The global financial system and national housing markets

What type of home-ownership policies will be adopted after the crisis ?

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As interpreted / modified by Christine Whitehead
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The development of the crisis

Global imbalances between over-consuming and over-saving countries

➔ Excess of liquidity ➔ Interest rates drop and remain low

➔ Prices and indebtedness increase everywhere *(except Germany and Japan)*

➔ Investors looking for a high return ask for higher risk financial products

- USA : The downturn triggered the subprime market crisis and the global financial crisis
- In European countries the downturn in housing markets began before the effects of the subprime crisis were felt
- at the same time other global economic factors were impacting on the real economies
- The global financial crisis has helped transform what was a slowdown in the housing market into a full-blown global economic crisis

Differential impacts: different housing systems

- Differences in tenure structures - and therefore in the numbers directly affected
- Varying degrees of flexibility in the mortgage market – and organisation of the mortgage chain
- Diversity of mortgages but similarity of Treasury management?
- Differences in regulation
- Differential impacts of the economic recession and downturn in the housing market
- Differential impacts of lower interest rates
- But global increases in risks/lower levels of confidence

The balance of tenure in the housing stock and level of indebtedness

	% of homeowners 2007	Residential mortgage debt to GDP ratio 2007	Defaults and repossessions
Germany	43,20 %	47,70 %	No increase 2007 / 2008
France	56,50 %	34,90 %	No increase 2007 / 2008
Spain	86,30 %	61.60 %	High increase 2007 / 2008
United Kingdom	70,00 %	86,30 %	High increase 2007 / 2008
Netherlands	54,00 %	100,00 %	No increase 2007 / 2008
United States	71,00 %	71,00 %	High increase 2007 / 2008
Canada	68,00 %	45,60 %	No increase 2007 / 2008
Italy	80,00%	19,80%	No increase 2007 / 2008

Sources: European Mortgage Federation National Experts, National Central Banks, National Statistics Offices, Eurostat, International Monetary Fund, SCHL

Differential workings of the mortgage credit chain

- The unbundling of the mortgage credit process
- The funding of mortgages
- The extent of risk sharing through insurance or a guarantee fund

The unbundling of the mortgage credit process

(Broker, originator, servicer, securitization agency, and investor are separate companies)

In the extreme:

The originator can transfer the risk to the borrower or to the investor.

Limits negotiation during the amortization between the mortgagor and the mortgagee.

Externalization of the risk : reduces the incentives for the originator to pay attention to the risk.

Organisation of the mortgage supply chain

	France	Germany	Spain	United Kingdom	Netherlands	United States	Canada
Mortgage underwriting process	No valuation of the home by a third party appraiser. The value = the price. No credit bureau ("positive file"). "Negative": file of defaulting borrowers	Credit bureau and systematic valuation of the home	Systematic valuation of the home	Credit bureau and systematic valuation of the home	"Negative": file of defaulting borrowers. Mandatory consultation for the guarantee fund applicants. Bureau Krediet Registratie Valuation	Credit bureau. Systematic valuation of the home	Credit bureau Systematic valuation of the home
Organisation of the mortgage process	No unbundling. Originators keep the servicing of the loan and keep the debt on their balance sheets		No unbundling. In house servicing		A large share of the mortgages are serviced by a company separate from the originator	Unbundled. Partition between broker, originator, servicer, securitisation agency and investors	Mostly integrated. Most lenders keep the servicing of the loans
The universal banks' market share	Around 80 % of the loans are supplied by universal banks	Around 60 % of the loans are supplied by universal banks; 20% by specialised mortgage lenders	Mostly universal banks and saving and loans				Around 80 % of the loans are supplied by universal banks
The mortgage brokers' market share	High progression during the last ten years: < 15%	Around 1/3 of mortgages	< 20% of mortgages	Around 80 % of mortgages	Most mortgages are sold through brokers. Brokers must be members of a professionnal association	Large share of the market	Around 30 % of mortgages

The funding of mortgages

Deposits : direct attention to the risks

Covered bonds : guarantee for the investor in case of bank bankruptcy, but the risk stays on the balance sheets – and the problems are emerging

Securitization : **externalization/diversification of the risk**

- True-sale securitization:

  no negotiation between the mortgagee and the mortgagor

- Synthetic securitization:

  No constraint linked to the ratio between the volume of loans and the originator's corporate funds.

  Freed from the constraints of maturity of loans.

  No incentive to pay attention to the risk, unless the originator keeps a "subordinate share" (as in the UK)

Snímek 8

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gl2	Maybe 'The originator is freed ....'? gl; 6.5.2009
gl4	gl; 15.6.2009

Funding of the mortgages

	Deposits	Covered bonds	Securitization (ABS)
USA			> 50 %
UK			> 30 %
Spain		15 %	> 31 %
Germany		30 %	
Netherlands			17 %
Euro area	60 %	17 %	7 %

Sharing the risk through an insurance or a guarantee fund

➔The risk (or a part thereof) can be insured *(USA, UK, Canada).*

➔The risk (or a part thereof) can be guaranteed by a public fund, if the borrower has a low income (*USA : FHA; France : FGAS; Netherlands : Stichting Waarborgfonds Eigen Woningen*).

Insurances and funds are supposed to limit and share the risks and can help regulate mortgage products.

