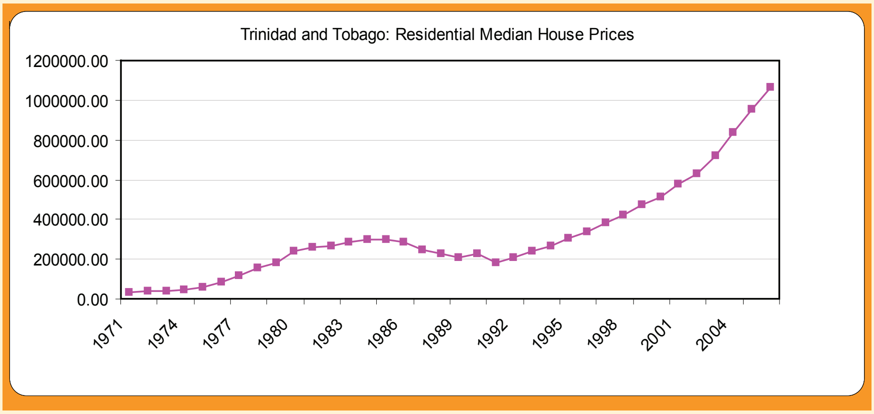


Table 7
Estimated Median Residential House Prices
Trinidad and Tobago
1971 - 2006 (3-Bedroom House)

Year	Median House Price	Percentage Change
1971	$34,000	-
1972	$36,000	5.9
1973	$39,000	8.3
1974	$47,000	20.5
1975	$60,000	27.7
1976	$85,000	41.7
1977	$120,000	41.2
1978	$154,000	28.3
1979	$182,000	18.2
1980	$237,000	30.2
1981	$260,000	9.7
1982	$268,000	3.1
1983	$287,000	7.1
1984	$296,000	3.1
1985	$296,000	0.0
1986	$284,000	-4.1
1987	$249,000	-12.3
1988	$230,000	-7.6
1989	$210,000	-8.7
1990	$226,000	7.6
1991	$184,647	-18.3
1992	$209,886	13.7
1993	$237,770	13.3
1994	$268,486	12.9
1995	$302,235	12.6
1996	$339,230	12.2
1997	$379,700	11.9
1998	$423,892	11.6
1999	$472,068	11.4
2000	$511,618	9.0
2001	$577,750	12.9
2002	$627,375	8.6
2003	$721,481	15.0
2004	$835,475	15.8
2005	$951,250	13.9
2006	$1,065,000	12.0

Source: Central Bank estimates.
Estimates of the Median House prices are based on data collected from the Association of Real Estate Agents.
Values for the years 1991 - 2000 were computed using statistical interpolation methods and a double exponential smoothing algorithm.

Appendix B
The Mortgage Process

Access to mortgage financing for residential properties involves some critical steps that must be undertaken by the borrower (mortgagor) and the lender (mortgagee) before contractual arrangements could be completed. These stages include:

(i) the selection of an appropriate property by the mortgagor;
(ii) the completion of a mortgage application with a licensed mortgage originator;
(iii) determination of the creditworthiness of the borrower;
(iv) finalization of the mortgage contract once all conditions have been met.

(i) Selection of an Appropriate Property by the Mortgagor

- Borrower identifies an appropriate property either through a real estate agent or direct contact with the owner of the property.

- Borrower ensures that the property identified for purchase has a valid title deed and is free of encumbrances. Common encumbrances include unpaid land and building taxes, use of the property as collateral to secure other loans and court judgements against the property owner.

- Borrower secures the property by executing an Agreement for Sale with the property vendor which specifies the terms and conditions for acquisition of the property. This contract would typically require a down payment of ten per cent with the remainder payable within a period of 90 days.

(ii) Mortgage Application Process

- Borrower submits the application form to the lender and pays the processing fee once an appropriate property has been selected. Currently, application fees typically vary between TT$500 (for the Trinidad and Tobago Mortgage Finance Company) to TT$1,000 in the case of most commercial banks. This fee is generally not refundable.

- Lender often supplements the information on the application with an interview to clarify any outstanding questions.

(iii) Mortgage Evaluation/Qualification Process

- In deciding whether or not to underwrite the loan, the lender reviews the borrower's application taking account of the age of the borrower, the indebtedness of the borrower, the borrower's ability to service the loan and the loan-to-value ratio of the property.

- The indebtedness of the borrower is measured by the total debt service ratio (TDSR), which is computed as the percentage of monthly debt expenses including the proposed mortgage instalment to gross monthly income. This measure gives a broad indication of the borrower's ability to meet his/her monthly debt obligations. The industry standard in this regard is currently 40 per cent. This means therefore, that no more than 40 per cent of a person's gross monthly income must be committed to debt-servicing.

- The instalment-income ratio gives an indication of the maximum amount of the mortgage instalment for which the borrower is able to qualify. This currently varies between 30-35 per cent of the gross monthly income.

- The loan-to-value ratio, which is computed as the percentage of the amount of the mortgage loan to the market value of the property, gives an indication of the extent of protection available to the lender in the event that the borrower defaults on the loan.

(iv) Finalization of the Mortgage Contract

- Lender approves mortgage if requirements are met and issues a commitment letter to the borrower. This letter outlines the terms of the mortgage including the amount of the loan, the interest rate payable, conditions relating to late payments of the monthly instalments, penalties relating to early repayment of the mortgage (prepayment penalties) and any other conditions that the lender may deem necessary to consummate the loan process.

