



Kaupping's debt-adjustment (skuldaaðlögun) equivalent to debt-acceptance

New Kaupping's has recently announced and marketed a new remedy for the homes, the so called debt-adjustment (i. skuldaaðlögun). It is a complex financial product that can not be considered acceptable nor fair for Icelandic homes to accept. It's main purpose seems to guarantee debtors willingness to pay and to secure the operational conditions for the bank. This so called remedy also seems intended to create atonement (i. friðþægingu) for the government not to take real action to correct the confiscation that has taken place in Icelandic homes, due to the inflation and the weakening of the Icelandic krona, neither of which Icelandic homes can be made responsible for.

Since all loans to buy houses are either inflation or foreign exchange indexed, the principal and monthly payments have increased up to 140% from the year 2007, creating a huge financial crisis for many families. This new remedy thus seems to be intended to force these homes to formally accept a debt that they did not establish themselves, and which has now created a status of broken and probably illegal premises in terms of linking household loans to inflation or foreign currency.

For the benefit of New Kaupping

Even though the remedy may be helpful for some households, especially households that did take a pricing indexed loan and had low equity (when buying the property) it can not be considered to be helpful for those that had higher equity and/or those that borrowed money with a foreign currency linkage. One of the preconditions for the remedy is to change foreign currency indexed loans to Icelandic krona. Such an act could only benefit the bank since the principal of these loans has in some cases tripled from the date of borrowing due to the weakening of the krona. These homes would thus affix their loss as well as the confiscation of their equity in their homes. The remedy is therefore unfair, and if the so called „wait-loan“ (deferred loan) will be written off in three years the unequal treatment of borrowers will become a reality.

To explain how the remedy works it is necessary to take an example comparing two homes with different equity proportions at the date of borrowing . The loans for both homes were foreign currency indexed, amounting to 16 million Icelandic kronas, and both were borrowed in the middle of year 2007. Home A owned 24 mkr. in a property that had a market value of 40 mkr (probably because the borrowers were older and had been for a longer time in the labour market) and thus had an equity of 60%. Home B, also borrowed 16 mkr. and the loan was also foreign currency indexed but this home bought a property with 20 mkr. market value and thus only owned 4 mkr., or an equity of 20% (probably young first buyers). Both loans were to 25 years and the premise was for about 110 thousand monthly payment for both homes (see table 1).

Table 1:

Status – April 2007 – foreign currency indexed loan	Heimili A	Heimili B
Home market value	40.000.000	20.000.000
Foreign currency indexed loan (JPY+CHF)	16.000.000	16.000.000
Equity	24.000.000	4.000.000
Equity proportion	60%	20%
Monthly payments (25 years)	110.000	110.000

As can be seen in table 2, the principal had increased about 140% from the day of borrowing and monthly payments are now about 260 thousand Icelandic kronas. The equity proportion for home B is now negative, amounting to 133% negative equity but for home A the negative equity amounts only to 17%. Thus different treatment can be expected for the two homes that originally both took equal loans, but had different equity (see table 3).

Table 2:

Status- July 2009 - foreign currency indexed loan	Heimili A	Heimili B
Home market value (20% decrease)	32.000.000	16.000.000
Foreign currency indexed loan (JPY+CHF)	37.350.000	37.350.000
Equity at end of July 2009	-5.350.000	-21.350.000
Equity proportion	-17%	-133%
Montly payments (25 years)	264.563	264.563

Table 3:

After debt-adjustment by Kaupþing	Heimili A	Heimili B
Loan balanced to 80% of market value	25.600.000	12.800.000
Deferred-loan for 3 year (No inflation linkage nor bearing interest rates)	11.750.000	24.550.000
Monthly payments next 3 years (now loan to 40 years)	150.701	75.350
Equity	-5.350.000	-21.350.000
Loss	24.000.000	4.000.000

Premises for calculations:

Credit period: 25 years and changes to 40 years with debt-adjustment.

Interest rate: 4,5%

Down payments: 1 mkr. from the day of borrowing.

