

FITCH: LOW INTEREST RATES MAY IMPACT FUTURE MORTGAGE PERFORMANCE

Fitch Ratings-Milan/London-16 June 2009: Fitch Ratings says today that European market-standard mortgage underwriting policies, with respect to debt-to-income (DTI) ratios, could lead to a weaker performance of floating-rate loans originated in the current low interest rate environment.

Within its European RMBS and mortgage covered bond analysis Fitch pays particular attention to how a lender assesses affordability. Subject to the lender's approach to affordability assessment, the agency may assume higher default probabilities for floating-rate loans originated during periods of low interest rates.

The DTI ratio, which measures the financial commitments of the mortgage applicant, including the instalment of the requested loan, against an applicant's net income, is one of the key drivers behind the mortgage underwriting policies of European banks. For floating-rate loans, the DTI ratio has some limitations as a tool in assessing loan affordability, as the applicant's debt service commitments on the requested loan will be subject to varying interest rate levels.

While this shortcoming can be addressed by factoring the potential increases in interest rates into the assigned ratio, Fitch's analysis of European mortgage lenders' underwriting policies shows that such a forward-looking approach to DTI calculations has rarely been employed.

"In those countries where the bulk of mortgage originations consisted of floating-rate products, such as Italy, Spain, Portugal and Greece, the limited use of forward-looking DTI ratios was one of the main factors that contributed to the wave of delinquencies and defaults experienced in 2007 and 2008 by floating-rate loans originated between 2003 and 2005," says Michele Cuneo, Senior Director in Fitch's European structured finance team.

As an example, Euribor-linked loans originated between 2003 and 2005 had an initial DTI ratio based on interest rates of around 2%. As such, when Euribor moved to around 4% in 2007-2008, the affordability of these mortgages was significantly affected, especially for loans that were originally approved with high DTI ratios.

Fitch expects that floating-rate loans originated in the current low interest rate environment by banks whose underwriting policies do not rely on forward-looking DTI ratios will show a similar sensitivity to interest rate shifts as the 2003-2005 vintages. These loans are likely to be even more sensitive to interest rate movements, with respect to lenders who did not tighten their DTI thresholds during the financial crisis, as low interest rates resulted in more low-income borrowers becoming eligible for a loan.

Contacts: Michele Cuneo, Milano, Tel: +39 02 87 90 87 230; Suzanne Albers, London, +44 20 7417 6325; Gregg Kohansky, +44 20 7682 7491.

Media Relations: Julian Dennison, London, Tel: +44 020 7682 7480, Email: julian.dennison@fitchratings.com.

Fitch's rating definitions and the terms of use of such ratings are available on the agency's public site, www.fitchratings.com. Published ratings, criteria and methodologies are available from this site, at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance and other relevant policies and procedures are also available from the 'Code of Conduct' section of this site.