Other forms of insurance for mortgagor: income; house price etc

Product regulation and consumer protection

- Equity withdrawal
- Fixed or adjustable rate, with or without cap
- Negative amortization
- Teaser rate loan
- Rate ceiling (usury rate)
- Mortgage duration
- Maximum LTV
- Prepayment penalty
- Disclosure, consumer protection and housing counseling

Regulation of mortgage products

	France	Germany	Spain	United Kingdom	Netherlands	United States	Canada
Net equity withdrawals	No	No	Legal since 2008 but hasn't been used	Yes	Yes	Yes	Yes
Characteristics of the mortgages	Fixed rate, < 30 % adjustable rate	Fixed rate over 5 to 10 years, with negotiation for the subsequent 5 year term.	Mostly variable rate - one year	Majority tracker/short term fixed – changes rapidly	65 % fixed rate . Fixed rate over 5 to 10 years.	Mostly fixed rate, but the share of adjustable rate has been increasing	"Rollover" mortgage loan with fixed long-term maturity and interest rate adjusted every five years
Risk tarification : maximum gap between two applicants	Usury rate. Ceiling of 150 basis points	Usury rate : 12 basis points or 100% above the average market rate	“no abnormal” rate, i.e. * 2,5 times the legal rate.	No usury rate	No more than 16,5 % above average rate	600 to 800 basis points above the average rate	BV2 y rate but at not efficient for the mortgage loans. CMHC doesn't use a “*risk based pricing”* approach
Non recourse or full recourse	Full recourse except for the mortgage guaranteed by the FGAS.	Full recourse	Full recourse	Full recourse	Full recourse	Full recourse or non recourse depending on the state.	Full recourse except in Alberta for some loans

BV2 60 what - 60%? 60 basis points?
Bernard Vorms; 7.5.2009

Additional policies : Safety nets and social protection

	USA	UK	Nordic systems	France
Employment protection	Low	Low	Low	High
Unemployment compensation/mortgage support	Low	Fair	Generous	Fair
Help to find new job	Non active	Active	Active/ efficient	Not efficient
Duration of unemployment	Short	Currently Short	Short	Long

The difficulties currently facing borrowers – and institutions

- Insolvent mortgagors
  - Unemployment
  - Amortization plan (teaser rate loan)
  - (But also benefits to those on tracker mortgages)
- Negative equity
  - Mortgagor “under water”: cannot move
  - Difficulties in remortgaging
  - Difficulties in setting up mortgage rescue
- First time buyers
  - Higher deposits
  - higher costs
  - lack of confidence

Schemes to help mortgagors in Europe

Deferment of part of the monthly repayments

Consumer/institution negotiation

Government sponsored schemes: The length of the loan is increased by the same length

- Who bears the risk ?
- Who pays the interest on the deferred monthly payments?

Mortgage rescue

- Who buys the house?
- What kind of guarantee does the mortgagor and mortgagee receive?

First time buyers

- Assistance with deposits
- Risk sharing schemes

Future homeownership policies

1. Balance between tenures

- For stability, households must have a choice between tenures
- Differential governmental interest in private and social renting -

  emphasis on flexibility versus risk reduction/housing support
- Lower costs of moving between tenures

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gl; 15.6.2009

Future homeownership policies

2. *Affordability policies*

- Stabilising the system - the importance of tax incentives in increasing volatility: mortgage interest relief – the Netherlands; lack of capital gains tax/property tax UK
- Extending choice – intermediate tenures; support for particular groups (existing mortgagors/first time buyers/developers)
- The efficiency of particular tools depends partially on house price and interest rate levels - but also on economic conditions

  France : the value of the 0% loan for newly built houses was around 10% of the cost of the house in 1996 compared with 4% in 2006. Its effect was reduced by 50%.

  Individual European States are powerless over interest rate variations.
- Governments may have continuously to adjust their affordability policies. In the light of changing housing market and wider economic circumstances. However this has within it other inefficencies

Future homeownership policies

3. Access to credit and regulatory change

- Distinctions need to be drawn between macro regulation – levels of indebtedness and the security of the finance system as compared to reduing market failures – eg assymetry of information between different stages of mortgage chain and particularly consumers; and regulation which reduces risk through exclusion.

- Area of regulation under discussion include:

1. Schemes that split the link between the mortgagee and the mortgagors should be avoided.
2. Schemes that allow the originator to be freed from the consequences of borrowers' defaults should be forbidden.
3. Traceability of the risk should be guaranteed for investors.
4. Guarantee funds, which guarantee lenders, could regulate products aimed at low and middle income borrowers and also, to some extent, guarantee mortgagors.
5. Access to housing counselling, independent from the lender should be free, at least for low-income first time home owners.
6. Even in a global economy, governments retain full power to regulate the products and consumer protection, all rules that are very difficult to bypass.

A halt to the integration of the European mortgage market ?

- The main benefit expected from a higher level of integration is “abundant, non-restrictive and inexpensive credit” ➔This was a factor in the origin of the crisis.
- Differences among regulation of national products and consumer protections rules are among the main obstacles to European mortgage market regulation ➔ These differences help to explain why the difficulties of current borrowers vary from one country to one other.
- According to the London Economics Survey, an integrated European market should have similar rules to those in the UK – but this is almost certainly unacceptable across Europe
- In particular, governments that have less control over affordability policies will try to keep the power to define the legal characteristics of the homeownership process and mortgage supply.

The continuing postponement of the integration of European mortgage markets is an aspect of the collateral damage from the subprime crisis.

What Next?

- Signs of improvement in flexible mortgage systems – but is this the lull before the storm?
- Structural change towards renting?
- Freeing up the wholesale market through increased use of regulated vanilla products?
- Reductions in public spending but increases in regulation

Wishing Bernard well

Merci Beaucoup a tous