Both families have now lost all their equity when they bought their houses/apartments two years ago. Home A has lost 24 mkr. but home B has lost 4 mkr. Both homes have now lower monthly payments to make, but home B much lower than home A. Both homes now have to pay off this loan for the next 38 years, but not for 23 years as they originally intended. This may make the whole difference depending on the age of the homeowners. Thus using the market value of the home as a basis for decisions about the treatment is very questionable in terms of fairness. The changes that have occurred in terms of both the principal and the monthly payments should serve as a better and more fair basis for any remedy or corrections offered. The question is: Why don't these two homes, with the same amount of debt, not get equal treatment?

When the same example is calculated for an pricing indexed loan also amounting to 16 million Icelandic kronas, it is clear that the debt for home A is less than the market value of the home and thus does not qualify for the remedy. Home B on the other hand, has now negative equity and

qualifies for the treatment. Thus, the remedy is likely to benefit this group of homeowners, those that had little equity when buying the property and took loans with inflation linking.

Table 4:

Status- April 2007 – pricing indexed loan	Heimili A	Heimili B
Home market value	40.000.000	20.000.000
pricing indexed loan	16.000.000	16.000.000
Equity	24.000.000	4.000.000
Equity proportion	60%	20%
Monthly payments (25 years and 7,5% interest rate)	119.042	119.042

Table 5:

Status – July 2009 – pricing indexed loan	Heimili A	Heimili B
Home market value (20% decrease)	32.000.000	16.000.000
pricing indexed loan (m.v. 18% inflation)	21.863.000	21.863.000
Equity at end of July 2009	10.137.000	-5.863.000
Equity proportion	32%	-37%
Monthly payments (for 25 years)	167.890	167.890

Table 6:

After debt-adjustment by Kaupþing	Heimili A	Heimili B
Loan balanced to 80% of market value (not available to A)	21.863.000	12.800.000
Deferred-loan f. 3 year (No inflation linkage nor bearing interest rates)	0	9.063.000
Monthly payments (25 years loan for A / 40 year loan f. B)	167.890	84.842
Equity	10.137.000	-5.863.000
Loss	13.863.000	4.000.000

Premises for calculations:

Credit period: 25 years

Interest rate: 7,5%

Credit period after debt-adjustment: 40 years

Inflation: 18% (according to the inflation index - Statistics Iceland, for 2008)

Unacceptable uncertainty about treatment of the Deferred-loan: promise for a write-off or a longer rope?

It can be expected that the bank will enforce a full payment of the Deferred-loan in three years when the review by the bank will take place. Therefore, one can wonder whether the remedy is engineered in order to motivate people to negotiate based on lower monthly payments for the time being. Thus the question about how or on what premises the bank plans to engineer the cases then can not be avoided. The following questions arise; will everyone will get the same treatment? On what grounds will decisions be made then? Will the whole process be transparent? This uncertainty is disadvantageous and not acceptable for Icelandic families.

Two Ministers have expressed that the Icelandic banks should be able to write off private debts soon and they both seems to acknowledge the fact that such write-off will take place (Minister of Business Affairs and Minister of Social Affairs and Social Security) and the regulation nr. 534/2009 passed by

the Ministry of Finance allows now for a write-off for individuals without the write-off being taxed as a revenue/income. In addition, at a meeting with the managers of Kaupþing, on the 24th of June it was understood by HH board members that Kaupþing intended to write-off the Deferred-loans later. However, it has now been expressed by the Bank's representative in a radio interview that IMF will not allow such write-off. The question is therefore whether it is correct that IMF does not allow the government, nor the banks, to CORRECT (by some called write-off) the loans.

Finally, Kaupþing's remedy is only acceptable and a real remedy for some homes but not for others. Thus, the question arises what remedies will be available to other homes. In addition, If the debt-adjustment is intended to create atonement for the government against the strong demand for CORRECTING the loans, it is important to emphasise that Kaupþing does not promise any real correction nor write-off. In addition the remedy does create unacceptable inequality between borrowers, based on what their equity is.

31. júlí 2009

The Board of The Icelandic Homes Coalition (IHC)

/Stjórn Hagsmunasamtaka heimilanna (HH)