- Borrower, if satisfied with the term and conditions of the mortgage, signs the commitment letter and returns it to the lender with the commitment fee. This fee is roughly 1 per cent of the total value of the mortgage. In some institutions, this fee is not refundable if the applicant decides not to purchase the property or finds an alternative source of financing to acquire the property.

- Lender, through its attorney, begins the process of preparing a number of legal documents to complete the transaction, the most important of which are the Deed of Conveyance (which may be prepared by the Borrower's attorney) and the mortgage contract (Deed of Mortgage).

- The Deed of Conveyance essentially transfers ownership of the property from the vendor to the purchaser and therefore allows the purchaser to offer it as security for the mortgage. The Deed of Mortgage represents the loan agreement between the purchaser and the mortgage lending institution and specifies, inter alia, the terms and conditions regarding instalment payment, interest rate, the term of the mortgage and penalties in the event of a default.

- There are a number of legal fees that must also be settled in the process of completing the mortgage contract and these are often underestimated by the potential borrower. For sizeable mortgage loans, these fees can be quite large and can place additional financial strain on the borrower if they are not budgeted for at an early stage. A list of the common fees that are encountered in closing the mortgage transaction is presented in Box 5.

Box 5
Typical Mortgage Fees

- o The Title Search fees (for some institutions there is a standard fee of $300 while other institutions charge $500 or up to $1,000);
- o Stamp Duty to register the Deed of Conveyance;
- o Stamp Duty to register the Deed of Mortgage;
- o Attorney's fees to prepare the Deed of Conveyance;
- o Attorney's fees to prepare the Deed of Mortgage.

• Borrower registers Deeds of Conveyance and Mortgage by paying the relevant stamp duties to the Board of Inland Revenue. The stamp duty payable for the conveyance of property depends on the value of the property (See Table 8). In the case of the Deed of Mortgage, the stamp duty is only charged where the value of the mortgage loan exceeds $315,000 and is payable on the entire sum at a rate of 0.2 per cent.

Table 8
Stamp Duty on the Conveyance of Property

PROPERTY VALUE	STAMP DUTY PAYABLE (%)
Up to $450,000	0%
For the next $100,000 up to $550,000	5.0 %
For the next $100,000 up to $650,000	7.5%
For every dollar thereafter	10.0%

TABLE 9
FINANCIAL INSTITUTIONS: REAL ESTATE MORTGAGE LOANS OUTSTANDING 1995-2005 (TT$ MILLIONS)

INSTITUTIONS	END OF PERIOD									
	1995	%	2000	%	2003	%	2004	%	2005	%
1.PRIVATE SECTOR Deposit-Taking Institution										
Commercial Banks	921.5	15.4	732.5	11.3	578.4	7.9	2,285.7	28.5	4,437.3	49.8
Trust and Mortgage Companies	1433.4	27.4	2,487.8	38.3	3,466.0	47.2	2,233.0	27.8	826.1	9.3
Finance Companies and Building Associations	56.0	0.9	43.1	0.7	47.2	0.6	67.6	0.8	74.2	0.8
Trustee Funds Under Administration	384.9	7.0	462.5	7.1	292.0	4.0	271.9	3.4	508.3	5.7
Sub-Total	**2,795.8**	**50.8**	**3,725.9**	**57.4**	**4,383.6**	**59.6**	**4,858.2**	**60.6**	**5,845.9**	**65.6**
Non Deposit-Taking										
Insurance Companies	606.6	10.3	495.4	7.6	644.5	8.8	689.6	8.6	737.9	8.3
Pension Funds	223.1	4.8	286.9	4.4	417.8	5.7	306.6	3.8	144.1	1.6
HMB	-	-	-	-	-	-	65.8	0.8	96.5	1.1
Sub-Total	829.7	15.0	782.3	12.1	1062.3	14.5	1062.0	13.2	978.5	**11.0**
TOTAL PRIVATE SECTOR	**3,625.5**	**65.8**	**4,508.2**	**69.5**	**5,445.9**	**74.1**	**5,920.2**	**73.8**	**6,824.4**	**76.6**
2. PUBLIC SECTOR										
N.H.A./H.D.C.	780.5	13.2	629.0	9.7	536.0	7.3	497.6	6.2	433.3	4.9
N.I.B.	617.0	9.5	407.0	6.3	274.0	3.7	232.0	2.9	194.0	2.2
T.T.M.F.	624.5	11.5	943.3	14.5	1,093.0	14.9	1,371.1	17.1	1,462.7	16.4
TOTAL PUBLIC SECTOR	**2,022.0**	**34.2**	**1,979.3**	**30.5**	**1,903.0**	**25.9**	**2,100.7**	**26.2**	**2,090.0**	**23.4**
TOTAL (1 & 2)	**5,647.5**	**100.0**	**6,487.5**	**100.0**	**7,348.9**	**100.0**	**8,020.9**	**100.0**	**8,914.4**	**100.0**

Source: Central Bank of Trinidad and Tobago

KEY MORTGAGE TIPS

- Provide evidence of income (job letter, pay-slip, financial statements {if self employed}).
- Ensure valid title deed exists for the property.
- Obtain valuation report from a registered valuator.
- Ensure current land and building tax receipts and WASA certificate exist for the property.
- Ensure that mortgage is affordable (mortgage instalment plus other loans should not exceed 40% of your gross income).
- Budget for legal fees.

Central Bank of
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